1.1.2 OSC Staff Notice 15-704 – Request for Comments on Proposed Enforcement Initiatives

OSC STAFF NOTICE 15-704
REQUEST FOR COMMENTS ON PROPOSED ENFORCEMENT INITIATIVES

Purpose of the Notice

Staff of the Ontario Securities Commission (the "**OSC**" or "**Commission**") have been examining new enforcement initiatives aimed at resolving enforcement matters more quickly and effectively. These initiatives are intended to 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.

1. **New program for explicit No-Enforcement Action Agreement** ("**No-Enforcement Action Agreement**" or "**Agreement**") under which a party would explicitly not be subject to OSC enforcement action in exchange for self-reporting matters that may involve breaches of Ontario securities law or activities that would be considered contrary to the public interest, and for cooperating in an investigation.

2. **New No-Contest Settlement program** ("**No-Contest Settlement**") under which a protective order could be made in the absence of a specific admission by the respondent of a breach of the *Securities Act* (Ontario) (the "**Act**").

3. **Clarified process for self-reporting** under the OSC's credit for cooperation program to ensure that all parties are informed on how best to self-report and come forward with information.

4. **Enhanced public disclosure of credit granted for cooperation** to provide greater certainty of potential outcome for all parties that may consider self-reporting.

In developing these initiatives, OSC staff ("**OSC staff**" or "**staff**") have reviewed enforcement practices at the Commission and other agencies, and have considered ongoing comments and feedback received from market participants, the securities litigation bar and investor advocates. OSC staff believe these initiatives will contribute to successful enforcement outcomes in ways that are feasible, measurable and practical.

Staff are planning to move forward with these initiatives through an update and revision of the OSC's credit for cooperation program. This will be done as part of a phased approach. At this time, OSC staff are inviting public comment.

The comment period is 60 days and is open until December 20, 2011 The feedback OSC staff receive will help us evaluate the initiatives and inform future developments.

OSC staff have also been examining the prospect of introducing a new whistleblower program, under which incentives (including possibly financial compensation and/or protection from retaliation) would be provided to persons who provide the OSC with information about misconduct in the marketplace. Such a program would be a first for securities regulators in Canada and would represent a new source of information to support enforcement activity. A whistleblower program is presently the subject of ongoing study and, as part of a phased approach, may result in a separate staff notice inviting public comment in the near future. Important questions as to the funding of such a program and the possible need for legislative amendments have led staff to conclude that additional consideration is necessary.

Background

Experience with OSC's Credit for Cooperation Program Since 2002

In June 2002, the Commission published Staff Notice 15-702 *Credit for Cooperation* (the "**Credit For Cooperation Program**" or "**Program**"). It notes that as part of the Commission's compliance policy, market participants should have an incentive to self-police, self-report, and self-correct matters that may involve breaches of Ontario securities law or activities that would be considered contrary to the public interest. It also notes that cooperation provided by a market participant during an investigation or litigation can translate into a form of credit.

The Credit for Cooperation Program provides examples of what staff consider to be cooperation by market participants and describes types of credit that market participants could receive in exchange for cooperating with staff. For example, staff may recommend (i) reducing the scope of the allegations made against a market participant in an enforcement proceeding, (ii) reducing sanctions to be sought in respect of a market participant, and (iii) in some cases, not naming a market participant in an enforcement proceeding.

The Credit for Cooperation Program can result in significant time and cost savings for market participants and the OSC. It can allow staff to conduct more streamlined investigations and to resolve cases more quickly by using means other than contested

hearings. The Program can also enhance investor protection by allowing staff to complete more enforcement matters and impose protective sanctions sooner, and by improving the compliance processes of market participants.

In reviewing the incidence of market participants requesting credit for cooperation under the Program in recent years, Staff have observed that the Program has not been widely accessed by market participants, or other parties, and the benefits listed above have not been achieved.

Feedback about the Program provided by market participants and their counsel has identified certain reasons for this low rate of use:

- A perceived misalignment of expectations and outcomes in the application of the Program – a disconnect in expectations between staff and the market participants as to what is meant by cooperation.

- A lack of certainty as to what type of credit would be provided to a market participant contemporaneous with their self-reporting.

- Some misunderstandings as to how a market participant might approach staff to initiate discussions.

- There are few public precedents which would guide parties in assessing potential benefits, especially in instances where no enforcement action took place.

As a result, opportunities to expedite both the investigation and the resolution of enforcement matters have not been fully exploited. In circumstances where the Commission's mandate is to impose future oriented orders in the public interest, this has resulted in a number of cases that have required significant commitments of staff time and increased costs where earlier resolution with the party should have been possible.

Impact of Civil Litigation on Enforcement Activity

OSC staff have observed in recent years that persons or companies contacted during an investigation for their documents and testimony are increasingly concerned about concurrent civil litigation or class action lawsuits that may arise against them. This can impact the timeliness and effectiveness of investigations. The concurrent presence of civil litigation results in delays in document production, both in terms of preparing documents for civil production (which may be more complicated than producing a response to an OSC summons) and broad assertions of privilege in circumstances where there may be a desire on the part of a witness to provide the information to OSC staff but fear that waiving privilege in respect of staff will result in a general waiver for the purpose of civil litigation.

In addition to negatively impacting investigative work, concurrent civil litigation negatively impacts the prospect of agreeing on the appropriate settlement of matters on a timely basis because such respondents are concerned that admissions they make in OSC proceedings (which are public) will be used against them in civil litigation. A primary barrier to resolution in such cases has been the issue of admissions, not the issue of the appropriate sanction.

Where the issue of liability and sanction cannot be resolved, the Commission litigation process has become more litigious and time-consuming, especially when the Commission proceeding occurs before the civil action.

These trends result in enforcement staff taking more time per matter, and consequently being engaged in a fewer number of files. By natural extension, this results in fewer enforcement orders, imposed after lengthy delays.

1. <u>No-Enforcement Action Agreements</u>

No-Enforcement Action Agreements will be available in a range of situations. They will now be explicit in those circumstances where market participants self-report and remediate immediately. In the past, staff have simply advised the market participant that no action would be taken. By making staff's decision explicit, market participants will have greater certainty of result.

In addition to situations of immediate self-remediation, staff will consider an Agreement where a party is self-reporting and may also be reporting in respect of the conduct of others. As noted by staff in this review, breaches of Ontario securities law, or activities that would be considered harmful to Ontario capital markets, typically involve more than one participant. This can include:

- The activities of multiple individuals within one organization; for example, activities of directors and officers of a reporting issuer that result in a failure by the reporting issuer to comply with its continuous disclosure requirements.

- The activities of multiple individuals or entities across different organizations; for example, activities by persons to manipulate the price and trading in the securities of an issuer for personal gain and to the detriment of public investors of that issuer.

Persons participating in such activities make efforts to conceal their conduct and the joint enterprise. In this context, if everyone participating in the misconduct remains silent, then there is a risk that (a) the misconduct will not be discovered and/or (b) even if the misconduct is discovered, individuals will not be held to account owing to a lack of direct evidence about their involvement.

One strategy to pierce the shield that appears to surround joint actor misconduct in the marketplace is to provide an incentive for a person or entity to self-report.

Key elements of the No-Enforcement Action Agreement include:

1) The Credit For Cooperation Program will be updated to make express reference that staff will not only not recommend the commencement of a prosecution under section 122 of the Act, but will also not initiate a proceeding under section 127 and/or an application under section 128. This clarification will provide the marketplace with greater certainty that a possible outcome is a commitment that no action will be taken by OSC staff. A No Enforcement Action Agreement relates only to actions that can be taken by OSC staff and does not confer any immunity from criminal enforcement or civil liability.

2) Any Agreement will be contingent on the self-reporting person providing detailed information prior to the Agreement sufficient to enable staff to determine both the nature of the misconduct and the involvement of the self-reporting person or entity in that misconduct.

3) The party reporting will be required to disgorge any amount obtained as a result of their misconduct.

4) It will be a condition of any Agreement that the party provide active and ongoing cooperation to OSC staff during an investigation and litigation that is directed at the activities of other persons. This may include providing documentation and testimony (including at a hearing) to staff and assisting staff in identifying other sources of information.

5) The commitment by a party who has entered into an Agreement to provide ongoing cooperation and assistance to OSC staff will be documented.

6) A factor informing whether an Agreement is available in a specific circumstance will be the timing of the self-reporting. For example, there may be more than one person who may choose to self-report their involvement in multi-party non-compliant activity. Generally, it will be the first such self-reporting individual who will be eligible for such an Agreement. The aim is to create an incentive for early self-reporting. Individuals who self-report subsequently may be entitled to other forms of credit for their cooperation. However, depending on the circumstances, it may be possible for more than one individual to receive the benefit of an Agreement with the same fact situation.

7) If a self-reporting person or entity with whom a No-Enforcement Action Agreement has been entered fails to:

    a) comply with their commitment to provide ongoing cooperation and assistance (including a requirement that they tell the full truth) to OSC staff during the ensuing investigation and litigation;

    b) is found to have not provided full and accurate information to staff prior to the making of the Agreement;

    c) is found to have benefited by their misconduct to a greater extent than previously disclosed;

    then the Agreement will be revoked and staff will not be precluded from commencing any appropriate proceeding against the party.

8) Generally, if an enforcement investigation has been ongoing and an individual who has already been identified by OSC staff as having involvement with the multi-party activity under investigation contacts staff to request a No-Enforcement Action Agreement, then the availability of such an Agreement in those circumstances will depend on the nature of the information provided, including whether new and/or additional information is provided that assists in enforcement activity directed at other principals involved in the multi-party activity.

Eligibility to participate in a No-Enforcement Action Agreement

Registrant firms, public companies, market participants and insiders of public companies are examples of those who might be considered eligible to enter into No-Enforcement Action Agreements with staff. In addition, individuals, such as directors, officers or employees of any entity, including those described above, might also be eligible. Staff are of the view that all who report under the this program would be eligible for consideration.

Timing and process for requesting a No-Enforcement Action Agreement

OSC staff believe that a No-Enforcement Action Agreement should generally only be available to a party if it has provided relevant, reliable and useful information and cooperated with staff before or shortly after the investigation has commenced and where remediation and/or disgorgement (as appropriate) has occurred. The earlier staff receive useful information, the more effective our investigations can be.

Factors to consider prior to entering into a No-Enforcement Action Agreement

Timeliness, relevance, reliability and usefulness of the information are just a few of the factors that OSC staff would need to consider before entering into an Agreement. In addition, there may be implications with respect to the information that would need to be considered and balanced against the potential benefits of the information in an investigation.

Staff are of the view that an Agreement will likely be entered into if the information relates to misconduct in the marketplace that might be difficult or impossible for OSC staff to detect on a timely basis (for example, multi-party conduct such as insider trading or market manipulation) or is reasonably expected to cause OSC enforcement action against another person whose involvement in the misconduct reflects a higher degree of severity or participation.

As noted, OSC staff plan to take into consideration whether the party has completed substantive remedial measures to address the misconduct within its organization, including changes to its internal controls and policies and procedures in considering a request for an Agreement from a corporate actor.

OSC staff welcome comments on the broad features of the No-Enforcement Action program set out above.

2. <u>No-Contest Settlement Program</u>

Many enforcement actions are resolved by way of settlement agreements entered into between OSC staff and respondent(s).

Settlement agreements support a number of important public interest objectives. They include:

- expediting a formal resolution of a matter;
- reducing the expense of conducting a contested enforcement action, which frees resources to work on other enforcement matters;
- obtaining earlier regulatory sanctions in respect of, and commitments from, market participants to prevent ongoing and/or future harm to investors or capital markets; and
- facilitating the cooperation of individuals who may provide ongoing cooperation and assistance to staff in connection with enforcement action taken against others.

Despite the interest on the part of respondents to resolve a matter with staff, some settlements cannot be finalized because respondents will not make admissions due to the potential risk to them of making public statements.

Settlement agreements presented to the Commission for approval have generally included an admission by the respondent both of facts and of non-compliance with Ontario securities law or conduct contrary to the public interest. Recent amendments to the OSC's *Rules of Procedure* (Rule 12) have eliminated the explicit requirement for admissions in the settlement agreement to be presented to a Commission panel for approval.

One strategy to encourage settlements and thereby increase the number of protective public interest orders is to provide an incentive for a cooperating market participant to settle a matter more expeditiously. In this regard, OSC staff are formalizing a No-Contest Settlement program in which a cooperating market participant could resolve their enforcement matter without admitting facts or non-compliance with Ontario securities law or conduct contrary to the public interest.

Key elements of the No-Contest Settlement program include:

1) The Respondent proposing to enter into a No-Contest Settlement must have cooperated with OSC staff during the investigation. Examples of such cooperation include:

   a) the Respondent self-reported the misconduct in a timely manner;

   b) the Respondent took remedial steps to address the non-compliance – including (as appropriate) providing compensation to affected third parties where applicable and implementing enhanced internal control procedures at the organization, preferably prior to the self-reporting but in any event contemporaneously with providing cooperation to OSC staff; and

   c) the Respondent provided cooperation to OSC staff in connection with enforcement activity directed at other persons; for example, the person may have initially sought a No-Enforcement Action Agreement, and despite not being the first person to contact OSC staff to on the matter but continued to provide ongoing assistance to OSC staff where an Agreement was not available.

2) The No-Contest Settlement must meet the public interest requirements set out in the Act in respect of orders made pursuant to section 127.

3) The Respondent has not previously been the subject of enforcement or regulatory activity by the OSC or any other agency.

Notwithstanding the formalization of a No-Contest Settlement program, OSC staff will continue to welcome proposals from market participants to enter into negotiations aimed at settling enforcement matters on a basis that includes an admission of facts, or an admission of non-compliance with Ontario securities law or conduct contrary to the public interest.

Form of No-Contest Settlements

OSC staff will be modifying the wording in settlement agreements that deals with the description of facts and the description of non-compliance with Ontario securities law. In short, staff will not require, in appropriate cases, that a settling respondent admit a breach of the Act or specific conduct contrary to the public interest.

In addition, OSC staff propose to make greater use of voluntary settlement agreements (where appropriate) entered into between OSC staff and respondents that may be approved by the Executive Director under the *Guidelines for the Approval by the Executive Director of Settlements of Enforcement Matters*, published on November 28, 2008.

Eligibility for No-Contest Settlements

The OSC currently enters into settlement agreements with market participants as well as other individuals and firms. OSC staff are of the view that No-Contest Settlements should be available to both market participants and others in appropriate circumstances.

OSC staff welcome comments on the broad features of the No-Contest Settlement program set out above.

3. Clarified Process for Self-Reporting

Under the Credit for Cooperation Program, market participants have self-reported and cooperated in a variety of ways, including:

- proactively bringing information and documentation to the attention of OSC compliance staff during on-site compliance reviews,

- taking the initiative to contact enforcement staff once misconduct or conduct contrary to the public interest has been identified internally at their firm, and

- responding openly and cooperatively with staff when contacted in the context of an investigation.

Nonetheless, OSC staff have concerns that there are many market participants (and other parties) who do not know what steps they might take to self-report. Such uncertainty may be a factor inhibiting persons from self-reporting. Staff further understand that parties may be reluctant to self-report because by doing this, they believe they might become named in an enforcement action and also become exposed to third-party civil litigation.

All of this impacts the effectiveness and timeliness of enforcement activity.

One strategy to facilitate more timely and more candid self-reporting is to provide market participants and other parties with greater clarity of process for self-reporting. In this regard, OSC staff are formalizing a proffer process that aims to provide greater transparency and certainty for self-reporters.

Key elements of this proffer process include:

1) Flexibility to self-report misconduct or conduct contrary to the public interest through an intermediary, such as legal counsel in a manner which – at the point of initial referral to OSC staff – protects the identity of the self-reporter. This could take the form of a written communication or meeting between OSC staff and such counsel. The objective would be to facilitate a line of communication leading, ultimately, to cooperation between the self-reporter and staff. The contact from counsel could include an indication of interest on the part of the self-reporter for entering into a No-Enforcement Action Agreement, reduced sanctions or the prospect of settlement on a no-contest basis, along with a commitment by the self-reporter to provide ongoing cooperation.

2) A framework to facilitate OSC staff obtaining more detailed information – including documentation and testimony – to best enable staff to evaluate the self-reported information and the nature of credit for cooperation that might be appropriate in the circumstances. This could take the form of a proffer meeting, documented in an agreement between staff and the self-reporting person, at which the self-reporting person agrees to provide testimony during the investigation that cannot be used against them by OSC staff in a future enforcement proceeding. Such testimony could, however, be used against other persons.

3) A proffer meeting might also be used for the purpose of offering to enter into settlement discussions and/or provide ongoing cooperation in an investigation directed at other persons.

4) Proffer agreements will provide “use immunity” prohibiting the Commission from using any statement made by the proffering party against him if the cooperation process breaks down.

5) Proffer agreements will not, in any circumstances, provide “derivative use immunity” prohibiting the Commission from using evidence derived from the proffered statement against the proffering party.

6) The “use immunity” offered in a proffer agreement does not prevent the use of the proffered statement in any prosecution for perjury, obstructing justice, the giving or contradictory evidence, or related offences arising from the proffered statement.

OSC staff welcome comments on the broad features of the proffer process set out above.

4. <u>Enhanced Public Disclosure of Credit Granted for Cooperation</u>

OSC staff have received feedback from market participants and their counsel indicating that self-reporting could be enhanced if persons had better access to information about the credit that was granted by OSC staff to cooperating persons in other or comparable circumstances.

In order to respond to this, OSC staff are formalizing enhancements to the manner in which staff publicly disclose the credit that has been granted to cooperating persons. This supports the strategy of encouraging more market participants and other parties to come forward with their information and cooperate with staff. It also enhances the transparency of the enforcement process.

Key elements include:

1) For proceedings before hearing panels of the Commission, OSC staff will provide information about cooperation provided by a party to the hearing panel and in public announcements following the completion of the proceeding.

2) For settlements (whether a traditional settlement or proposed No-Contest Settlement), OSC staff will 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.

3) For matters relating to the proposed No-Enforcement Action Agreement, OSC staff will develop some form of generic report or periodic notice that would describe the type of cooperation provided and remedial steps taken by a market participant in exchange for such Agreement.

OSC staff welcome comments on the broad features of this public disclosure framework and are interested in hearing any other suggestions on the issue enhancing public disclosure of the effects of cooperation. The Comment period is open until December

20, 2011. Submissions made are not confidential. All comments will be posted on the Commission website at www.osc.gov.on.ca. Thank you in advance for your comments and please submit them to the attention of the Office of the Secretary.

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October 21, 2011