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Securities enforcement: Regulators' enforcement capabilities continue to grow

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While securities enforcement activity ramped up in the United States in 2016, contested regulatory enforcement cases in Canada were overshadowed by a number of significant record-setting "no-contest" settlements in Ontario that secured approximately $250 million in compensation and returned fees to clients.

Although there were few court cases of note on the regulatory front in Canada, a number of jurisdictions gave themselves new tools to employ in their battles against capital market abuses. The OSC became the first regulator in Canada to introduce a "bounty-based" whistleblower policy. This policy is being hailed by the OSC as a "game changer" and an important means through which to obtain crucial evidence needed to pursue a number of complex securities violations, such as insider trading, market manipulation and sophisticated fraud, which have historically eluded regulators. Québec's securities regulator, the Autorité des marchés financiers (AMF), also launched its own "whistleblower" program this year, albeit one that does not offer monetary rewards to whistleblowers and instead focuses on offering protections to those who come forward and report misconduct.

These expanded enforcement initiatives come after securities regulators in 2015 collectively imposed twice the amount of monetary sanctions than were imposed in 2014, in addition to imposing the highest aggregate amount of monetary sanctions since 2009.

The OSC and AMF launch whistleblower programs

In an effort to encourage the reporting of corporate misconduct, in July 2016, the OSC launched its Whistleblower Program and the Office of the Whistleblower. Modelled on the whistleblower program introduced a few years ago by the SEC, but with some key differences, the OSC's program offers a monetary "bounty" to individuals reporting information to the regulator that leads to successful regulatory action against perpetrators of securities law violations.

Under the OSC's program, where whistleblower tips lead to an administrative proceeding which results in a sanction or settlement, whistleblowers may be eligible for a reward of 5% to 15% of the total sanctions imposed and/or voluntary payments made where they exceed $1 million in total. The first $1.5 million awarded to a whistleblower is not contingent on the regulator collecting those sanctions, and rewards are capped at a maximum of $5 million. The OSC's approach differs from the SEC's whistleblower program, which has no cap on the total award amount, and which has paid out awards as high as US$30 million in 2014 and US$17 million in June 2016. While culpable whistleblowers are eligible for an award under the OSC's program under certain circumstances, whistleblowers' rewards are likely to decrease in line with their complicity in the reported misconduct.

Individuals with compliance roles – for example, internal or external auditors, Chief Compliance Officers, directors, officers and in-house counsel – are eligible for OSC whistleblower rewards in certain circumstances, such as when a minimum of 120 days have passed since they internally reported the misconduct through the appropriate procedure. Employees outside these roles may report straight to the OSC and are not required to first report potential corporate misconduct through internal workplace channels in order to be eligible for a whistleblower reward. This approach could undermine the culture of compliance in some companies by creating incentives for employees to bypass internal processes in favour of reporting directly to the OSC in the hope of obtaining lucrative whistleblower awards.

The new Whistleblower Program also provides protection for employees who come forward and report misconduct. The Ontario *Securities Act* (OSA) was recently amended to prohibit reprisals against whistleblowing employees by their employers and to void any confidentiality provision that prevents employees from reporting corporate misconduct. The OSC has the power to enforce these anti-reprisal provisions through its public interest jurisdiction under the OSA. In addition, the OSC is required to use "all reasonable efforts" to protect whistleblowers' identities except where the whistleblower consents or where disclosing his or her identity is necessary to allow the respondent to make full answer and defence in an administrative proceeding.

The Office of the Whistleblower received more than 30 tips in its first two-and-a-half months. According to the newly appointed OSC Chair, Maureen Jensen, these tips detail securities law violations that the OSC has been targeting in its securities enforcement actions, such as accounting misstatements and improper failures to disclose, which the OSC would not have been able to find without the tips.

The AMF's whistleblower program, by contrast, does not provide financial rewards for those who report securities law violations and focuses on offering protections to whistleblowers. Under the AMF's program, whistleblowers are given the benefit of informer privilege and the protection of various anti-reprisal measures, such as immunity from possible civil suits that arise from reporting the misconduct.

No-contest settlements reach record highs

The introduction of the OSC's Whistleblower Program coincides with the regulator's approval of a series of record-breaking no-contest settlements. Introduced in 2014 as part of the OSC's Credit for Cooperation program to reward industry participants for reporting misconduct and cooperating with the regulator, no-contest settlements allow alleged wrongdoers in administrative proceedings to settle with the OSC without admitting to an offence.

Prior to 2016, the largest no-contest settlement approved by the OSC was a $13.5 million settlement with a large Canadian financial institution in November 2014 regarding excess client fees. That settlement was dwarfed in February 2016 by a no-contest settlement under which an investment management firm agreed to return $156.1 million to harmed investors as a result of allegations that the value of certain mutual funds were inaccurately calculated.

Additional no-contest settlements approved by the OSC in 2016 also surpassed the previous high-water mark. In July 2016, an approximately $20 million settlement with three dealers of a Canadian financial institution was approved regarding fee overcharges that had not been detected by the dealers' internal control systems. The OSC approved an even larger no-contest settlement with several dealers at another Canadian bank in October 2016. Those dealers agreed to compensate clients a total of $73.3 million, including opportunity costs, in connection with excess fees. Despite the significant increase in no-contest settlement

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amounts this year, the OSC's settlements are considerably smaller than those entered into and approved by the SEC, including a controversial settlement made between the SEC and Citigroup for US$285 million.

Recent decisions highlight jurisdictional reach, deference to provincial regulators and private party standing

The most common securities violations targeted by regulators in 2015 were illegal distributions, fraud and insider trading. In 2016, several judicial and regulatory decisions had important implications for securities enforcement:

- *McCabe v. British Columbia (Securities Commission)*: The British Columbia Court of Appeal confirmed that the B.C. securities regulator has jurisdiction over alleged securities law wrongdoing where there is a real and substantial connection between the misconduct and the province, even where the link between the regulator's province and the misconduct is not as strong as the link between the misconduct and another province.
- *Fiorillo v. Ontario Securities Commission*: The Ontario Divisional Court clearly signalled that appellate courts will grant a high degree of deference to the OSC's specialized knowledge of financial markets. In dismissing an appeal from an OSC decision finding that the appellants had engaged in insider trading and tipping, the Court noted that it was not uncommon in insider trading and tipping cases for the bulk of the evidence to be circumstantial. Osler represented one of the parties to the appeal. (At the time of writing, the OSC's decision in *Finkelstein*, where a panel made a similar finding in reliance on circumstantial evidence, was still under appeal.)
- *Corus Entertainment*: The OSC narrowed private party standing for public interest (section 127) applications in contested transactions. The Catalyst Group, which opposed Corus Entertainment's proposed acquisition of Shaw Media, was denied standing to bring an application under the OSC's public interest jurisdiction for an order requiring Corus to amend or supplement its management information circular. Given the tactical timing of the request, this would have forced Corus to delay its special meeting. The decision in *Corus*significantly narrows the scope of private party standing under section 127 of the OSA and represents a rollback of previous decisions on this issue. Osler represented Corus in this proceeding.
- *R. v. Peers*: The Supreme Court of Canada granted leave to appeal from a decision of the Alberta Court of Appeal that concluded that charges under Alberta's *Securities Act* (the ASA) do not warrant a jury trial. Section 11(f) of the *Charter* grants individuals the right to a trial by jury where the maximum punishment for an offence is five years' imprisonment or a "more severe punishment." In *Peers*, the individuals charged with offences under section 194 of the ASA, which has a maximum penalty of imprisonment for five years less a day, plus a fine of up to $5 million, argued that the potential punishment amounted to a "more severe punishment" and that they therefore had a right to a jury trial. The Alberta Court of Appeal disagreed, finding that the legislature deliberately chose five years less a day of

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imprisonment as the maximum penalty in order to avoid having complex securities matters dealt with by jury trials.

With the new tools recently given to securities regulators in Ontario and Québec to help combat capital market abuses, regulators are hoping for meaningful advancements in securities enforcement in Canada. For now, however, it seems that regulatory enforcement activity is limited, with a sparsity of contested hearings relative to prior years. Moreover, while the OSC's Whistleblower Program has already seen some early success in encouraging tips, none of these tips, understandably, has yet progressed to the stage of a public enforcement proceeding or the payment of a whistleblower award. The future effectiveness of whistleblower programs in Ontario and Québec may encourage other provincial securities regulators to expand their enforcement toolkits and adopt similar programs.