

FAIR

Canadian Foundation *for*  
Advancement *of* Investor Rights  
Fondation canadienne *pour* l'avancement  
*des* droits *des* investisseurs

**A REPORT ON**

# **A CANADIAN STRATEGY TO COMBAT INVESTMENT FRAUD**

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## Executive Summary

The purpose of this report is to identify and analyze the types of investment fraud that are perpetrated in Canada in order to identify strengths and weaknesses of the Canadian regulatory system and to identify potential improvements to the current system.

In examining investment fraud in Canada, the definition of investment fraud was limited to fraud involving securities that directly affect individual retail investors. These include Ponzi schemes, pump and dumps, forex scams, real estate investment scams and other related schemes such as affinity fraud, boiler rooms, advance fee scams, and internet fraud.

Numerous regulators, police agencies, and other organizations across the country share responsibility for preventing, deterring and detecting fraud, and taking enforcement action against it. Despite these disparate organizations' overlapping duties to protect Canadian investors against fraud, no formal strategy or framework exists to ensure that the system works efficiently. The securities regulatory system in Canada has been criticized for its lack of effective regulation, particularly in the area of enforcement and fraud prevention. Independent studies have criticized the Canadian system for its inadequate enforcement and inconsistent investor protection across the different jurisdictions within Canada.

Canada does not have a framework in place to collect, track and report on investment fraud complaints and aggregate that information at a national level. Those responsible for dealing with investment fraud in Canada publish only limited information relating to complaints; securities regulators publish varying amounts of information while there do not appear to have been any publications in recent years by police agencies. This is problematic, as investors have been found to have a low awareness of securities regulators, and appear to be more likely to report investment fraud to police agencies. As a result, it is likely that only a small portion of actual complaints are accounted for in publically-available reports. Further, reporting rates have generally been found to be extremely low, so the number of complaints received would likely only be the tip of the iceberg in measuring the prevalence of investment fraud in Canada.

The research and subsequent interviews conducted to inform this report confirmed that there is a dearth of publically-available information available in Canada relating to investment fraud. This was both surprising and instructive for our key findings:

1. There is no authoritative measure of the size or scope of investment fraud in Canada.
2. As a result of the lack of public information, it is difficult (if not impossible) to gain an accurate measure of the prevalence of investment fraud in Canada and the associated harm to Canadian investors. Further, it is also very difficult to evaluate whether those responsible for enforcement are using their limited resources as efficiently as possible and are meeting their objectives.
3. Some regulatory enforcement departments interviewed during the course of this project appear to dismiss the idea that such metrics, including the identification of trends, would improve the regulatory framework. This raises the question of how regulators responsible for preventing investment fraud can prioritize their efforts absent such crucial information.
4. A review of the enforcement cases concluded in 2012 by members of the Canadian Securities Administrators (the umbrella group for provincial and territorial securities regulators) suggests that a significant portion of securities fraud enforcement cases involved unregistered individuals. This finding was reinforced during stakeholder interviews, where interviewees

commented that investment fraud tends to be perpetrated by non-registrants more often than registrants and non-registrants tend to be involved in the more egregious cases of fraud.

5. Some of the characteristics of fraud victims include: high return expectations, susceptibility to persuasion techniques, and a self-assessed aggressive investing style. These investors are also willing to take on risk; believe that most people can be trusted; frequently enter contests, lotteries and/or sweepstakes; and are highly educated. A separate segment determined to have higher susceptibility to fraud is visible minorities, who are not over-confident but are more aggressive with respect to taking risk with their investments. A considerable proportion of known Canadian fraud victims have been victimized multiple times.
6. There are many costs associated with investment fraud, including monetary loss; psychological harm; time lost; erosion of trust in others; high levels of stress and anger; depression; feelings of isolation; anxiety attacks; increased vulnerability to physical illness; and extreme weight loss or gain. Fraud affects not only direct victims, but also their family and friends, either directly through a loss of inheritance or responsibility to financially support a parent or indirectly through the aforementioned costs and their impact on the direct victims' relationships.

Generally, the primary objective of victims following investment fraud is to recover their losses. However, the rate of recovery of losses following investment fraud is low. Investors' avenues for redress are limited. As a result, prevention is essential to protecting investors.

7. A deterrence-based approach to regulatory enforcement is appropriate to combating fraud (as contrasted with a compliance-based strategy), as fraudsters are not generally law-abiding and will violate securities law where the perceived benefits exceed the cost of sanctions. The evaluation of the cost of sanctions necessarily requires an estimation of the likelihood of being caught and successfully prosecuted. As a result, detection and prosecution have a deterrent effect. Certainty, timeliness and severity are elements of a successful deterrence strategy.
8. Securities regulators' enforcement divisions and police (in conjunction with crown attorneys) decide whether alleged investment fraud cases proceed administratively, quasi-criminally or criminally based on the facts of each individual case. From stakeholders we heard that factors include: the severity and egregiousness of the fraud, including the value of the fraud and the number of victims harmed; the available and admissible evidence; the burden of proof; applicable limitations periods; the appropriate sanction(s); the capacity and expertise of regulators and police at that point in time; market trends (for market signaling purposes); the overall strength of the case; and the likelihood of success.
9. Interviews with stakeholders garnered comments that stressed the importance of dealing with registered individuals and registered securities. Securities regulators advise that investors verify the registration of firms and/or individuals with whom they intend to transact in order to protect themselves against fraud. However, review of the current system suggested that it is not user-friendly for investors.
10. The "exempt market" may increasingly become a gateway to fraud by providing easy opportunity for fraudsters. The relationship between fraud and the exempt market warrants closer examination. More data on the exempt market and on investment fraud perpetrated in Canada could help to determine the relationship between prospectus exemptions and investment fraud with a view to developing better protection. It is essential to ask how investors can differentiate between legitimate prospectus-exempt investments and fraudulent investments. If such differentiation is unlikely to occur, tools to better protect investors should

be developed, including clearer warnings about the correlation of fraud and exempt market investing.

11. Technology has increased opportunities for investment fraud and has led to a need for new detection tools. Regulators in Canada have been recognized for developing leading-edge tools aimed at detecting fraudulent online offers. The Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) is another potential source of detection information, but is currently limited to sharing information with police forces and specific government agencies. If FINTRAC were permitted to share intelligence with securities regulators, it might provide earlier detection and interruption of fraudulent investment schemes and reduced investor harm. Whistleblower programs are another detection tool that should be considered.

The report reviews data regarding investment fraud that is published in the United States, Australia and the United Kingdom.

Recommendations resulting from the research include:

- Collect better information regarding investment fraud in Canada;
- Undertake research regarding the profile of victims and fraudsters in Canada;
- Publicize enforcement reports on investment fraud complaints and trends;
- Set and coordinate enforcement priorities across Canada among groups responsible for combating investment fraud;
- Improve detection of investment fraud using available tools;
- Obtain recourse for victims of investment fraud;
- Develop a comprehensive registration check system;
- Launch an awareness campaign regarding investment fraud and the aforementioned comprehensive registration check system;
- Consider the development of a national fraud agency to centralize reporting and enforcement relating to investment fraud; and
- Examine the nexus between the exempt market and fraud.

In conclusion, the disparate system for combating investment fraud in Canada makes it difficult to evaluate the efficacy of the current system. The results of our research did not provide comfort that the Canadian system responsible for protecting investors against investment fraud is robust. We hope this research encourages the entities in Canada who are responsible for combating investment fraud to consider the issues raised and work together to improve the system to better protect the Canadian investing public from fraud.

## **Acknowledgement**

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## 1. Foreword

The purpose of this project was to undertake research and analysis and consult with stakeholders to develop a practical framework directed at retail investor issues relating to investment fraud in Canada. We wished to identify and analyze the types of investment fraud that are perpetrated in Canada in order to identify strengths and weaknesses of the Canadian system and to identify potential improvements to the current system.

## 2. Methodology

The method used to complete this project employed a review of existing literature, studies, and reports relating to investment fraud in Canada and elsewhere.

We also reviewed all of the fraud cases that were concluded by Canadian securities regulators in 2012 (as identified by the Canadian Securities Administrators' ("CSA") 2012 Enforcement Report). FAIR Canada did not review and analyze the CSA's 2013 Enforcement Report, as it was released while we were in the process of finalizing this report.

Additionally, one-on-one interviews with stakeholders were conducted in order to ensure that all relevant information was covered and to garner insight into the roles of the various stakeholders responsible for combating investment fraud in Canada. FAIR Canada thanks our interviewees for their insights, information, and candor. Their contributions are greatly appreciated.

Our research focused on securities fraud that directly affects individual retail investors, such as Ponzi schemes and boiler rooms, except to the extent that any other type of fraud was classified as fraud by the CSA in its 2012 Enforcement Report. Other types of securities fraud, such as insider trading or issuer fraud have been excluded from this review as these areas have been extensively reviewed and studied in other reports.

## 3. Fraud

### 3.1. What is fraud?

"Fraud is considered one of the most egregious securities regulatory violations, even having a place in the [*Criminal Code* of Canada]. Not only is fraud an affront to the individual investors directly targeted, but also decreases confidence in the fairness and efficiency of the entire capital market

system.”<sup>1</sup> The Oxford dictionary defines it as “wrongful or criminal deception intended to result in financial or personal gain.”<sup>2</sup>

Many of the provincial securities acts have provisions prohibiting fraud.<sup>3</sup> The test for fraud under the various securities acts was set out in the British Columbia Court of Appeal’s decision in *Anderson v. British Columbia (Securities Commission)*<sup>4</sup>. That case determined that fraud in the regulatory context requires proof of both the *actus reus* (the wrongful act or omission) as well as *mens rea* (mental element). In its reasons, the Court held that fraud under securities acts must meet the legal test for fraud set out under the *Criminal Code* and considered by the Supreme Court in *R. v. Théroux*<sup>5</sup>.

In *R. v. Théroux* Justice McLachlin stated:

... the *actus reus* of the offence of fraud will be established by proof of:

1. the prohibited act, be it an act of deceit, a falsehood or some other fraudulent means; and
2. deprivation caused by the prohibited act, which may consist in actual loss or the placing of the victim’s pecuniary interests at risk.

Correspondingly, the *mens rea* of fraud is established by proof of:

1. subjective knowledge of the prohibited act; and
2. subjective knowledge that the prohibited act could have as a consequence the deprivation of another (which deprivation may consist in knowledge that the victim’s pecuniary interests are put at risk).<sup>6</sup>

The Court stated in *Anderson* that fraud in the regulatory context requires “evidence that is clear and convincing proof of the elements of fraud, including the mental element”.<sup>7</sup>

In administrative proceedings before a securities commission pursuant to violations of securities act provisions, the standard is based on the balance of probabilities rather than the criminal standard of having to prove the *mens rea* element beyond a reasonable doubt.

### 3.2. “Investment Fraud”

For the purposes of this report, FAIR Canada has limited its definition of investment fraud to fraud involving securities that directly affect individual retail investors.

In particular, we consider Ponzi schemes; pump and dumps (market manipulation); boiler rooms (involving the dissemination of false information and high-pressure selling tactics); and foreign

<sup>1</sup> David Johnston & Kathleen Doyle Rockwell, *Canadian Securities Regulation*, 4<sup>th</sup> ed (Markham: LexisNexis Canada, 2006) at 420.

<sup>2</sup> Oxford Dictionaries, *Fraud*, online: Oxford Dictionaries.  
<<http://www.oxforddictionaries.com/definition/english/fraud?q=fraud>>.

<sup>3</sup> For example: *Securities Act*, R.S.O. 1990, c. S.5, s. 126.1; *Securities Act*, R.S.B.C. 1996, c. 418, s. 57; *Securities Act*, R.S.A. 2000, c. S-4, s. 93; *Securities Act*, R.S.Q. c. V-1.1, s. 199.1; and *Securities Act*, S.N.B. 2004, c. S-5.5, s. 69.

<sup>4</sup> *Anderson v British Columbia (Securities Commission)*, 2004 BCCA 7 (available on CanLII) [*Anderson*].

<sup>5</sup> *R. v Theroux*, [1993] 2 SCR 5, (available on CanLII).

<sup>6</sup> *Ibid.* See also, Robert J. van Kessel & Paul S. Rand, *The Law of Fraud in Canada* (Canada: LexisNexis Canada, 2013) at 772-773.

<sup>7</sup> *Anderson*, *supra* note 4 at para 29.

exchange trading scams to be investment fraud for the purposes of this report as these types of cases are ones in which the requisite elements of fraud exist (i.e. deceit and deprivation<sup>8</sup>).

FAIR Canada notes that some of the 2012 CSA enforcement cases that were classified as illegal distributions (or other categories) could have also been proceeded with as violations of securities act fraud provisions. For example, in the Concrete Equities<sup>9</sup> case in Alberta, the Alberta Securities Commission (“ASC”) disciplined the individuals involved by imposing sanctions for illegally distributing securities and for making misleading and untrue statements in offering documents. It is arguable that the case could have been pursued under securities fraud provisions as the Royal Canadian Mounted Police (“RCMP”) charged two of the individuals involved with fraud and theft in January 2014.<sup>10</sup> However, given the vast number of illegal distribution cases and the introduction of a discrete fraud category, FAIR Canada limited its review to those cases that were categorized as fraud by the CSA.<sup>11</sup>

Our discussion of investment fraud is not directed at insider trading or market manipulation such as wash trades or match trades, although much of the general discussion and many recommendations may well also be relevant to these types of fraud.

### 3.3. Types of Fraudulent Investments

The following types of fraud have been used time and again, and continue to be used, to defraud investors. While they may appear easy to spot, that often is not the case:

Successful fraud looks just good enough to be true. By mimicking the persuasive strategies, communications streams, and payment mechanisms of legitimate commerce, skilled fraudsters give few indications that their offers are scams. Fraudsters’ methods anticipate informed, skeptical consumers by providing numerous markers of legitimacy, authenticity, and appeals to trust. The means by which fraudsters contact targets and obtain money mirror trends in everyday transactions, with the internet outpacing all other mechanisms.<sup>12</sup>

#### Ponzi Schemes

The Ponzi scheme is one of the most common forms of investment fraud. A Ponzi scheme lures investors in with the promise of high returns. The fraudster pays investors from funds contributed by new investors and steals the rest. The schemes require a consistent flow of money from new investors to continue. Ponzi schemes tend to collapse when it becomes difficult to recruit new investors or when a large number of investors ask to cash out.

In Ponzi schemes, investors typically deal with someone who is not registered and investors receive “interest” payments or account statements but the investment is not legitimate. Most investors do not get their money out and the promoters of the scheme vanish, taking the money with them.

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<sup>8</sup> CSA Report Archive, *2012 Enforcement Report*, online: Canadian Securities Administrators <<http://er-ral.csa-acvm.ca/wp-content/uploads/2013/02/CSA-2012-English-FINAL-Feb-19-13.pdf>> at 20.

<sup>9</sup> *Aurora, Re*, 2012 ABASC 7

<sup>10</sup> John Cotter, *Dave Humeniuk, Varun Aurora Charged In \$23-Million Concrete Equities Mexico Fraud Case*, online: Huffington Post <[http://www.huffingtonpost.ca/2014/01/22/dave-humeniuk-varun-aurora-charged\\_n\\_4645542.html](http://www.huffingtonpost.ca/2014/01/22/dave-humeniuk-varun-aurora-charged_n_4645542.html)>. See also, *Aurora, Re*, 2012 ABASC 7.

<sup>11</sup> We note that the CSA does not define fraud in the 2012 Enforcement Report.

<sup>12</sup> Martha Deevy, Shoshana Lucich, & Michaela Beals, *Scams, Schemes & Swindles: A Review of Consumer Financial Fraud Research*, online: Financial Fraud Research Center <<http://fraudresearchcenter.org/wp-content/uploads/2012/11/Scams-Schemes-Swindles-FINAL-On-Website.pdf>> at 6 [*Scams, Schemes & Swindles*].

Examples of such schemes that garnered extensive media attention include: Madoff<sup>13</sup>, Stanford<sup>14</sup>, Earl Jones<sup>15</sup>, and Brost and Sorenson<sup>16</sup> (the Arbour Energy case). Arbour Energy was a large Ponzi scheme originating in Alberta in which the promised rate of return was paid to initial investors using funds provided by subsequent investors. Among the investments that were recommended were illegitimate companies controlled by the fraudsters, Milowe Brost and Gary Sorenson. This was a fraudulent investment scheme that harmed hundreds of investors and involved a lengthy administrative proceeding of over six years following which the wrongdoers were banned from the capital markets and were assessed sanctions of \$54 million. The RCMP charged Brost and Sorenson with fraud and a criminal trial is expected to occur in 2014. The U.S. Securities and Exchange Commission (“SEC”) also obtained a judgment of \$210 million and \$100 million in penalties.

There are no specific prohibitions dealing with Ponzi schemes in Canadian securities law or the *Criminal Code*; instead, the general fraud provisions apply. Provisions relating to illegal distributions are relevant as fraudsters do not usually attempt to comply with securities requirements by becoming registrants or distributing their securities in accordance with securities regulatory requirements.

### **Pump and Dumps**

In pump and dumps, fraudsters attempt to get investors to put their money into stocks that are alleged to be under-valued, in an effort to artificially inflate their value. These stocks are promoted through fictitious emails, social media messages, and news releases. The investors are unaware that the person or company contacting them owns a large quantity of the stock and that the company is not legitimate. As the investors buy the shares the share price increases. Once the price hits a targeted amount, the fraudster sells their shares and the stock price plummets, leaving the investors holding securities with little or no value. A pump and dump is a form of market manipulation that directly harms individual investors.

### **ForEx Scams**

Online foreign exchange (forex) currency frauds are often operated in foreign jurisdictions. They promote high returns coupled with low risks from investments in forex contracts and often lure investors with the concept of leveraging their investment to control a significant amount of foreign currency for a relatively small initial investment. In these scams, an investor’s money will not be invested as claimed, and when the money is wired into an offshore account it will be difficult, if not impossible, to recover the funds. For example, in the B.C. case Canada Pacific Consulting Inc. and Michael Robert Shanz<sup>17</sup>, Shanz solicited German and Swiss residents to open trading accounts with his company, claiming the investment would be in gold futures and foreign exchange trading. None of the money was invested as promised.

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<sup>13</sup> SEC News, *SEC Charges Bernard L. Madoff for Multi-Billion Dollar Ponzi Scheme* (December 11, 2008), online: Securities and Exchange Commission <<http://www.sec.gov/news/press/2008/2008-293.htm>>.

<sup>14</sup> SEC News, *Investigation of the SEC’s Response to Concerns Regarding Robert Allen Stanford’s Alleged Ponzi Scheme* (March 31, 2010), online: Securities and Exchange Commission <<http://www.sec.gov/news/studies/2010/oig-526.pdf>>.

<sup>15</sup> Ingrid Peritz, *Earl Jones Given 11-Year Prison Term for Fraud* (February 16, 2010), online: Globe and Mail <<http://www.theglobeandmail.com/news/national/earl-jones-given-11-year-prison-term-for-fraud/article1208829/#dashboard/follows/>>.

<sup>16</sup> Jeff Gray, *Calgary Men, Companies Face \$54-Million in Sanctions for ‘Massive Fraud’* (September 28, 2012), online: Globe and Mail <<http://www.theglobeandmail.com/report-on-business/calgary-men-companies-face-54-million-in-sanctions-for-massive-fraud/article4575410/#dashboard/follows/>>.

<sup>17</sup> *Canada Pacific Consulting Inc. and Michael Robert Shantz*, 2012 BCSECCOM 195.

### Real Estate Investment Scams

Schemes involving real estate development projects or buying, renovating, flipping or pooling distressed properties are popular with con artists and many investors are unaware that such investments can be scams as they believe they are investing in actual real property rather than investing in a security which purports to invest in real property. For example, the case of Shire International Real Estate Investments Ltd.<sup>18</sup>, involved fraud wherein investors believed they were investing in various real estate ventures but the offering memoranda misrepresented how the investors' monies would be applied and monies were diverted to other ventures and purposes, causing losses to the investors.

### **3.4. Fraudulent Schemes**

While not specific types of investments, there are also some types of schemes that are commonly used to carry out investment fraud and sell fraudulent investments. Below are some of the most common schemes relating to investment fraud.

#### Affinity Fraud

Many investment frauds involve an element of affinity fraud, whereby fraudsters focus on a group or groups with whom they share an affiliation such as family, friends and social organizations (including ethnic groups, religious organizations or other communities). The New Brunswick case of William Priest<sup>19</sup> is one such example. Priest was a mortgage advisor who offered clients investments in real estate projects in which he claimed to be involved. Priest used these investments to cover his personal expenses, and pay back other clients. He exploited family and community relationships to fraudulently obtain \$600,000. Marketing a fraudulent investment scheme to members of an identifiable group or organization continues to be a successful practice for Ponzi scheme operators and other fraudsters.

#### Boiler Rooms

Boiler rooms are scams in which a temporary office, called a boiler room, is used to lend legitimacy to fraudulent operations. The company will have a website and a toll-free number, often along with a respectable office address to lure in investors.

Boiler rooms may be used to perpetrate various types of fraud (both investment and other) and are often used in conjunction with pump and dumps. They might use a phony survey to find out about targets' investment experience, offer free research, or try to get information such as a mailing address, phone number and email address out of potential victims. Fraudsters often use this information to call potential victims with a sales pitch, often calling multiple times. These networks of scam artists are highly organized, with many operations selling their victim lists to other boiler rooms. Because of this, victims of boiler room scams are at high risk of being targeted again.<sup>20</sup>

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<sup>18</sup> *Shire International Real Estate Investments Ltd.*, Re, 2012 ABASC 79.

<sup>19</sup> NBSC Newsroom, *William Watson Priest Ordered to Pay Money Obtained from Defrauded Investors*, online: New Brunswick Securities Commission <[http://www.nbsc-cvmnb.ca/nbnc/news\\_content\\_display.jsp?news\\_id=420&id=24&pid=4](http://www.nbsc-cvmnb.ca/nbnc/news_content_display.jsp?news_id=420&id=24&pid=4)>.

<sup>20</sup> OSC Investor Brochures, *Boiler Room Scams*, online: Ontario Securities Commission <[http://www.osc.gov.on.ca/en/Investors\\_res\\_boiler-room.htm](http://www.osc.gov.on.ca/en/Investors_res_boiler-room.htm)>.

### Advance Fee Scams

Investors in this scheme are persuaded to pay the fraudster money in order to take advantage of an offer promising high returns. The scammer takes the money advanced and the investor is left with no legitimate investment. For example, the Lehman Brothers<sup>21</sup> case involved misrepresentations to investors about the identity and nature of the business and promised to purchase shares at a higher than market price if fees were provided in advance to facilitate the transaction.

Advance fee scams are also used to defraud individuals who have been the victims of an earlier fraud. Fraudsters will contact victims, telling them that, for an upfront fee, they will help to recover earlier losses. Instead, they abscond with the upfront fees they collect and investors suffer additional losses (the upfront fees paid).

### Internet Fraud

Many of the aforementioned types of fraud are perpetrated through the internet. Interviews with stakeholders revealed a belief that many fraudulent offerings made to Canadian investors are perpetrated by fraudsters who are located in other jurisdictions, particularly certain developing countries. These cases are particularly problematic for enforcement departments or criminal prosecutors to successfully prosecute.

The Australian Crime Commission has noted that off shore, internet investment frauds are “incredibly sophisticated and very difficult for even experienced investors to identify.”<sup>22</sup> It may be useful for regulators to add warnings against sending money off shore in fraud prevention literature, and identify this as a warning flag for investment fraud.

## **4. The Canadian Regulatory Framework**

### **4.1. Overview**

Each province and territory in Canada has its own securities laws and regulatory agency. Provincial and territorial agencies collaborate under the auspices of the CSA. Where consensus is reached, members of the CSA may enter into interprovincial agreements such as multilateral or national instruments (such as National Instrument 23-101 “Trading Rules”) which advance consistency between Canadian jurisdictions.

Police agencies are responsible for investigating criminal fraudulent activity and Crown Attorneys have the responsibility for prosecuting fraud criminally.

There are varying levels of expertise, experience, and resources among those agencies responsible for enforcement activities relating to investment fraud.

The Canadian system has been criticized for its lack of regulation at a national level, particularly in the area of enforcement and fraud prevention (see discussion in section 8.6). Independent studies

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<sup>21</sup> OSC Proceedings, *In the Matter of Lehman Brothers & Associates Co.*, online: Ontario Securities Commission <[https://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad\\_20111216\\_lehman.pdf](https://www.osc.gov.on.ca/documents/en/Proceedings-RAD/rad_20111216_lehman.pdf)>.

<sup>22</sup> ACC Crime Profile Fact Sheets, *Serious and Organised Investment Frauds*, online: Australian Crime Commission <<https://www.crimecommission.gov.au/publications/intelligence-products/crime-profile-fact-sheets/serious-and-organised-investment-frauds>> [*Serious and Organised Investment Frauds*].

have criticized the Canadian system for its inadequate enforcement and inconsistent investor protection across Canada. Canada has been said to have

a “securities enforcement mosaic,” where “each provincial commission has its own priorities, depth of resources, and level of expertise. Resources are spread thin and the benefits of coordination are diluted.” The Crawford Report expressed “profound concern about ineffective enforcement,” and stated pointedly that this is a “domestic and international embarrassment for Canada.”<sup>23</sup>

## 4.2. Criminal Code and Securities Act Fraud Provisions

### Securities Law Fraud Provisions

The most obvious provisions relating to securities fraud are those that explicitly prohibit fraud. Most provincial securities acts prohibit any act relating to securities that the person or company knows or reasonably ought to know perpetrates a fraud.<sup>24</sup> For example, Alberta’s *Securities Act* provides in section 93:

No person or company shall, directly or indirectly, engage or participate in any act, practice or course of conduct relating to a security or exchange contract that the person or company knows or reasonably ought to know will

- a) result in or contribute to
  - i) a false or misleading appearance of trading activity in a security or an exchange contract, or
  - ii) an artificial price for a security or an exchange contract,
- or
- b) perpetrate a fraud on any person or company.<sup>25</sup>

The definitions used in provincial securities statutes are intentionally broad.

The Ontario provision also includes a prohibition against “attempts at fraud”.<sup>26</sup> Manitoba, Newfoundland and Labrador, and Nunavut do not have provisions describing a general prohibition on fraudulent activity in connection with securities. Where a province’s securities act does not contain an express prohibition on fraud, other provisions are used to deter such conduct (for example, Ponzi schemes can be dealt with as “illegal distributions” under securities laws) or they must be addressed through criminal proceedings.<sup>27</sup> This may affect the number of cases classified as fraud in the CSA’s enforcement reports.

Further, Part 3 of National Instrument 23-101 Trading Rules includes a provision prohibiting market manipulation and fraud that applies to all provinces except Alberta, British Columbia, Ontario,

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<sup>23</sup> See the Canadian Bankers Association’s factum submitted in connection with the Supreme Court of Canada’s hearing concerning a proposed Canadian Securities Act, available online at <[http://www.cba.ca/contents/files/misc/msc\\_20110110\\_scc\\_factum\\_en.pdf](http://www.cba.ca/contents/files/misc/msc_20110110_scc_factum_en.pdf)> at 2.

<sup>24</sup> *Supra* note 3.

<sup>25</sup> *Securities Act*, R.S.A. 2000, c. S-4, s. 93.

<sup>26</sup> *Securities Act*, R.S.O. 1990, c. S.5, s. 126.1(2).

<sup>27</sup> Robert J. van Kessel & Paul S. Rand, *The Law of Fraud in Canada* (Canada: LexisNexis Canada, 2013) at 769 [Law of Fraud].

Quebec and Saskatchewan, which have their own respective provisions in their securities acts relating to manipulation and fraud.<sup>28</sup>

The Canadian self-regulatory organizations (“SRO”), the Investment Industry Regulatory Organization of Canada (“IIROC”) and the Mutual Fund Dealers Association of Canada (“MFDA”) regulate investment dealers and mutual fund dealers, and their employees (known as registered representatives or approved persons) and can discipline their member dealers or their employees for breaching IIROC or MFDA rules. The SROs’ provisions relating to fraud address behavior that violates the requirement to “observe high standards of ethics and conduct in the transaction of their business” and to “not engage in any business conduct or practice which is unbecoming or detrimental to the public interest”.<sup>29</sup>

### **Quasi-Criminal Proceedings Pursuant to the Securities Act**

Quasi-criminal proceedings are matters prosecuted in Provincial Court pursuant to securities act provisions (rather than the *Criminal Code*) where the penalty can include jail time. In some jurisdictions securities regulators have the power to directly prosecute quasi-criminal matters in court. In other jurisdictions, securities regulators may refer these offences to Crown counsel for prosecution. In quasi-criminal matters, the elements of the offence need to be proven beyond a reasonable doubt, but the accused has available to him or her the common law defence of due diligence and any other defences set out in the provision itself or otherwise prescribed by law, which must be proven on a balance of probabilities.<sup>30</sup>

### **Criminal Code Provisions Relating to Fraud**

The *Criminal Code* provides offences that are relevant to investment fraud. It is generally accepted that a criminal prosecution is the appropriate action for the more serious cases of fraud, those that involve large losses, or where perpetrators demonstrate flagrant or repetitive conduct.<sup>31</sup> The *Criminal Code* has been expanded in recent years to increase the number of securities-related offences<sup>32</sup> as well as to increase the penalties for existing criminal offences related to securities.<sup>33</sup>

Successful criminal prosecution of investment fraud may be more difficult than administrative proceedings or quasi-criminal proceedings due to various factors, including the criminal standard of proof (beyond a reasonable doubt), the full Charter rights afforded an accused under the *Criminal*

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<sup>28</sup> Section 3.1 of NI 23-101 provides:

- (1) A person or company shall not, directly or indirectly, engage in, or participate in any transaction or series of transactions, or method of trading relating to a trade in or acquisition of a security or any act, practice or course of conduct, if the person or company know, or ought reasonably to know, that the transaction or series of transactions, or method of trading or act, practice or course of conduct
  - (a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, a security or a derivative of that security; or
  - (b) perpetrates a fraud on any person or company.

<sup>29</sup> See IIROC Dealer Member Rule 29.1. A similar provision exists in MFDA Rule 2.1.1.

<sup>30</sup> Joseph Groia & Pamela Hardie, “Securities Litigation and Enforcement”, 2<sup>nd</sup> Edition at 416 [*Securities Litigation and Enforcement*].

<sup>31</sup> *Law of Fraud*, *supra* note 27 at 722.

<sup>32</sup> Bill C-13, An Act to amend the Criminal Code (capital markets fraud and evidence-gathering), 37<sup>th</sup> Parliament, 3<sup>rd</sup> Session. These measures were enacted in S.C. 2004, c.3. See *Securities Litigation and Enforcement*, *supra* note 30 at 472.

<sup>33</sup> *Standing Up for Victims of White Collar Crime Act*, S.C. 2011, c. 6.

*Code*, the criminal procedural rules that apply, and the difficulty in making out the full *mens rea* component of the criminal offence<sup>34</sup>.

A commonly used provision to prosecute fraud is the general fraud offence found at section 380(1) of the *Criminal Code*.<sup>35</sup> This section can apply to any transaction when it is alleged that someone has defrauded the public or any person by deceit, falsehood or other fraudulent means. The financial planner Earl Jones was charged and convicted under this provision.<sup>36</sup> The maximum penalty is fourteen years imprisonment where the amount defrauded is greater than \$5,000 or two years where it is under \$5,000. As noted in FAIR Canada's earlier fraud report, Earl Jones received an eleven year sentence and would be eligible for parole within two years.<sup>37</sup> Other *Criminal Code* offences are section 380(2) (fraud affecting the public markets), section 382 (market manipulation such as matched orders and wash trades) and section 400 (circulation of a false prospectus, statement or account).

## 5. The Scope of the Problem

### 5.1. Canadian Investment Fraud Statistics

There is a dearth of publically-available data regarding investment fraud in Canada. A surprising result of the research conducted during the course of this project was the lack of empirical information available relating to investment fraud in Canada.

As noted in section 6.3 (Harm to Victims), there does not appear to be an authoritative source that provides a measure of the size of the problem or the scope of investment fraud in Canada. The CSA publishes an Investor Index report every three years, which provides self-reported experience with fraud (discussed below in section 5.4).

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<sup>34</sup> Section 380(2) of the *Criminal Code* requires not only that the Crown prove that the accused used deceit, falsehood or other fraudulent means, but also that the accused subjectively intended to defraud when using one of these means. Proof of intent is the highest possible *mens rea* standard in criminal law and a lesser form of *mens rea*, such as willful blindness or recklessness will not be sufficient. See *Securities Litigation and Enforcement*, *supra* note 30 at 484.

<sup>35</sup> *Criminal Code*, R.S.C. 1985, c. C-46, s. 380(1) [*Criminal Code*] provides:

(1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service, (a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years, where the subject-matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; or (b) is guilty (i) of an indictable offence and is liable to imprisonment for a term not exceeding two years, or (ii) of an offence punishable on summary conviction, where the value of the subject-matter of the offence does not exceed five thousand dollars.

(1.1) When a person is prosecuted on indictment and convicted of one or more offences referred to in subsection (1), the court that imposes the sentence shall impose a minimum punishment of imprisonment for a term of two years if the total value of the subject-matter of the offences exceeds one million dollars.

<sup>36</sup> *R. v Jones*, [2010] QJ No 956, 2010 QCCQ 851 at paras 21-24 (CQ), leave to appeal to QC CA refused [*R. v Jones*].

<sup>37</sup> FAIR Canada, *A Decade of Financial Scandals* (February 2012), online: Canadian Foundation for Advancement of Investor Rights <[http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm\\_Final-0222.pdf](http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf)> at 27 [*A Decade of Financial Scandals*].

According to the U.S. Financial Fraud Research Center<sup>38</sup>, “there are two primary sources of data for victimization prevalence and incidence estimates: 1) self-report complaint data from agencies; and 2) data from surveys.”<sup>39</sup>

Given that there is no national framework in place to collect, track and report on investment fraud complaints, it is difficult (if not impossible) to gain an accurate measure of the prevalence of investment fraud in Canada and the associated harm to Canadian investors. Further, it is also very difficult to evaluate whether those responsible for enforcement are using their limited resources as efficiently as possible and are meeting their objectives, including deterring and prosecuting financial fraud.

#### **Limited Publication of Complaints Data**

Most provincial and territorial securities regulators in Canada do not publish data on the number of complaints they receive and fewer break out the data to provide the number of complaints that were fraud-related. Other empirical information that is not disclosed by most of the securities commissions is the number of cases that were investigated versus the number that were pursued as enforcement cases, or the amount of known investment fraud losses in their jurisdiction.

#### **Limited Information Regarding Investment Fraud-Related Criminal Cases**

Further, there is limited publicly-available information regarding the number of complaints, investigations or prosecutions of investment fraud reported to police and brought through the criminal courts nor is there any reliable data on the amount of victims losses to investment fraud (even for known or uncovered frauds) in a given year or over any given time period.

#### **Self-Regulatory Organizations**

The SROs (IIROC and the MFDA) provide more data. They also disclose the number of complaints received, the source of the case (i.e. public complaint, compliance review, etc.) and the number of files opened from these sources. The MFDA, in addition, breaks down the cases opened by type including fraud<sup>40</sup> whereas IIROC only provides data on the most common complaints opened in a given year.<sup>41</sup>

#### **No Other Meaningful Publicly-Available Statistics on Investment Fraud**

Interviews with stakeholders did not identify any meaningful publicly-available statistics to assist in measuring the incidence and prevalence of investment fraud in Canada aside from those outlined below. Some regulators indicated that they are in the process of developing internal metrics and

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<sup>38</sup> The Financial Fraud Research Center (FFRC) is a collaboration between the Stanford Center on Longevity and the FINRA Investor Education Foundation. It aims to advance the fight against financial fraud and focuses on individual consumer victimization.

<sup>39</sup> Martha Deevy & Michaela Beals, *The Scope of the Problem: An Overview of Fraud Prevalence Measurement* (2013), online: Financial Fraud Research Center <<http://fraudresearchcenter.org/wp-content/uploads/2013/11/Scope-of-the-Problem-FINAL.pdf>> at 7 [*Scope of the Problem*].

<sup>40</sup> MFDA Enforcement, *Enforcement Statistics*, online: Mutual Fund Dealers Association of Canada <<http://www.mfda.ca/enforcement/enfStats.html>>. See also, MFDA Enforcement, *MFDA Annual Report 2012*, online: Mutual Fund Dealers Association of Canada <<http://www.mfda.ca/about/AnnReports/EnfAR2012.pdf>>.

<sup>41</sup> IIROC Enforcement, *2012 Enforcement Report: Protecting Investors and Fostering Fair and Efficient Capital Markets Across Canada*, online: Investment Industry Regulatory Organization of Canada <[http://www.iiroc.ca/Documents/2013/b3b8c708-1cfc-4234-ba68-f31c61d64681\\_en.pdf](http://www.iiroc.ca/Documents/2013/b3b8c708-1cfc-4234-ba68-f31c61d64681_en.pdf)> at 21-22.

proxies for impact analysis, but did not suggest that the measurement of the prevalence and incidence of fraud was a high priority. Some regulatory enforcement departments that we spoke to seemed to dismiss the idea that such metrics, including the identification of trends, would improve the regulatory framework. This raises the question of how regulators responsible for preventing such fraud prioritize efforts absent such crucial information. It has been commented that “[u]nder-reporting also has implications for how enforcers select cases to pursue... This research suggests that over-reliance on a complaints-driven process may result in some of the worst scams not being investigated.”<sup>42</sup> In our view, estimates of investment fraud prevalence and incidence could contribute to more-informed decisions about related policy, allocation of scarce resources, and potential proactive measures to reduce rates of fraud.

It would also be interesting to understand the impact of greater transparency and heightened awareness among financial consumers of the prevalence and incidence of investment fraud in Canada. If such information could lead to increased vigilance among individual investors, it would be a highly valuable investor education tool.

We note that a conflict of interest may arise between the roles of securities regulators to foster confidence in the market and their mandate to protect investors in relation to the publication of information relating to fraud. If measures of the prevalence and incidence of investment fraud were available, it is unclear whether they would foster confidence in the market. However, investor awareness of the prevalence and incidence of fraud could reinforce the message that investors should take steps to protect themselves prior to investing.

We outline below available statistical information on fraud in Canada and other jurisdictions.

## **5.2. CSA Enforcement Reports and Provincial/Territorial Reports**

The CSA’s annual enforcement reports summarize enforcement activities of the various jurisdictions in a calendar year. Through these reports, the securities regulators publish the number of proceedings commenced in a given year and the number of concluded proceedings and break these down into different categories. 2012 was the first year that fraud was included as a separate offence category.

The CSA’s annual enforcement reports contain important and useful information. However, the information provided in these reports is stale, given that these reports provide detailed information relating to cases concluded during the prior year. Many such cases may involve allegations of fraud dating further back. While the CSA’s enforcement reports also provide aggregate numbers of proceedings commenced (including respondents by the type of offence, including fraud), the reports provide limited details regarding such cases.

In addition to the CSA enforcement reports, each jurisdiction publishes information about its own enforcement activities. Some securities regulators report the number of complaints they receive while others do not.

The British Columbia Securities Commission (“**BCSC**”) and the Saskatchewan Financial and Consumer Affairs Authority (“**FCAA**”) break down these complaints by type to provide the number of complaints received that allege fraud. During the 2012-2013 fiscal year, in Saskatchewan, nine cases

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<sup>42</sup> OFT Publications, *Research on Impact of Mass Marketed Scams A summary of research into the impact of scams on UK consumers* (December 2006), No. OFT883, online: Office of Fair Trading <[http://www.oft.gov.uk/shared\\_oftr/reports/consumer\\_protection/oft883.pdf](http://www.oft.gov.uk/shared_oftr/reports/consumer_protection/oft883.pdf)> at 36.

were opened that alleged fraud out of 111 cases opened.<sup>43</sup> In British Columbia, thirty-eight out of 114 included allegations of fraud.

The ASC publishes three-year statistical information in its annual report about its enforcement activity, which includes information on the number of complaints received; the number of current cases (not broken out by type of case) and concluded investigations; the number of settlement agreements and amount collected; and the administrative penalties levied and the amount recovered. Similarly, the Financial and Consumer Services Commission (“FCSC”) of New Brunswick publishes the number of complaints received, new files from other sources and number of concluded cases. It also makes public the amount collected regarding each case or matter and the unpaid balance owing as does the OSC on its Delinquent List. The OSC, however, does not publish complaint data. The Autorité des marchés financiers (“AMF”) publishes complaint data in its annual report but it does not disclose the number of complaints related to fraud. The Manitoba Financial Services Agency 2013 Annual Report discloses the number of investigation and enforcement inquiries and the number of investigation files opened (56 out of 392) but does not indicate the portion of these that are related to fraud.<sup>44</sup> No complaint data could be found for Nova Scotia, Prince Edward Island or Newfoundland.

It would be beneficial if more complete data was provided by each of the jurisdictions.

### 5.3. 2012 Fraud Cases

The CSA annually publishes a consolidated enforcement report. The report issued for 2012 was the first that included a specific category for fraud. Prior to 2012, fraud cases were included within other categories of violations, but starting in the 2012 Enforcement Report, “[i]n order to distinguish fraud cases more clearly and to track the numbers of such cases...” it added fraud as a stand-alone category of securities offence.

Upon a review of these cases, it was observed that:

- The overwhelming majority of the cases (fifteen out of eighteen) involved perpetrators who were not registered;
- The majority of the cases (fourteen out of eighteen) involved enforcement actions through administrative proceedings where sanctions do not include jail time. Instead sanctions could include barring the individual from the markets (such as from trading or acting as a director or officer or registrant), administrative penalties, cost orders, and disgorgement orders.
- Fines and administrative penalties amounted to \$17,459,625 and the amount of restitution, compensation and disgorgement ordered was in the amount of \$99,743,113.
- In three out of eighteen cases there was a previous disciplinary or criminal record of at least one of the perpetrators. Despite the recidivism, in only one of those three cases (the Arbour Energy Inc. case) are we aware of any related Canadian criminal proceedings.<sup>45</sup>

<sup>43</sup> FCAA Annual Report, *Financial and Consumer Affairs Authority of Saskatchewan Annual Report 2012-2013*, online: Financial and Consumer Affairs Authority of Saskatchewan <<http://www.sfsc.gov.sk.ca/adx/asp/adxGetMedia.aspx?DocID=267,256,81,1,Documents&MediaID=9d08cd8d-13cc-458a-8f12-b6ce95238e3e&Filename=2012-2013+FCAA+Annual+Report.pdf>> at 14. Seven fraud cases were opened during the 2011-2012 time period out of 101 opened cases.

<sup>44</sup> MSC Report, *Manitoba Financial Services Agency 2012-2013 Annual Report*, online: Manitoba Securities Commission <[http://www.msc.gov.mb.ca/about\\_msc/2013\\_ar.pdf](http://www.msc.gov.mb.ca/about_msc/2013_ar.pdf)> at 23.

<sup>45</sup> Suzanne Wilton, *Calgarian Will Return to Face Ponzi Charges: Lawyer*, online: Calgary Herald <<http://www.calgaryherald.com/news/Calgarian+will+return+face+Ponzi+charges+lawyer/2041197/story.html>>.

While the administrative penalties and disgorgement orders are significant, it is likely that little, if any, of the monetary penalties or orders have been paid by the wrongdoers. The OSC and the FCSC are the only Canadian securities regulators that publish a list of those who have failed to pay their fines (the OSC on their Delinquent List and the FCSC in their Annual Report). As of December 31, 2013, payment had not been received for most of the fines owing in respect of the Ontario fraud cases listed in the CSA report.<sup>46</sup> Disclosure of the amount collected in the William Priest case from New Brunswick will be unknown until the publication of their next annual report. The ASC provides information on administrative penalties and ordered disgorgement but does not provide this information on a per case basis so it is not possible to determine how many of the Alberta fraud cases included in the CSA 2012 Enforcement Report went unpaid. We suspect that other commissions have a similar difficulty in actually collecting the fines owed, but cannot confirm this due to the non-publication of this data.

#### 5.4. CSA Investor Index

Every three years, the CSA conducts a public survey in order to gain insight into Canadian investors' financial knowledge, behavior and to estimate the prevalence of investment fraud in Canada.

The 2012 CSA Investor Index found that 27% of Canadians "...believe they have been approached with a possible fraudulent investment at some point in their life"<sup>47</sup> while "4.6% of Canadians believe they have been a victim of fraud"<sup>48</sup>. The estimated prevalence of investment fraud victimization was highest in Alberta (8.2%), and British Columbia and Ontario (both 5.8%).

It does not appear that CSA members have attempted to estimate the actual number of frauds that have been perpetrated based on these survey results to account for fraud under-reporting and under-admitting. As noted by the Financial Fraud Research Center, "[s]urvey measures rely on the accuracy of individuals' self-reports and on their willingness to share information with interviewers."<sup>49</sup> See section 6.4 for some of the reasons why fraud may be under-reported.

Further, there do not appear to be any measures of the incidence rate<sup>50</sup> of investment fraud in Canada (discussed below).

Granular complaint data from all the provincial securities regulators would be a good first step toward improved information, but must be considered in light of the fact that complaint data "...still vastly underestimate the scope of the problem due to the large number of victims who do not report to authorities."<sup>51</sup> See section 5.11 for more information on reporting rates. Interestingly, a comment we heard from several representatives of securities regulators and self-regulatory organizations was that the publication of complaints information could result in figures that were over-inflated if complaints were reported based on what complainants said, without further investigation by regulators. It was mentioned that investors may allege fraud in their initial

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<sup>46</sup> In the McErlean, Shaun Gerard and Securus Capital Inc. Matter, the Commission Order included \$8,892,906 in disgorgement and \$250,000 in costs. The Delinquent List shows that \$8,191,040.49 remains owing. The Sextant Capital Management Inc. case is not on the Delinquent List because the matter is under appeal.

<sup>47</sup> Canadian Securities Administrators, *2012 CSA Investor Index* (October 16, 2012), online: Canadian Securities Administrators <[http://www.securities-administrators.ca/uploadedFiles/General/pdfs/2012%20CSA%20Investor%20Index%20-%20Public%20Report%20FINAL\\_EN.pdf](http://www.securities-administrators.ca/uploadedFiles/General/pdfs/2012%20CSA%20Investor%20Index%20-%20Public%20Report%20FINAL_EN.pdf)> at 24 [*CSA Investor Index 2012*].

<sup>48</sup> *Ibid.*

<sup>49</sup> *Scope of the Problem*, *supra* note 39 at 7.

<sup>50</sup> The incidence rate measures the number of new cases in a given time period. Such a measure would indicate whether fraud is a growing problem.

<sup>51</sup> *Scope of the Problem*, *supra* note 39 at 19.

complaint but this in no way means that there actually is fraudulent activity and so the complaints data would not be accurate). An explanatory note accompanying published statistics could be one way of allaying these concerns. However, in light of very low reporting rates, the publication of complaints data would likely not over-estimate the problem.

Although the CSA's investor indices are a valuable source of information concerning investment fraud victimization in Canada, the questions posed to survey respondents regarding the fraud experience of Canadian investors do not permit inferences of trends in investment fraud nor do they allow for measurements of whether particular enforcement or other initiatives are having the intended effect(s). This is due to the fact that the questions as posed to determine whether the investor has ever been approach with, or victimized by, a fraudulent investment opportunity (prevalence) and does not provide an indication of incidence (that is, the number of new cases in a specified time period).

A heightened awareness of actual instances of investment fraud by retail investors could result in increased vigilance by investors, and thus less opportunity for (and actual incidences of) investment fraud in Canada. It is recommended that the CSA and governments prioritize the collection of statistics regarding investment fraud complaints. A single, centralized reporting repository could increase reporting if it provided clarification to investors as to where to lodge their complaints.

### **5.5. BCSC Investment Fraud Vulnerability Report**

A BCSC study found that nearly one-in-five older Canadians (17%) believe they have been a victim of investment fraud at some point in their lives.<sup>52</sup> Interestingly, BC and Alberta residents were noted to be most likely to believe that they have been the victims of fraud at least once in their life. Older investors in BC and Alberta were observed to be 4% more likely to self-report having been the victim of investment fraud than the next highest province, Ontario.<sup>53</sup>

This research also found that, for investors fifty and older, lower levels of education correlated with increased vulnerability to investment fraud. Further, 39% of victims reported having invested in multiple frauds and "[a]mong those who believe they have been victims of investment fraud, almost half (48%) lost over \$5,000 (on their most recent investment fraud)."<sup>54</sup>

### **5.6. Royal Canadian Mounted Police**

In 2012, the RCMP published a brief entitled "Capital Market Fraud – The Canadian Perspective"<sup>55</sup> (the "RCMP Brief") to provide an overview of criminal trends associated with capital market fraud and the involvement of organized crime and criminalized professionals. This brief noted that "...the RCMP Integrated Market Enforcement Teams (IMET) have carriage of the majority of criminal files."<sup>56</sup> The RCMP Brief noted that the most prevalent capital market offences reported were market manipulations and investment misrepresentations.

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<sup>52</sup> BCSC Publications, *National Investment Fraud Vulnerability Report*, online: British Columbia Securities Commission <<http://www.bcsc.bc.ca/uploadedFiles/2012NationalInvestmentFraudVulnerabilityReport.pdf>> at 6 [*Fraud Vulnerability Report 2012*].

<sup>53</sup> *Ibid.* at 7.

<sup>54</sup> *Ibid.* at 29.

<sup>55</sup> RCMP Capital Market Fraud, *The Canadian Perspective*, online: Royal Canadian Mounted Police <<http://www.rcmp-grc.gc.ca/pubs/imets-eipmf/2012-fraud-fraude-eng.htm>> [*Capital Market Fraud*].

<sup>56</sup> *Ibid.*

According to the RCMP, investment schemes were one of the top twelve schemes reported by Canadians as of March 14, 2007.<sup>57</sup> However, the RCMP does not appear to publish any current data relating to the prevalence or incidence of investment fraud.

As discussed below in section 8.6, the RCMP heads the Integrated Market Enforcement Team (“**IMET**”) which is charged with ensuring that those who commit serious capital markets fraud offences will be discovered, investigated, prosecuted, and incarcerated in an effective and timely fashion. The estimated loss to investors in the IMET cases which were brought between 2004 and 2009, where a total of 26 individuals were charged, totaled \$514.0 million.<sup>58</sup>

### **5.7. Statistics Canada**

Statistics Canada’s Uniform Crime Reporting Survey measures the incidence of crime in Canadian society and its characteristics. It provides an annual police-reported crime rate, which categorizes crime by “violent crime”, “property crime” and “other *Criminal Code* offences”. Property crimes are further categorized by break and enter or several categories of theft.

Statistics Canada’s General Social Survey, conducted every five years, includes a category of “Theft of personal property” which includes the theft of money where the perpetrator does not confront the victim. This may include statistics of investment fraud.

Neither of these statistical measurements is granular enough to provide meaningful information regarding the prevalence or incidence of investment fraud in Canada.

### **5.8. Canadian Anti-Fraud Centre**

The Canadian Anti Fraud Centre (“**CAFC**”) is the central agency in Canada that collects information and criminal intelligence on Mass Marketing Fraud (telemarketing), advanced-fee fraud letters (Nigerian letters), internet fraud and identity theft complaints from Canadian and American consumers and victims. It is believed that the CAFC accepts and tracks complaints relating to investments, although we were unable to locate any such public reports or verify this with the CAFC. The CAFC reported that in 2006 it received ninety-nine investment complaints.<sup>59</sup> It is unclear from their public documentation what their process is for dealing with such complaints.

### **5.9. Public Safety Canada**

Public Safety Canada prepared an evaluation of the IMET Initiative in 2010.<sup>60</sup> This report included a literature and document review, which covered materials from the Department of Justice Canada, Finance Canada, numerous securities enforcement experts, Public Prosecution Services Canada, the RCMP and others, and found that

[t]he literature and document review revealed that there exists no definitive, reliable, empirical measure or consensus on the size or extent of serious capital

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<sup>57</sup> RCMP Reports, Research and Publications, *Threat Assessment: Mass-Marketing Fraud* (November 2007), online: Royal Canadian Mounted Police <<http://www.rcmp-grc.gc.ca/pubs/ci-rc/marketing-eng.htm>> [*Threat Assessment*].

<sup>58</sup> RCMP Reports, Research and Publications, *2008-2009 Integrated Market Enforcement Program Annual Report*, online: Royal Canadian Mounted Police <<http://www.rcmp-grc.gc.ca/pubs/imets-eipmf/2009-eng.htm>>.

<sup>59</sup> *Threat Assessment*, *supra* note 57.

<sup>60</sup> Public Safety Canada, *Final Report 2009-2010 Evaluation of the Integrated Market Enforcement Team Initiative* (May 28, 2010), online: Government of Canada <<http://www.publicsafety.gc.ca/cnt/rsrscs/pblctns/archive-vltn-ntgrtd-mrkt-nfrcmnt-2009-10/index-eng.aspx>>.

market crime in Canada. The difficulty rests on a general inability to provide measures for estimates of fraud when these have been neither definitively identified nor proven. ... Nevertheless, there do exist a number of measurements that can be used as indicators and from which it can be deduced that the scope of the problem is significant.<sup>61</sup>

The report goes on to cite several measurements and statements, none of which give a true picture of the scope of investment fraud in Canada.

### **5.10. NASAA Data**

The North American Securities Administrators Association (“**NASAA**”) conducts an annual survey of its U.S. members to gather enforcement data and identify trends in securities fraud, regulatory issues, and investor protection.

In 2013, forty-nine of fifty-one U.S. NASAA members responded to the survey request. The survey requested responses regarding the following:

- The number of complaints or inquiries received from investors;
- The number of investigations and actions a state has conducted or initiated;
- The number of referrals between state securities regulators and other regulators and law enforcement agencies;
- Information on penalties, payments, costs and restitution resulting from enforcement actions;
- The results from state securities regulators’ efforts and assistance to prosecute criminal violations, including years sentenced and years of probation; and
- The type of actions conducted (administrative, civil or criminal), the most common products or practices relevant to these actions, and the most common type of actors targeted by these efforts.

The 2013 NASAA Enforcement Report<sup>62</sup> revealed that state securities regulators received 10,272 complaints from aggrieved investors, conducted 5,865 investigations, and reported 2,496 enforcement actions. More than 690 state enforcement cases involved fraud. According to NASAA, fraud is traditionally marked by material misrepresentations, false statements or a scheme designed to defraud or deceive an investor.<sup>63</sup> Similar to the comments we heard from stakeholders and findings from the CSA 2012 Enforcement Report, the majority of the fraud cases reportedly involved unregistered individuals and/or unregistered firms selling unregistered securities.

The NASAA information also provides information on the most common type of products that were at the center of enforcement actions. Regulation D offerings (private placement offerings) and oil and gas investments were the most frequent source of cases handled by NASAA members, following by Ponzi schemes, real estate investments or interests, and affinity fraud.<sup>64</sup> It notes that “there are active investigations into suspect oil and gas investment programs in more than two dozen states and in every region of the U.S. and Canada. Investors should conduct thorough due diligence and

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<sup>61</sup> *Ibid* at 13-14.

<sup>62</sup> NASAA Enforcement Statistics, NSAA Enforcement Report: 2013 on 2012 Data, online: North American Securities Administrators Association <<http://www.nasaa.org/wp-content/uploads/2013/10/2013-Enforcement-Report-on-2012-data.pdf>> [*NASAA Enforcement Report 2013*].

<sup>63</sup> *Ibid* at 7.

<sup>64</sup> *Ibid* at 8.

assess their own tolerance for considerable risk when considering the purchase of interests in oil and gas programs.”<sup>65</sup>

The NASAA report identifies the top five trends regarding securities enforcement actions and identifies top threats to investors and small businesses, noting the increased presence of questionable securities offerings made available via the internet.

### **Cases Involving Seniors**

The NASAA survey sought data on the type and nature of enforcement actions involving seniors. There were 367 enforcement actions involving the abuse of seniors. Again, unregistered securities were the most common product involved in senior cases, accounting for more than half of all reported senior-related enforcement actions.

With respect to trends, the NASAA report notes: “Affinity fraud remains a continuing trend in the types of reported senior abuse cases. Variable annuities, viaticals or life settlement products, and free lunch investment seminars also appear as continuing problems for senior investors.”<sup>66</sup>

### **5.11. FINRA Research**

Interestingly, U.S. research conducted by the U.S. Financial Industry Regulatory Authority (“**FINRA**”) suggests that 12% of known investment fraud victims denied ever losing money on an investment.<sup>67</sup> Research by AARP<sup>68</sup> (formerly the American Association of Retired Persons) corroborates these findings, noting that “[o]nly 1 in 4 investment fraud victims, having lost between \$1,000 and \$25,000 in a scam, admitted to having been scammed or swindled in the preceding 3 years.”<sup>69</sup>

## **6. Victims**

### **6.1. Victimization in Canada**

As noted above in section 5.4, “[j]ust over one-quarter of Canadians (27%) believe they have been approached with a possible fraudulent investment at some point in their life.”<sup>70</sup> The 2012 CSA Investor Index found that “4.6% of Canadians believe they have been a victim of fraud...”<sup>71</sup>

It is important to remember that in each of the cases outlined in the CSA enforcement reports victims were harmed by fraud. These victims are only the tip of the iceberg, as the reporting rate is low (see section 6.4 below).

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<sup>65</sup> *Ibid* at 10.

<sup>66</sup> *Ibid* at 8.

<sup>67</sup> FINRA Investor Education Foundation, *Senior Fraud Risk Survey* (2007), online: Financial Fraud Research Center <[http://www.finra.org/web/groups/sai/@sai/documents/sai\\_original\\_content/p036702.pdf](http://www.finra.org/web/groups/sai/@sai/documents/sai_original_content/p036702.pdf)>.

<sup>68</sup> AARP Foundation, *Off the Hook: Reducing Participation in Telemarketing Fraud* (2003), online: AARP Foundation <[http://assets.aarp.org/rgcenter/consume/d17812\\_fraud.pdf](http://assets.aarp.org/rgcenter/consume/d17812_fraud.pdf)>.

<sup>69</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 15.

<sup>70</sup> *CSA Investor Index 2012*, *supra* note 47.

<sup>71</sup> *Ibid*.

## 6.2. Characteristics Common to Victims of Investment Fraud

### Attitudes

The CSA's 2009 Investor Index found that "[t]he strongest predictors of being a victim relate to over-confidence, attitudes about investments and level of investment activity."<sup>72</sup> Attitudes found to be predictive of victimization included high return expectations and a self-assessed aggressive investing style.<sup>73</sup> These investors are also willing to take on risk, believe that most people can be trusted, frequently enter contests, lotteries and/or sweepstakes, and are highly educated.<sup>74</sup> A separate segment determined to have higher susceptibility to fraud is visible minorities, who are not over-confident but "are more aggressive with respect to taking risk with their investments."<sup>75</sup>

### High Return Expectations

One concerning finding of research undertaken has been that most Canadians have unrealistically high expectations of the returns they should expect on their investments. This is particularly worrisome because a promise of high, risk-free returns is a hallmark of a fraudulent investment scheme. The 2012 CSA Investor Index also found that two-in-five Canadians failed a general investment knowledge test.<sup>76</sup> Concerns about retirement-preparedness may lend a sense of urgency to investors' decision-making and may cloud their judgment in recognizing warning flags of fraud.

Research by the BCSC to test fraud vulnerability among Canadians aged fifty and older found that

those older Canadians who have unrealistic expectations about market returns, who do not understand the relationship between risk and reward, who expose themselves to risky sales situations, and who have a lack of basic investment knowledge are more likely to fall victim to a fraudulent investment offer. Fear of running out of money in retirement drives vulnerability to investment fraud even further.<sup>77</sup>

These findings suggest the need for further research to determine why such individuals do not take steps to protect themselves. Is it due to a lack of awareness of the need to check registration (and a lack of awareness of the availability of tools to do so)? Are there behavioural factors that impede careful decision-making? Securities regulators need to answer such questions in order to design a system to protect vulnerable investors.

### Male, Educated, Older, High Income

U.S. research by AARP (formerly the American Association of Retired Persons) suggests that victims of investment fraud are more likely than the general public to be male, college-educated, report an annual income of \$50,000 or more, and have a higher age than the general public.<sup>78</sup> However, these

<sup>72</sup> IPSOS Reid, *CSA Investor Index 2009, Prepared for: Canadian Securities Administrators Investor Education Committee, Final Report* (October 5, 2009) online: Canadian Securities Administrators <[https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA%20Investor%20Index%202009%20Final\\_EN.pdf?n=6519](https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA%20Investor%20Index%202009%20Final_EN.pdf?n=6519)> at 80 [CSA *Investor Index 2009*].

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> *Ibid* at 81.

<sup>76</sup> *CSA Investor Index 2012, supra* note 47.

<sup>77</sup> *Fraud Vulnerability Report 2012, supra* note 52 at 4.

<sup>78</sup> Karla Pak & Doug Shadel, *AARP Foundation National Fraud Victim Study* (March 2011), online: AARP Foundation <<http://assets.aarp.org/rgcenter/econ/fraud-victims-11.pdf>> [*Fraud Victim Study*].

studies “... may not distinguish the victim from the typical consumer in that specific marketplace. For example, is the profile of a male, wealthy, educated and risky investor a unique marker of investment fraud vulnerability, or is it merely the profile of the typical investor?”<sup>79</sup>

### Persuasion and Sales Situations

AARP research also measures respondents’ interest in persuasion tactic statements used to market products, such as “This investment will generate a guaranteed return of 50% to 100% in the first year.” Unsurprisingly, the group of investment fraud victims indicated more interest in such statements than the general population.<sup>80</sup>

The research by the BCSC about older Canadians also found that those “...who are easily persuaded through risky sales situations, do not take steps to protect themselves before making an investment, and who have lower levels of investment knowledge are more vulnerable than others to investment fraud offers.”<sup>81</sup>

Furthermore, the AARP research looked at respondents’ exposure to sales situations and found that victims of investment fraud reported exposing themselves to certain sales situations significantly more than the general population. Investment fraud victims were much more likely to report attending sales presentations, opening and reading all mail, and calling toll-free numbers for free information than the general population.<sup>82</sup>

AARP research reveals victims’ interest in persuasion statements used by conmen and sales people and increased exposure to sales situations, such as attending free lunch seminars, opening and reading all of their mail or sending away for free information.<sup>83</sup> Even after having been victimized, investment fraud victims continue to be at risk of again encountering fraud and falling for it. These findings are bolstered by findings by the CSA that 31% of fraud victims are defrauded a second time<sup>84</sup> and the BCSC’s findings that thirty-nine percent of victims have been defrauded multiple times<sup>85</sup>.

### Life Events

Interestingly, preliminary, albeit tenuous, results from AARP research did not support the hypothesis that victims were more likely to have more major life events (such as a change in employment status, a negative change in financial status, divorce, death of a spouse or partner, or serious illness or injury) around the time of their victimization. It did indicate that financial fraud victims get excited about the prospect of financial gains, but are not upset by the prospect of financial loss. As a result, “...they may be operating at a disadvantage in terms of assessing the risks of any given transaction. It is like seeing only the benefits in a cost-benefit analysis.”<sup>86</sup>

More recent research from AARP finds that key risk factors to becoming a victim of online fraud include: feeling isolated/lonely; loss of a job; negative change in financial status; and being

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<sup>79</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 23.

<sup>80</sup> *Fraud Victim Study*, *supra* note 78 at 7 and Table 2.

<sup>81</sup> *Fraud Vulnerability Report 2012*, *supra* note 52 at 6.

<sup>82</sup> *Fraud Victim Study*, *supra* note 78 at 12 and Table 3.

<sup>83</sup> *Ibid* at 29-30.

<sup>84</sup> *CSA Investor Index 2009*, *supra* note 72 at 72.

<sup>85</sup> *Fraud Vulnerability Report 2012*, *supra* note 52 at 29.

<sup>86</sup> *Fraud Victim Study*, *supra* note 78 at 31.

concerned about debt.<sup>87</sup> This research concludes that if individuals have experienced a major life event this can affect their ability to resist fraud offers.<sup>88</sup> This may be an area that warrants study in Canada, in order to identify risk factors relevant to investment fraud victimization.

### **Different Victim Profiles, Different Impacts of Fraud**

It is important to note that while measuring the prevalence of fraud among certain investor profiles is critical to policy-making and enforcement efforts, the impact on different victim profiles is also an important consideration. While the common perception that older, uneducated people are the most common victims of investment fraud may not be supported by research, it is important to remember that the impact of investment fraud on older investors may be much more severe given the fact that they have a shorter time horizon within which to recover from the losses they sustain. Older investors are also more likely to rely on their investments to provide for their day-to-day expenses.

### **BlueHedge Isn't Real**

During the BlueHedge Investments Awareness Campaign between November 27, 2011 and February 5, 2012, Canadian securities regulators ran a public education initiative that included online ads and social media promotions pointing to the website for a fictitious company, BlueHedge Investments. During the ten-week campaign, the BlueHedge website received almost 18,000 visits from across Canada. Consumers who tried to provide personal information or who clicked on an "Invest Now" link were redirected to an investor education website ([www.BlueHedgeIsntReal.ca](http://www.BlueHedgeIsntReal.ca)), where regulators provided information and tools, including the five red flags to recognizing an online investment scam.

BlueHedge was a very novel and unique initiative by the CSA, and the results appear to support much of the research on victimization. However, BlueHedge primarily educated those investors who were captured by that campaign. It is recommended that provincial securities commissions and governments focus attention on raising broader consumer awareness of common investment fraud tactics and teach financial consumers to recognize the signs of fraud.

### **Affinity Fraud and Friends and Family Exemption**

Many victims, particularly of Ponzi schemes, are discovered to be close to the perpetrator, including immediate family members, close friends and business associates. Affinity fraud is a common characteristic in many of the most egregious cases of fraud, and it would be interesting to know how prevalent fraud is under the friends and family exemptions in the jurisdictions that allow for such an exemption. Given that a friends and family exemption is premised on the theory that those close to the promoter can gauge that person's trustworthiness, if many cases that involve serious investor harm also involve perpetrators who target friends and family, the rationale for this exemption may merit closer review.

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<sup>87</sup> Doug Shadel, Karla Pak & Jennifer H. Sauer, *Caught In The Scammer's Net: Risk Factors That May Lead to Becoming an Internet Fraud Victim* (2014), online: AARP  
<[http://www.aarp.org/content/dam/aarp/research/surveys\\_statistics/econ/2014/Caught-In-The-Scammer%E2%80%99s-Net-Risk-Factors-That-May-Lead-to-Becoming-an-Internet-Fraud-Victim-AARP-Survey%20-of-American-Adults-Age-18-and-Older-AARP-res-econ.pdf](http://www.aarp.org/content/dam/aarp/research/surveys_statistics/econ/2014/Caught-In-The-Scammer%E2%80%99s-Net-Risk-Factors-That-May-Lead-to-Becoming-an-Internet-Fraud-Victim-AARP-Survey%20-of-American-Adults-Age-18-and-Older-AARP-res-econ.pdf)> at 1 [*Scammer's Net*].

<sup>88</sup> *Ibid* at 14.

### Investor Education Fraud Initiatives

The BCSC, through its Be Fraud Aware<sup>89</sup> campaign, has prepared extensive materials for consumers that provide information on investment fraud. In particular, it prepared two compelling commercials<sup>90</sup> depicting a fraudster which is intended to alert investors to the warning signs of investment fraud and highlight persuasion techniques. It is unfortunate that these videos do not appear to have been broadcast on television outside British Columbia, although we recognize that to do so would be costly.

While virtually all provincial securities regulators provide some form of information regarding investment fraud online, Canadian financial consumers would benefit greatly from a coordinated approach that would avoid duplicative efforts and leverage limited budgets to reach investors across the country, rather than just those within a given province. We understand that the CSA Investor Education Committee works together to coordinate and share information but education strategies are determined at the provincial level. A national campaign to raise awareness of fraud, including persuasion techniques, is recommended.

### Victim Statistics Needed

As noted earlier in section 5.10, an enforcement report issued by NASAA noted that data from U.S. state securities regulators observed that “[u]nregistered securities, in the form of promissory notes... outnumbering the reported cases involving “traditional securities” by about four to one.”<sup>91</sup> There is no public data on the types of frauds investors fall victim to in Canada, including the common types of products at the centre of such enforcement actions. FAIR Canada recommends that such data be made public if it is collected, or if it is not, that such data be collected and disclosed.

## **6.3. Harm to Victims**

### Financial Loss

Our review did not identify any complete empirical measures or estimates of the financial cost of investment fraud in Canada. We did not find any attempts to quantify the cost of investment fraud in Canada. It is recommended that such estimates would serve as a warning to investors and could provide an indication, on an annual basis, of the effectiveness of the system in place in Canada.

Investors typically lose all or most of the money they invest in a fraudulent investment. The 2012 CSA Investor Index found that 56% of fraud victims lost all of the money they invested, while 23% recovered less than 50% of their investment.

The estimated loss to investors in the IMET cases which were brought between 2004 and 2009, where a total of twenty-six individuals were charged, totaled \$514.0 million.<sup>92</sup>

Given that following investment fraud a victim’s priority is to recover their losses, and the fact that they are at a significant disadvantage in recovering funds from the perpetrators of the fraud, there is

<sup>89</sup> Be Fraud Aware, *A Program of the BC Securities Commission*, online: Be Fraud Aware <[www.befraudaware.ca](http://www.befraudaware.ca)>.

<sup>90</sup> These commercials are available for viewing on the BCSC’s YouTube channel at <http://www.youtube.com/BCSCInvestRight>. The videos are entitled “Stolen Dreams” and “Two-Faced”.

<sup>91</sup> *NASAA Enforcement Report 2013*, *supra* note 62 at 8.

<sup>92</sup> RCMP Reports, Research and Publications, *2008-2009 Integrated Market Enforcement Program Annual Report*, online: Royal Canadian Mounted Police <<http://www.rcmp-grc.gc.ca/pubs/imets-eipmf/2009-eng.htm>>.

a role for regulators to play in acting as a catalyst or facilitator to help investors in recovering their losses. As noted below, some, but not all, provincial regulators have the power to order disgorgement and restitution.<sup>93</sup> While cases involving fraud in administrative proceedings may involve a disgorgement order, it appears that securities commissions rarely collect the money so ordered.

### **Non-Financial Harm**

The harm that results from fraud is not limited to financial harm. There are many costs related to investment fraud – monetary, psychological, physical, and time (which is said to be one of the least-understood costs of investment fraud).<sup>94</sup> Investment fraud erodes victims’ trust in other people, investments, and financial markets.<sup>95</sup> Victims experience higher stress levels, anger, depression, feelings of isolation, anxiety attacks, and increased vulnerability to physical illness and extreme weight loss or gain.<sup>96</sup> As noted in the sentencing decision of Earl Jones, “[t]he accused not only robbed the victims of their money, he robbed them of their freedom and self-esteem and of a decent life they expected in their retirement. All of them trusted him. For many, this world has no meaning anymore. He is responsible for irrevocable changes in all of the victims’ lives and this has left all of them humiliated.”<sup>97</sup>

Costs are not limited to direct victims – family and friends are also affected by fraud either directly (for example, loss of inheritance or a responsibility to support elderly parents) or indirectly (for example as a result of psychological harm to the victim which affects relationships).<sup>98</sup>

Some have suggested that “judges should be provided with greater context-training and education on the harms caused by corporate and white collar crime. Serious consideration should also be given to the creation of specialized courts for capital markets misconduct.”<sup>99</sup>

It has been noted that “[f]raud is one of the few crimes in which the victims may be made to feel complicit in their own victimization.”<sup>100</sup> This may contribute to low reporting levels. Worse, where investment fraud is perpetrated in closely-knit communities, whether based in faith, ethnicity, or some other common characteristic, the guilt caused by exposing close friends or family to a fraudulent investment causes that much more devastation to victimized individuals.

### **Limited Loss Recovery**

Generally, the primary objective of victims following investment fraud is to recover their losses. “While regulators exercising their powers of enforcement have generally interpreted their mandate as forward looking and grounded in principles of deterrence, aggrieved investors are most interested in being made whole as a result of capital market misconduct.”<sup>101</sup>

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<sup>93</sup> Expert Panel on Securities Regulation, *Creating an Advantage in Global Capital Markets: Final Report and Recommendations* (Ottawa: Department of Finance Canada, 2009), at 35 [*Expert Panel*].

<sup>94</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 9.

<sup>95</sup> Innovative Research Group Inc., *2007 CSA Investor Study: Understanding the Social Impact of Investment Fraud*, online: Manitoba Securities Commission: <[http://www.msc.gov.mb.ca/about\\_msc/2007\\_csa\\_invest.pdf](http://www.msc.gov.mb.ca/about_msc/2007_csa_invest.pdf)> at 1.

<sup>96</sup> *Ibid.*

<sup>97</sup> *R. v Jones*, *supra* note 36.

<sup>98</sup> *Scams, Schemes & Swindles*, *supra* note 12 at page 12.

<sup>99</sup> Poonam Puri, *Enforcement Effectiveness in the Canadian Capital Markets: A Policy Analysis* (June 14, 2005), online: Investor Voice <[http://www.investorvoice.ca/Research/Puri\\_Enforcement\\_Effectiveness\\_01Dec05.pdf](http://www.investorvoice.ca/Research/Puri_Enforcement_Effectiveness_01Dec05.pdf)> at 27 [*Puri Policy Analysis*].

<sup>100</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 12.

<sup>101</sup> *Puri Policy Analysis*, *supra* note 99 at 3.

As noted above, recovery of losses following an investment fraud is low. According to the CSA's most recent investor index, only 20% of fraud victims recovered 50% or more of the money they invested in a fraudulent investment. 56% of investors lost all of the money they invested in the fraudulent investment.<sup>102</sup>

Investors' avenues for redress are limited. Civil remedies are expensive, time-consuming, and in instances of fraud limited funds are available for recovery unless a third party is found to be partially responsible. In most fraud cases investors' money disappears and cannot be recovered. If the fraud involves a registrant who is a member of an SRO and the fraud results in the insolvency of the registrant firm, compensation fund coverage may provide compensation to fraud victims. We note that fraud, absent insolvency, would not be covered by a compensation fund.<sup>103</sup> However, as noted in section 5.3, most of the fraud cases completed by securities regulators during 2012 were by non-registrants (and thus non-SRO members) so the practical implications of compensation coverage in fraud cases may be limited.

Practically speaking, investors who are defrauded by individuals who are not employed by SRO-member firms (which, based on the data provided by the CSA 2012 Enforcement Report and stakeholder interviews are likely to be the majority of investment fraud cases in Canada) have very limited options for the recovery of their lost funds and those options may not be worthwhile to pursue. Options available include: disgorgement and restitution orders (with little likelihood of actually collecting the amounts ordered to be disgorged); civil causes of action (where, if successful, there may be difficulty in collecting the amount ordered in the court judgment); and distribution of any funds recovered on a receivership. In instances of fraud, there are rarely funds or assets available for recovery at the end of the proceedings (receivership, trustee in bankruptcy, etc.), even where orders for such are obtained.

As noted above, some, but not all, provincial regulators have the power to order disgorgement and restitution.<sup>104</sup> While cases involving fraud in administrative proceedings may involve a disgorgement order, it appears that securities commissions rarely collect the money so ordered.

Quebec is the only jurisdiction in North America to have set up a compensation system, the Fonds d'indemnisation des services financiers (the "**Fonds**") that covers investor losses resulting from fraud. Claims must meet three main criteria:

- The representative or firm must have been duly certified by the AMF by a sector covered by the Fonds (i.e. in the case of securities, the person or firm must be a registrant).
- Claimants must demonstrate that they were the victims of fraud and that the fraud was committed by the representative or firm.
- The fraud must concern financial products that the firm or representative was authorized to offer within the limits of the certificate issued by the AMF.

The Fonds' coverage is limited to \$200,000 per claim. Non-registrant fraud is not covered by the Fonds.<sup>105</sup> The Fonds had a positive balance as of the end of March 2013.<sup>106</sup>

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<sup>102</sup> CSA *Investor Index 2012*, *supra* note 47 at 34.

<sup>103</sup> See the Canadian Investor Protection Fund and the MFDA Investor Protection Corporation's websites for more information.

<sup>104</sup> *Expert Panel*, *supra* note 93 at 35.

#### 6.4. Reporting by Victims

As noted in section 5.11, reporting by victims is commonly considered to be low. “[P]revalence and cost estimates should be viewed as the visible tip of a much larger iceberg of fraud losses.”<sup>107</sup>

Common reasons that people do not report fraud include: embarrassment; lack of incentive (i.e. little benefit and potentially a cost to reporting); and lack of clarity as to whom they should report the fraud.<sup>108</sup> Canadian’s low level of awareness of securities regulators is likely also a factor.<sup>109</sup> Of Canadians who believe they had been approached with a fraudulent investment but did not report it, the top three reasons for not reporting were: “didn’t fall for it”, “too much spam to report it all” and “knew it was reported by others”.<sup>110</sup> Research out of the U.S. suggests that two of the primary reasons victims fail to report are: ““would not have made a difference” (53%) followed by “didn’t know where to turn” (40%).”<sup>111</sup>

One research report out of the U.S. estimated an under-reporting rate of over 60% based on interviews with known victims and their self-reported victimization<sup>112</sup> and another found that only 29% of victims reported their victimization to authorities<sup>113</sup>. An analysis comparing all victims together suggests that older victims (55 years of age and older) were less likely to acknowledge victimization than younger victims (under 55 years of age).<sup>114</sup>

While some surveys suggest that almost half of Canadians (47%) would report suspected fraud to the police or RCMP<sup>115</sup>, other research indicates that only 29% of Canadians “...who believe that they have been approached with a fraudulent investment said they reported the most recent occurrence to the authorities. Half (50%) reported it to either local police or the RCMP, while 4% reported it to their provincial or territorial securities regulator.”<sup>116</sup>

These findings raise a number of concerns. Low reporting rates mean that there is a significant amount of potential fraud that is never brought to the attention of the appropriate authorities. Those responsible for protecting the public from investment fraud (particularly securities regulators) should be alarmed by these figures and should undertake to determine why the rates of reporting are so low and identify ways to increase reporting rates. Further, relatively high rates of reporting to police as compared with Canadian securities regulators suggests not only that there is a very low public awareness of securities regulators, but also that it is possible that only the most serious cases are being reported to any authorities, and that egregious securities law offences may be going

<sup>105</sup> AMF Reference Guide: Protection Mechanisms, Consultation on Compensation of Quebec Consumers of Financial Products and Services, November 2011. Available online at [https://www.lautorite.qc.ca/files/pdf/consultations/indemnisation/AMF-guide-ref\\_mecanisme-protection-an.pdf](https://www.lautorite.qc.ca/files/pdf/consultations/indemnisation/AMF-guide-ref_mecanisme-protection-an.pdf)

<sup>106</sup> AMF Publications, *Rapport Annuel de Gestion 2012-2013*, online: Autorité des Marchés Financiers <<http://www.lautorite.qc.ca/files/pdf/publications/autorite/rapports-annuels/autorite/amf-rapport-annuel-2012-2013.pdf>> at 118.

<sup>107</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 9.

<sup>108</sup> *Ibid* at 16.

<sup>109</sup> *CSA Investor Index 2012*, *supra* note 47 at 78.

<sup>110</sup> *Ibid* at 31.

<sup>111</sup> Applied Research and Consulting LLC, *Financial Fraud and Fraud Susceptibility in the United States: Research Report From a 2012 National Survey*, online: Financial Fraud Research Center <[http://www.finra.org/web/groups/sai/@sai/documents/sai\\_original\\_content/p337731.pdf](http://www.finra.org/web/groups/sai/@sai/documents/sai_original_content/p337731.pdf)> at 20 [*Fraud Susceptibility*].

<sup>112</sup> *Ibid* at 3.

<sup>113</sup> *Fraud Victim Study*, *supra* note 78 at 22.

<sup>114</sup> *Ibid* at 21.

<sup>115</sup> *CSA Investor Index 2012*, *supra* note 47 at 25.

<sup>116</sup> *Ibid* at 24.

unreported to regulators. Police may not pursue such complaints if they do not have the resources and if only small amounts are involved. It would be interesting to know the referral rates between securities regulators and police. As mentioned in section 5.10, such statistics are reported by NASAA. We recommend that these be included in data and reporting.

## 7. Fraudsters

Limited information exists regarding fraudsters' profiles. Much of what is known about fraudsters is anecdotal. However, "...there appears to be some consensus around common demographics of fraud offenders: male, white, and middle class."<sup>117</sup> "Fixated on an image of wealth and success that they are unable to achieve in the mainstream, the stereotypical fraudster goes outside the mainstream to cultivate money, power, and a stereotypically lavish lifestyle."<sup>118</sup>

Interestingly, U.S. research suggests that it is not uncommon for telemarketing fraudsters to have a (typically non-violent) criminal offence history.<sup>119</sup> Frequent job changes are believed to be common among investment fraudsters.<sup>120</sup> Such information should be considered in designing systems to allow investors to perform background checks.

The CSA 2012 Investor Index notes that 49% of the most recent investment fraud reported was encountered through e-mail.<sup>121</sup> The anonymity and reach of the internet appears to provide a means by which fraudsters contact potential victims. According to stakeholder interviews, social media is increasingly used by fraudsters to perpetrate fraud.

Interviews with stakeholders confirmed anecdotal evidence and the findings of our review of the CSA's 2012 Enforcement Report cases that much of the investment fraud that is perpetrated is carried out by unregistered individuals (see a discussion of this in section 5.3).

As we note in section 5.10, 2012 data from U.S. state securities regulators found that the majority of fraud cases "featured unregistered individuals selling unregistered securities. ... The most common type of actor in or "target" of state securities enforcement actions were unregistered individuals."<sup>122</sup> The report further identified the trend that "[t]hese fraudulent offerings are increasingly being marketed through the Internet."<sup>123</sup>

NASAA also observed that "[f]raudulent private placement offerings continue to rank as the most common product or scheme leading to investigations and enforcement actions by state securities regulators."<sup>124</sup>

Further, NASAA reported that "[r]etail investors chasing yield often find themselves falling prey to high-yield investment and Ponzi schemes promising unbelievably high rates of returns."<sup>125</sup> Affinity fraud appears to continue to be used successfully in U.S. states: "Marketing a fraudulent investment scheme to members of an identifiable group or organization continues to be a highly successful and

<sup>117</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 25.

<sup>118</sup> *Ibid* at 26.

<sup>119</sup> *Ibid* at 27.

<sup>120</sup> Jeffrey H. Doocy, et al., *Telemarketing Fraud: Who are the Tricksters and What Makes Them Trick?* Online: Palgrave MacMillan <<http://www.palgrave-journals.com/sj/journal/v14/n3/pdf/8340087a.pdf>> at 16.

<sup>121</sup> *CSA Investor Index 2012*, *supra* note 47 at 27.

<sup>122</sup> *NASAA Enforcement Report 2013*, *supra* note 62 at 7.

<sup>123</sup> *Ibid.* at 8.

<sup>124</sup> *Ibid.* at 9.

<sup>125</sup> *Ibid.*

lucrative practice for Ponzi scheme operators and other fraudsters. ... The most commonly exploited are the elderly or retired, ethnic groups, and the deaf community.”<sup>126</sup>

At least one stakeholder interviewed noted that, given the current low interest rate environment, fraudsters do not need to tout particularly high rates of return in order to attract victims to invest.

## 8. Combating Fraud

### 8.1. The Importance of Enforcement

Enforcement is critical to a robust securities regulatory framework. A G20 working group noted that

[a]chieving the objectives of the regulatory framework requires not only sound regulation but also effective enforcement. No matter how sound the rules are for regulating the conduct of market participants, if the system of enforcement is ineffective – or is perceived to be ineffective – the ability of the system to achieve the desired outcome is undermined.

It is thus essential that participants are appropriately monitored, that offenders are vigorously prosecuted and that adequate penalties are imposed when rules are broken. A regulatory framework with strong monitoring, prosecution, and application of penalties provides the incentives for firms to follow the rules. This, in the end, adds to the framework’s credibility and enhances investor confidence in the financial system. Thus, a coordinated approach by securities regulators and self-regulatory organizations, law enforcement agencies and other actors in the legal system to monitor, investigate, and punish improper behaviour is necessary at a national and, in the context of globalization of the financial system, at the international level.<sup>127</sup>

Strong enforcement activity is correlated with the two main objectives most Canadian securities regulators are charged with: protecting investors and fostering fair and efficient markets. “Empirical studies show that strong enforcement activity is correlated with enhanced investor confidence and a reduced cost of capital.”<sup>128</sup>

Given the resource-intensiveness of enforcement, the fact that enforcement is an ex post tool, and the limited ability (due to a variety of factors) of regulators to recoup funds for investors, prevention is an ultimate objective of securities regulation, one to which other elements of combating fraud contribute.

### 8.2. Prevention

Given the limited options for recovery by victims of investment fraud, prevention is essential to investor protection.

#### Deterrence

A deterrence-based approach to regulatory enforcement is appropriate to combating fraud (as contrasted with a compliance-based strategy), as fraudsters are not generally law-abiding and will

<sup>126</sup> *Ibid.* at 10.

<sup>127</sup> G20 Working Group 1, *Enhancing Sound Regulation and Strengthening Transparency Final Report* (March 25, 2009), online: Reserve Bank of India <[http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/20\\_010409.pdf](http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/20_010409.pdf)> at 44.

<sup>128</sup> *Puri Policy Analysis*, *supra* note 99 at 7.

violate securities law where the perceived benefits exceed the cost of sanctions. The evaluation of the cost of sanctions necessarily requires an estimation of the likelihood of being caught and successfully prosecuted. As a result, detection and prosecution have a deterrent effect. Certainty, timeliness and severity are all elements of a successful deterrence strategy. Presence in the market is one of the biggest elements of deterrence.<sup>129</sup> Sanctions must be appropriate to the circumstances. “To achieve credible deterrence, wrongdoers must not only realize that they face a real and tangible risk of being held to account, but must also expect to face a meaningful sanctions.”<sup>130</sup> As a result, the dissemination of information regarding enforcement activity to potential fraudsters is also essential to meaningful deterrence.

Academic research confirms that dual private and public enforcement optimizes securities law compliance (rather than private or public alone), at least in fraud cases involving public companies.<sup>131</sup> A recent study concludes that private enforcement of securities law by way of class actions provides at least as much deterrent value (if not more) than public enforcement, including by the SEC.<sup>132</sup>

While the comparative merits of public and private mechanisms may be open to debate, it is clear that both play important roles in the effective enforcement of securities legislation. They operate in tandem to secure a common objective, which is ensuring general compliance with securities regulations. It is widely understood that a robust and effective system of both public and private enforcement mechanisms is essential to an effective regime for the enforcement of securities legislation. It is important to ensure effective private and public enforcement of securities laws, working in tandem, in the interests of investor protection and capital market integrity.

Stakeholder interviews revealed that enforcement divisions of securities regulators are placing greater emphasis on pursuing quasi-criminal (rather than administrative) proceedings as they recognize that barring non-registrants from the markets is necessary but insufficient to prevent further harm as it does not prevent individuals from trying to defraud investors in the future. Given that orders for disgorgement and administrative fines often go unpaid (see section 5.3), these are not a strong deterrent against fraud.

The practical reality is that enforcement divisions and police decide whether alleged investment fraud cases are proceeded with administratively, quasi-criminally or criminally based on the facts of each individual case. From stakeholders we heard that factors include: the severity and egregiousness of the fraud, including the value of the fraud and the number of victims harmed; the available and admissible evidence; the burden of proof; applicable limitations periods; the appropriate sanction(s); the capacity and expertise of regulators and police at that point in time; market trends (for market signaling purposes); the overall strength of the case; and the likelihood of success.

It has been noted that

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<sup>129</sup> Poonam Puri, *OSC Dialogue 2013* (October 8, 2013), online: Ontario Securities Commission <[http://www.osc.gov.on.ca/static/\\_/Dialogue2013/dwo\\_20131008\\_04-enforcement.mp3](http://www.osc.gov.on.ca/static/_/Dialogue2013/dwo_20131008_04-enforcement.mp3)>.

<sup>130</sup> FSA Documents, *Enforcement Annual Performance Account 2012/13*, online: Financial Services Authority <<http://www.fca.org.uk/your-fca/documents/annual-report/fsa-enforcement-annual-performance-account-2012-13>> at 54 [*FSA Enforcement*].

<sup>131</sup> Stephen J. Choi & A.C. Pritchard, *SEC Investigations and Class Actions: an Empirical Comparison* (February 25, 2014) online: Social Science Research Network <[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2109739](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2109739)>.

<sup>132</sup> *Ibid.*

...communication and information sharing between law enforcement and regulatory agencies is limited, partly due to varying interpretations of related case law and existing legislation. As a result, investigational inefficiencies exist among agencies involved in the enforcement of Canadian capital markets as they are not currently aware of what others are pursuing. Improved information sharing methods would help mitigate this information gap.<sup>133</sup>

It is suggested that the development and publication of guidance on how regulators and police determine the most appropriate proceeding would result in more consistency, provide greater accountability, and would serve a deterrent purpose. We understand that Quebec uses a joint unit committee model that evaluates incoming cases and determines the best unit to handle the case. It is recommended that this model be examined in developing best practices for determining the most appropriate proceedings.

### **Avoidance**

Stakeholder interviews and a review of the 2012 CSA enforcement cases revealed a general consensus that a significant amount of egregious fraud is perpetrated by non-registrants and thus considerable investor harm would be avoided if investors verified that the individual and firm they deal, or intend to deal, with are registered. The absence of the registration of an individual who promotes securities is an indication that an investment opportunity should be scrutinized.<sup>134</sup> This appears to be an efficient and cost-effective way of reducing investment fraud and protecting investors.

However, 60% of those Canadians who say they have a financial advisor have never done any form of background check on their advisor.<sup>135</sup> Among the 38% who have done a background check on their advisor, the top sources used were the Internet and the advisor's employer. Low awareness of securities regulators (as noted in section 6.4) may contribute to these results.

As noted below in section 8.4, a registration check is not necessarily a straightforward matter for novice investors.

Members of the CSA also issue investor alerts, which are meant to warn investors of frauds, schemes and other behavior that does not comply with securities regulations. These alerts are meant to inform investors of activity of concern that regulators are aware is being conducted in their respective jurisdictions. The alerts are posted on securities regulators' websites and are consolidated on the CSA's website. They are also disseminated through email distribution lists and social media. While such warnings are a useful and important tool, it is unclear whether potential victims are likely to find and read them prior to being approached with a fraudulent investment.

### **8.3. Prospectus Exemptions**

It is important to differentiate between checking the registration of individual and firm market participants and prospectus qualification and exemptions for securities. The message that investors should check to see if someone is registered is an important one, but is complicated by the fact that legitimate investments may also be sold in the private markets by non-registrants. This may result in

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<sup>133</sup> *Capital Market Fraud*, *supra* note 55.

<sup>134</sup> According to the 'Investor Tools' section of the CSA's website, "Registration helps protect investors because securities regulators will only register firms and individuals if they are properly qualified."

<sup>135</sup> *CSA Investor Index 2012*, *supra* note 47 at 3.

a mixed message about the importance of checking registration. A qualification to a clear message dilutes the force of that message.

Further, exemptions may have the unintended consequence of making frauds easier to commit against a backdrop of "legitimate" investments that can only be purchased by the wealthy or by people close to the issuer. Such exemptions may tend to reinforce widespread jaundiced suspicions that the wealthy get rich through access to tricks or private information, and this may have the unintended consequence of making it easier for fraudsters to capture victims by offering them access to "what the rich already know."

Exemptions from the requirement for the issuance of a prospectus are set out in securities regulation and stipulate the conditions that must be followed in order to operate within the law. Currently in Canada, exemptions from the prospectus requirement include:

1. private issuer exemption;
2. close relatives, friends and business associates exemption;
3. accredited investor exemption;
4. minimum amount exemption;
5. offering memorandum exemption;
6. Northwestern exemption; and
7. equity crowdfunding exemption (in Saskatchewan only at present).

Note that not all provinces or territories offer all of these exemptions. For example, in Ontario, the exemptions are currently limited to the private issuer exemption, the accredited investor exemption and the minimum amount exemption.

While the review and approval of a prospectus by provincial securities regulators is not a guarantee that fraud will be prevented, "...it can be expected that the regulator's review would curtail plainly fraudulent investments"<sup>136</sup> and "...the absence of a prospectus can offer an informed investor a clear signal that the "too good to be true" investment opportunity warrants careful scrutiny."<sup>137</sup>

The clear message that should be conveyed is that if an investor checks registration and the firm or individual is not registered, then the investor should be far more wary about the proposed investment and it will be necessary for the investor to conduct considerable due diligence on their own (including seeking a second, independent opinion) in an attempt to verify whether it is a legitimate investment or not. If they are not able to conduct such due diligence, they should not invest.

However, the existence of the "exempt market" may open the door to fraud. It may create an opportunity for fraudsters and the relationship between fraud and the exempt market warrants closer examination. Is there a net benefit for retail investors or does it cause significantly more harm than good? Further consideration of the nexus between prospectus exemptions and investment fraud is warranted.

As noted in section 6.2 (which discusses the characteristics common to investment fraud victims), individuals who are more likely to be victimized by financial fraud tend to be less risk-averse and more trusting. Given the high-risk nature of the exempt market, it appears that those individuals who seek risk would be drawn to exempt securities. Whether victims are more likely to be defrauded because they are drawn to higher-risk securities or those who are more at risk of being

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<sup>136</sup> *Law of Fraud*, *supra* note 27 at 775.

<sup>137</sup> *Ibid* at 776.

defrauded end up in unregistered investments due to increased exposure to risky sales situations is unclear. What is important is to examine the relationship between the exempt market and investment fraud.

It is suggested that securities regulators consider gathering more data on the exempt market and on investment fraud perpetrated in Canada in order to determine the relationship between prospectus exemptions and investor protection against investment fraud with a view to developing better protection. It is essential to ask how investors can differentiate between legitimate prospectus-exempt investments and fraudulent investments. If this is not possible, tools to better protect investors should be developed, including clearer warnings about the correlation of fraud and exempt market investing.

#### **8.4. Registration Database and End-user Platform**

The results of our interviews with stakeholders stressed the importance of dealing with registered individuals and registered securities.

The simplest way investors can protect themselves against fraud is to perform a registration check using the National Registration Search (“NRS”). Currently in Canada, in order to check the registration status (if any) of a particular firm or individual, a consumer must:

1. Be informed enough to know that such a check can and should be conducted. There is a low awareness of the need for such a check among consumers.<sup>138</sup>
2. Determine whether they should search the registration information for their firm or the individual they are dealing with (or both). In order to search a firm, the firm’s registered name (if different from its operating name) must be ascertained.
3. Using the NRS, type in the name of the firm or individual they wish to search.

The results of such searches return the registration category(ies) (if any) of the firms and/or individuals searched. Whether the registration category would assure an average investor that the firm or individual is registered for the services they provide the investor is unknown. Québec registration information is available through the NRS, but additional information (such as terms and conditions) must be searched directly on the AMF website.

While getting to this point could be challenging for some investors, further checking whether the firm or individual has any history of disciplinary action (whether in the past or ongoing), presents a further challenge for investors (see below).

Testing of the registration check system in the course of our research suggests that search results vary widely depending on the inputs entered. For example, date ranges significantly impact the results of a given search. It is recommended that the user interface for the national registration search function initially return a broad result which can then easily be narrowed. It is unclear from the search page<sup>139</sup> which fields are mandatory.

During the course of our project the national registration search was updated and improved to include Ontario (the only jurisdiction previously not searchable in the database). This change results in significantly less complication for registration check instructions and thus less confusion for investors. We encourage securities regulators to continue to improve this important resource for investors.

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<sup>138</sup> CSA Investor Index 2012, *supra* note 47 at 3.

<sup>139</sup> CSA Investor Tools, *Are They Registered?* online: Canadian Securities Administrators <aretheyregistered.ca>.

### Disciplinary Search

Disciplinary action by regulators must be accessed through additional searches beyond the registration check. Investors must consult the CSA's Disciplined Persons List separately from the NRS to determine whether there has been disciplinary action against an individual. There has been minimal integration of ongoing regulatory actions with concluded cases, and as a result if a regulator has alleged fraud but an order has not been issued, this will not show up in a disciplinary search.

Further, we understand that the BCSC is in the process of including criminal securities-related sanctions in its database. It is recommended that all Canadian jurisdictions incorporate relevant criminal proceedings into their databases so that investors are able to get relevant information about any criminal proceedings in addition to administrative and quasi-criminal cases. This is important in the event that an individual has been disciplined criminally but not administratively. Otherwise, the criminal disciplinary history for that individual will not be provided through a search of the CSA's Disciplined Persons Search.

### **8.5. Detection**

Stakeholder interviews confirmed that intelligence is an important element of detection. Investment fraud is detected by securities regulators and police in numerous ways, including complaints reported by investors, compliance reviews, referrals from agencies such as the Canadian Anti-fraud Centre, and the results of surveillance techniques, such as internet data mining tools (discussed below).

While the following initiatives are important tools in combating investment fraud, evidence suggests that only a small proportion of frauds are reported to securities regulators. Regulators are encouraged to raise their profile in order to ensure more frauds are detected. We heard from stakeholders that fraudsters are fast-moving and innovative. Increased reporting could assist in earlier detection and intervention, and result in decreased harm to investors.

### The Internet

Advancements in technology, particularly the internet, have created opportunities for the perpetration of investment fraud. As noted in the CSA's 2013 Enforcement Report, "CSA members investigate cases that involve more complex schemes, greater levels of subterfuge and an increased use of online resources to perpetrate securities law violations."<sup>140</sup>

Canadian regulators have been recognized for developing leading-edge tools for detecting fraudulent activity. NASAA notes in a 2012 news release regarding a spike in crowdfunding presence on the internet that, "NASAA members are being trained in the use of an innovative online data mining tool developed by the staff of the Enforcement Division of the New Brunswick Securities Commission to help identify potentially fraudulent websites."<sup>141</sup>

The CSA's 2013 Enforcement Report notes that "...the Ontario Securities Commission's (OSC) Technology & Evidence Control Unit uses advanced software to support its investigations and in

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<sup>140</sup> CSA Report Archive, *2013 Enforcement Report*, online: Canadian Securities Administrators <<http://er-ral.csa-acvm.ca/wp-content/uploads/2014/02/CSA-2013-English.pdf>> at 2 [*2013 CSA Enforcement Report*].

<sup>141</sup> NASAA Newsroom, *NASAA Sees Sharp Spike in Crowdfunding Presence on the Internet* (December 5, 2012), online: North American Securities Administrators Association <<http://www.nasaa.org/18951/nasaa-sees-sharp-spike-in-crowdfunding-presence-on-the-internet/>>.

New Brunswick, the Financial and Consumer Services Commission has developed software that enables the early detection of potential scam investment websites.”<sup>142</sup>

### **FINTRAC**

The Financial Transactions and Reports Analysis Centre of Canada (“**FINTRAC**”) is an independent government agency whose mandate “...is to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities...”<sup>143</sup> According to FINTRAC, “[m]oney laundering is the process used to disguise the source of money or assets derived from criminal activity. Profit-motivated crimes span a variety of illegal activities from drug trafficking and smuggling to fraud, extortion and corruption.”<sup>144</sup>

Under the *Criminal Code*, the provision relating to money laundering makes it an offence to use, transfer the possession of, send or deliver, transport, transmit, alter, dispose of or otherwise deal with any property or the proceeds of property with intent to conceal or convert the property, knowing or believing that all or a part of the property was obtained directly or indirectly by the commission of a designated offence. Fraud, including the general fraud provision and fraud affecting the public market, is a designated offence under the *Criminal Code*.<sup>145</sup>

FINTRAC is required to receive, among other things, suspicious transactions reports and reports of international electronic funds transfers of \$10,000 or more.<sup>146</sup> FINTRAC does not have powers to gather evidence, lay charges, or seize and freeze assets nor does it investigate or prosecute suspected offences.<sup>147</sup> Instead, FINTRAC is limited to sharing information with police forces and specific government agencies (such as Canada Revenue Agency) under specific circumstances. FINTRAC does not currently share intelligence information with securities regulators.<sup>148</sup>

During parliamentary hearings of the Standing Committee on Finance, Denis Meunier, Assistant Director, Financial Analysis and Disclosures, FINTRAC was asked about the Earl Jones<sup>149</sup> case. It was noted that that case was conducted over a period of many years and that the bank told him that his use of his account “was clearly illegal”<sup>150</sup>. In response, Mr. Meunier advised that

[a] bank that detects that kind of conduct on the part of a client is obliged to send us suspicious transaction reports when it determines that it has reasonable grounds to think that transactions are connected with money laundering. When we receive that information, we put it together, and if we reach the disclosure threshold required by the legislation, we have to share it with the police... If those requirements are met, we have to disclose the information.<sup>151</sup>

<sup>142</sup> 2013 CSA Enforcement Report, *supra* note 140 at 2.

<sup>143</sup> FINTRAC-CANAFE, *Who We Are* (Date Modified: 2013-12-13), online: Financial Transactions and Reports Analysis Centre of Canada <<http://www.fintrac-canafe.gc.ca/fintrac-canafe/1-eng.asp>>.

<sup>144</sup> FINTRAC-CANAFE, *What is Money Laundering*, online: Financial Transactions and Reports Analysis Centre of Canada <<http://www.fintrac-canafe.gc.ca/fintrac-canafe/definitions/money-argent-eng.asp>>.

<sup>145</sup> *Criminal Code*, R.S.C. 1985, c. C-46, ss. 462.3(1) and 380(1).

<sup>146</sup> Parliament of Canada Publications, *Number 062 3rd Session 40th Parliament* (March 8, 2011), online: Parliament of Canada <<http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=5023784&Language=E&Mode=1>> [*Parliament of Canada*].

<sup>147</sup> *Ibid.*

<sup>148</sup> *Ibid.*

<sup>149</sup> *R. v Jones*, *supra* note 36.

<sup>150</sup> *Parliament of Canada*, *supra* note 146.

<sup>151</sup> *Ibid.*

It is unclear whether the suspicious transaction reports were provided to FINTRAC in this case and then shared with the police. Presumably, if the system was working properly, FINTRAC would have been provided with information regarding the Earl Jones case that could, potentially, have brought the fraud to light earlier and perhaps prevented some investor harm.

Successful perpetrators of investment fraud steal money from investors. As highlighted in the Earl Jones example, many such transactions are likely to be detected by anti-money laundering compliance systems, which are then required to be reported to FINTRAC. Early detection of investment fraud could reduce investor harm, by intercepting fraudulent investment schemes early on (and thereby preventing further investor harm), by freezing assets before they disappear or tracing the assets in order to recover funds and by deterring fraudsters by increasing the likelihood of being caught. Tools that allow for the ability to trace (and potentially freeze) the proceeds of investment fraud in an efficient and effective manner would greatly improve enforcement efforts and cause a significant deterrent effect, could lead to greater recovery for victims, and may also improve securities regulators' rates of fine collection.

Stakeholder interviews noted that FINTRAC equivalents in other countries share information with securities regulators in those jurisdictions. It is recommended that Finance Canada examine this issue and consider permitting such disclosure so that fraudulent investment schemes can be detected and interrupted at an earlier stage, and so that the ability to freeze and recover assets can be improved.

### **Whistleblower Programs**

Whistleblowers programs have become an important source of intelligence in other jurisdictions. Whistleblower programs can be designed to protect the identity of the whistleblower and protect whistleblowers from retaliation by their employers.

At this time, no whistleblower programs have been introduced by Canadian provincial or territorial securities regulators.<sup>152</sup> IIROC provides a Whistleblower Service, which was introduced in 2009. The MFDA also offers a Whistleblower Program.

We understand from stakeholder interviews and public documents that several securities regulators in Canada have considered, formally or informally, the introduction of a whistleblower program.<sup>153</sup> Given that a whistleblower program is a potential new source of intelligence information, it is recommended that the potential for, and ideal structure of, a whistleblower program be considered.

In the United States, there are two securities-related whistleblower programs already in place. FINRA has had an Office of the Whistleblower since March 2009 (which does not offer financial incentives) and the SEC has implemented the Dodd-Frank Whistleblower Program which does provide monetary awards to eligible individuals who voluntarily provide original information that leads to successful Commission enforcement actions. The SEC Office of the Whistleblower received 3,238 tips in fiscal 2013. A US\$14 million award was provided to a whistleblower in fiscal 2013 whose information led to an SEC enforcement action that recovered substantial investor funds. Less than six months from the whistleblower's tip, the SEC was able to bring an enforcement action against the perpetrators and secure investor monies.

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<sup>152</sup> (2011) 34 OSCB 10720, OSC Staff Notice 15-704 – Request for Comments on Proposed Enforcement Initiatives, online: Ontario Securities Commission <[http://www.osc.gov.on.ca/documents/en/Securities-Category1/sn\\_20111021\\_15-704\\_rfc-enforcement-initiatives.pdf](http://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20111021_15-704_rfc-enforcement-initiatives.pdf)> at 10720.

<sup>153</sup> *Ibid.*

The U.K. Financial Conduct Authority (“FCA”) also has a whistleblower program which commenced in May 2001 and provides a constant supply of information to the regulator. The program does not offer incentives to whistleblowers and does not give categorical assurances of confidentiality to whistleblowers although it does its best to protect the whistleblower’s identity.<sup>154</sup>

Whistleblowers and informants are a successful source of information on white-collar crime. Given the perceived lack of effectiveness in fighting white-collar crime in Canada, implementing a whistleblower program could help fight fraud and be an important additional enforcement initiative which would further the mandate of securities regulators. We note, however, that whistleblower programs may not be as useful in the reporting of investment fraud, as we define it in this paper, as it may be for other types of white collar crimes, such as issuer fraud.

## 8.6. Enforcement

### Perception of Poor Enforcement

There appears to be a perception, both domestically and internationally, that financial crimes are not a priority for criminal authorities in Canada. It has been noted that “credible and well-informed individuals sincerely believe that there have been, and continue to be, serious defects in Canada’s securities enforcement systems.”<sup>155</sup>

In 2009, the Expert Panel on Securities Regulation reported that it

...heard that the enforcement of securities law in Canada does not compare favourably relative to other jurisdictions. This is true whether it is administrative enforcement by securities regulators and self-regulatory organizations, criminal investigations by police, or prosecution in our courts. If a basic purpose of securities regulation is to protect investors, Canada’s system is falling short.<sup>156</sup>

The CFA Institute found Canada’s financial market integrity to be “somewhat effective” in 2010, noting that “...confidence in the integrity of the Canadian financial system among in-market respondents has slowly but steadily improved...”<sup>157</sup> It is interesting to note that, “...survey respondents outside Canada have consistently viewed the integrity of the Canadian market more favorably than do those inside Canada...”<sup>158</sup>

In 2009, the Canadian Advocacy Council for Canadian CFA Institute Societies asked its members for their opinions about the Canadian securities regulatory structure.<sup>159</sup> That survey found that 51

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<sup>154</sup> FCA Guidelines, *Guidelines for Dealing with Whistleblowing Calls under the Public Interest Disclosures Act 1998* (March 31, 2013), online: Financial Conduct Authority <<http://www.fca.org.uk/site-info/contact/whistleblowing/guidelines>>. The UK’s Whistleblower program is governed by the Public Interest Disclosures Act 1998.

<sup>155</sup> Peter de C. Cory & Marilyn L. Pilkington, *Research Study: Critical Issues in Enforcement* (September 2006) online: Task Force to Modernize Securities Legislation in Canada <[http://www.tfmsl.ca/docs/V6\(4\)%20CoryPilkington.pdf](http://www.tfmsl.ca/docs/V6(4)%20CoryPilkington.pdf)> at 191 [*Critical Issues in Enforcement*].

<sup>156</sup> *Expert Panel*, *supra* note 93 at 2.

<sup>157</sup> CFA Institute, *Financial Market Integrity Index Canada 2010* (2010), CFA Institute online: <<http://www.cfapubs.org/toc/ccb/2010/2010/8>> at 8.

<sup>158</sup> *Ibid.*

<sup>159</sup> Canadian Advocacy Council for Canadian CFA Institute Societies, *Canadian Regulatory Structure Survey Report* (June 2009), online: CFA Society <<http://cfasociety.org/cac/regulatory%20structure%20survey/canadianregulatorystructuresurveyreport.pdf>> at 4.

percent of respondents think the fairness, consistency and strength of enforcement in Canada is poor or very poor.<sup>160</sup> This survey also found that

[c]ompared to those with 10 years or less in the capital markets, those with more than 20 years were more likely to rate the fairness, consistency and strength of enforcement in Canada as very poor. In addition, a higher proportion of current compliance officers, senior executives, and regulators (24 percent) rated very poor than did those with no experience working as a compliance officer/senior executive/regulator.<sup>161</sup>

Cory and Pilkington note a number of issues in enforcement that have generated serious concern, including:

...the lack of effective enforcement in high profile securities cases in Canada; negative comparisons with the ability of U.S. authorities to bring timely and effective prosecutions; apparent delays in taking action to prevent loss to investors; perceived lack of fairness and integrity in some enforcement processes; complexity of jurisdiction and accountability; delays in adjudication; perceived inadequacy of some penalties imposed for capital markets crime; and perceived inadequacy in the remedies available to investors.<sup>162</sup>

A 2009 IMF working paper observed that

[a] recent example on how the lack of active and successful criminal enforcement can undermine the credibility of a regulatory framework can be found in the case of Canada, where the lack of criminal convictions leading to imprisonment has created a perception that enforcement is weak, in spite of all the disciplinary actions taken by the securities regulators and the self-regulatory organizations (which play a significant role in that jurisdiction).<sup>163</sup>

The same report notes that in many countries criminal authorities have not made financial crimes a priority, and that a shortcoming to good coordination between securities regulators and criminal authorities common to many countries is a lack of understanding of financial markets on the part of public prosecutors.<sup>164</sup> Another common shortcoming noted is a lack of skill and expertise on the part of regulatory investigators in gathering evidence in a way that satisfies the more rigorous criminal proceeding.<sup>165</sup>

The deterrent value of criminal sanctions is significant. "Criminal sanctions, which are particularly appropriate for very serious cases, involving multiple offences or large sums of money, or widespread damage to investors or the public, are an important deterrent."<sup>166</sup> It is important that investors, market participants, and potential fraudsters alike perceive criminal enforcement against investment fraud to be strong in Canada.

### **Responsibility for Enforcement**

<sup>160</sup> *Ibid* at 15.

<sup>161</sup> *Ibid* at 4.

<sup>162</sup> *Critical Issues in Enforcement*, *supra* note 155 at 197.

<sup>163</sup> Ana Carvajal & Jennifer Elliott, *The Challenge of Enforcement in Securities Markets: Mission Impossible?* (August 2009), online: International Monetary Fund <<http://www.imf.org/external/pubs/ft/wp/2009/wp09168.pdf>> at 22 [*Challenge of Enforcement*].

<sup>164</sup> *Ibid*.

<sup>165</sup> *Ibid*.

<sup>166</sup> *Ibid* at 21.

Responsibility for enforcement of financial crimes, including investment fraud, in Canada is not well-defined. This is concerning, as “[a]ccountability is compromised when responsibility is divided among so many jurisdictions and entities.”<sup>167</sup>

As seen in section 4, there are numerous regulators, police agencies, and governmental departments responsible for prosecuting investment fraud in Canada. The determination of the best response to a securities law violation is more of an art than a science, involving the severity and egregiousness of the fraud, including the value of the fraud and the number of victims harmed; the available and admissible evidence; the burden of proof; applicable limitations periods; the appropriate sanction(s); the capacity and expertise of regulators and police at that point in time; market trends (for market signaling purposes); the overall strength of the case; and the likelihood of success. In practice, we understand that often resources and expertise also determine whether a case is proceeded with administratively, quasi-criminally, or criminally in the various jurisdictions. At least one stakeholder suggested that, optimally, regulators would bring parallel or sequential proceedings (administrative and criminal).

When a regulatory disciplinary decision is made in one province, it may be entered into another jurisdiction through a reciprocal order. According to the CSA, “[r]eciprocal orders allow securities regulators to apply orders issued in another jurisdiction or by another regulatory authority in their own jurisdiction. This prevents individuals or companies sanctioned in one jurisdiction from moving and carrying on their conduct in another jurisdiction.”<sup>168</sup> The CSA’s 2012 Enforcement Report provides information on the number of reciprocal orders issued and the number of individual and company respondents affected by those reciprocal orders. However, it does not indicate the percentages of the cases that are concluded in each jurisdiction which are reciprocated in the other jurisdictions. Sixty-six reciprocal orders were issued in 2012 compared to 135 cases being concluded in that same year. The implication is that such orders are not always sought or obtained.

The RCMP’s IMET initiative was introduced in 2003 with the intention of combating serious criminal capital market fraud offences. The IMET program involves the following federal departments and agencies: Department of Justice Canada; Finance Canada; Public Prosecution Service of Canada; Public Safety Canada; and the RCMP. The goal of is IMET to detect, charge and prosecute those using capital markets to harm the economic interests of Canadians. The RCMP’s IMET website provides a significant amount of outdated information. As of March 2014, the most recent available annual report for the IMET program was for 2008-2009. The most recent posting on the ‘IMET Newsroom’ page is from November 2012. A 2010 evaluation of the IMET initiative was highly critical of the results produced by the program. During stakeholder interviews, we received conflicting information as to whether IMETs were still operational. Our understanding is that they are operating in some Canadian cities, including Vancouver and Montreal. We requested a meeting with representatives of the RCMP but were unable to obtain an interview by the time of the completion of this report.

From its inception in 2003 until June of 2012, the IMET program charged forty-seven individuals with *Criminal Code* offences.<sup>169</sup> Thirteen individuals have been convicted receiving sentences ranging from eighteen months to thirteen years. Seven cases remain before the courts.

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<sup>167</sup> *Critical Issues in Enforcement*, *supra* note 155 at 196

<sup>168</sup> *2013 CSA Enforcement Report*, *supra* note 140 at 17.

<sup>169</sup> RCMP Integrated Market Enforcement Teams, *Backgrounder: Integrated Market Enforcement Team* (June 28, 2012), online: Royal Canadian Mounted Police <<http://www.rcmp-grc.gc.ca/imet-eipmf/backgrounder-information-eng.htm>>.

Much criticism has been directed at the IMET program for the amount of money it has cost and the meager results it has produced. FAIR Canada has previously recommended the creation of an expert national agency under the Attorney General of Canada dedicated to combating financial fraud.<sup>170</sup> This recommendation envisioned a

national antifraud organization reporting to the Attorney General of Canada, lead by senior securities experts (with backgrounds in law, accounting, finance and technology), dedicated to protecting investors and fostering confidence in capital markets. A body of this type has been consistently recommended or supported by the reform-oriented task forces appointed over the last decade and their research experts.<sup>171</sup>

### **Coordination in Canada**

Stakeholder interviews revealed some of the different approaches Canadian securities regulators are taking to address deficiencies in the system of enforcement against investment fraud. These include developing specialized teams that include members of police agencies, seconding police staff to work at securities regulators for cross-training purposes, and providing direct support and specialized knowledge to prosecutors as they bring forward criminal charges involving investments, including fraud.

The regulatory enforcement departments we interviewed indicated a good working relationship with local police agencies. However, these working relationships may be dependent upon the individuals rather than their office. At the national level, we understand from interviews that the CSA-level enforcement committee of CSA members has met annually with IMET contacts in the past, that some enforcement departments have more formal investigation teams with the RCMP or provincial police and that in other jurisdictions informal group meetings may be held in an ad-hoc manner between enforcement departments and police.

Interviews with some regulatory enforcement staff suggest that resources (both for regulators and police) limited the amount of action taken and that the expertise required presents challenges in ensuring robust enforcement.

Given the possibility of a common Canadian securities regulator and the Supreme Court of Canada's reasons in *Reference re Securities Act*<sup>172</sup>, there may exist an opportunity to design an optimal national fraud enforcement agency. In the meantime, it is recommended that better coordination would improve Canada's reputation for enforcement and better protect investors. We understand that Quebec uses a joint unit committee model that has formal relationships with the relevant police authorities and thereby evaluates incoming fraud cases and determines the best unit to handle the case. It is recommended that this model be examined in determining best practices for other securities regulators or with respect to a national fraud agency.

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<sup>170</sup> *A Decade of Financial Scandals*, *supra* note 37.

<sup>171</sup> *Ibid.* at 37-38.

<sup>172</sup> *Reference re Securities Act*, [2011] 3 SCR 837 [*Reference re Securities Act*].

### International Enforcement Cooperation

Many enforcement matters involve more than one country as misconduct is not limited to geographical boundaries. For example, the Sino-Forest<sup>173</sup> investigation involves the review of documents and the examination of the role of gatekeepers including the use of auditing staff and conducting interviews in China where most of the documents will not be in English. The case of Zungui Haixi Corporation involved a corporation where virtually all of its assets and books and records, as well as the controlling shareholder, the chief executive officer and chief operating officer were located in China.<sup>174</sup>

To address the challenges of fraud and wrongdoing not respecting jurisdictional boundaries, regulators in different jurisdictions internationally enter into information sharing and collaboration memoranda of understanding (“**MOU**”) where the regulator can receive and share enforcement-related information. For example, the U.K.’s Financial Services Authority (now the FCA) has entered into MOUs allowing it to share information and intelligence with each of the OSC, the BCSC, and the AMF; and the U.S. SEC has entered into MOUs with each of the BCSC, the OSC, and the AMF in order to share intelligence and provide assistance in the investigations of conduct in other jurisdictions.

In addition, there are more than 100 signatories to the International Organization of Securities Commissions’ (“**IOSCO**”) Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information<sup>175</sup> (“**IOSCO MMOU**”) for information sharing, which allows for requests for assistance where evidence can be obtained from another jurisdiction in a more timely manner and which advances international cooperation on enforcement matters. Requests for international assistance are increasing in frequency.<sup>176</sup>

IOSCO recognizes that more can be done at the international level to improve enforcement amongst its many members. As such IOSCO has approved a mandate for a committee to conduct a review of the core elements of a credible deterrence framework for securities regulation, including strategies and good practices. In its Annual Report 2012, IOSCO reports, “[t]aking into account the wide divergence in international sanctions regimes, the mandate envisions, where appropriate, the development of a set of founding principles upon which credible deterrence frameworks could be built.”<sup>177</sup> Publication of the findings of its review is expected in March 2014. In addition, the IOSCO committee launched a Legislation Forum in order “to gather and disseminate examples of legislation, policies and practices of jurisdictions from across the globe that might be useful to other regulators seeking to enhance their enforcement powers. It also is aimed at informing IOSCO members of interesting and novel legislative developments in the area of enforcement.”<sup>178</sup>

<sup>173</sup> OSC Proceedings, *In the Matter of Sino-Forest Corporation*, Allen Chan, Albert Ip, Alfred C.T. Hung, George Ho, Simon Yeung and David Horsley, online: Ontario Securities Commission <[https://www.osc.gov.on.ca/en/Proceedings\\_rad\\_20140218\\_sino-forest.htm](https://www.osc.gov.on.ca/en/Proceedings_rad_20140218_sino-forest.htm)>.

<sup>174</sup> OSC Proceedings, *In the Matter of Zungui Haixi Corporation*, online: Ontario Securities Commission <[https://www.osc.gov.on.ca/en/Proceedings\\_rad\\_20120828\\_zungui2.htm](https://www.osc.gov.on.ca/en/Proceedings_rad_20120828_zungui2.htm)>.

<sup>175</sup> IOSCO Library, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information* (May 2002 revised May 2012), online: International Organization of Securities Commissions <<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD386.pdf>>.

<sup>176</sup> The OSC Enforcement Activity in 2012 report notes that the OSC made thirty-five requests to international (other than U.S.) regulators in 2012, up from thirty-three in 2011. It received nineteen such requests in 2012, up from ten in 2011. See Ontario Securities Commission, *OSC Enforcement Activity in 2012* (February 28, 2013), online: OSC <[https://www.osc.gov.on.ca/en/NewsEvents\\_nr\\_20130228\\_osc-2012-enf-rpt.htm](https://www.osc.gov.on.ca/en/NewsEvents_nr_20130228_osc-2012-enf-rpt.htm)>.

<sup>177</sup> IOSCO Library, *Annual Report 2012*, online: International Organization of Securities Commissions <[http://www.iosco.org/annual\\_reports/2012/pdf/annualReport2012.pdf](http://www.iosco.org/annual_reports/2012/pdf/annualReport2012.pdf)> at 29.

<sup>178</sup> *Ibid.*

## 9. Data Available in Other Jurisdictions

Other jurisdictions have differences in their system of enforcement which makes comparisons more difficult to undertake. We outline below the types of information made publically available by some other common law jurisdictions.

### 9.1. United States

#### Securities and Exchange Commission

The U.S. SEC publishes annual data in its enforcement reports that includes enforcement statistics and the top ten complaints received from investors. In 2013 advance fee fraud and Ponzi schemes were among the ten most common investor complaints.<sup>179</sup> The 2013 SEC report indicates that 22,626 files relating to complaints were closed during that fiscal year.<sup>180</sup>

The SEC's enforcement report includes information regarding SEC-related criminal cases, although these are not broken down into allegation categories, nor are the criminal cases provided.

The SEC's classification system for reporting its enforcement action includes allegation categories relating to both activities (ex. delinquent filing) and the type of respondent (ex. Broker-Dealer).<sup>181</sup> Fraud is not one of the primary allegation classifications used in the SEC's enforcement data. The statistics include whether the SEC's action proceeded by civil action or administrative proceedings.

#### North American Securities Administrators Association

As noted in section 5.10 above, U.S. state securities regulators (reported through NASAA) deal with a large portion of the investment fraud cases that arise in the U.S. NASAA provides highly detailed statistics in their annual enforcement reports. In 2012, more than 690 state enforcement cases involved fraud.<sup>182</sup> NASAA also reports the number of complaints received by state securities regulators (10,272 in 2012).<sup>183</sup> The reports also provide contextual information, such as the fact that the majority of fraud cases reportedly involved unregistered individuals and/or unregistered firms selling unregistered securities and provides the most common type of products that were at the center of enforcement actions.<sup>184</sup>

#### Financial Industry Regulatory Authority

The U.S. SRO, FINRA, has a mission to safeguard the investing public against fraud and bad practices. FINRA publishes its enforcement statistics, including the annual number of investor complaints it received. FINRA referred 260 cases of potential fraud to the SEC and other federal or state enforcement agencies in 2012.<sup>185</sup>

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<sup>179</sup> Securities and Exchange Commission, *Select SEC and Market Data Fiscal 2013*, online: Securities and Exchange Commission <<http://www.sec.gov/about/secstats2013.pdf>> at 20.

<sup>180</sup> *Ibid.*

<sup>181</sup> *Ibid* at 3.

<sup>182</sup> *NASAA Enforcement Report 2013*, *supra* note 91 at 7.

<sup>183</sup> *Ibid* at 3.

<sup>184</sup> *Ibid.*

<sup>185</sup> FINRA Documents, *2012 Year in Review and Annual Financial Report*, online: Financial Industry Regulatory Authority <<http://www.finra.org/web/groups/corporate/@corp/@about/@ar/documents/corporate/p291721.pdf>>

### Other Measures of Fraud

There are numerous other sources of fraud statistics in the U.S. The Financial Fraud Research Center<sup>186</sup>, the National White Collar Crime Center<sup>187</sup>, AARP (whose research is discussed throughout the report), and many other organizations and academics conduct research and publish information regarding investment fraud in the U.S.

## **9.2. Australia**

The Australian Securities and Investments Commission (“ASIC”) publishes written information regarding its approach to enforcement.<sup>188</sup> This guidance includes information on how they select matters for formal investigation and how they decide which enforcement tools to use.

### ASIC Fraud Statistics

ASIC reports fraud as part of a category of “Misappropriation, theft, fraud”. ASIC publishes semi-annual reports on its enforcement outcomes, and identifies how its concluded cases were proceeded with (i.e. criminal, civil, administrative remedies, enforceable undertakings/negotiated outcomes, or public warning notices). For the six-month period ending December 2013, ASIC’s enforcement outcomes included ten cases of misappropriation, theft or fraud, of which five were proceeded with criminally and five administratively.

ASIC’s annual reports list the number of investigations commenced and completed for the year as well as the number of inquiries it receives, including online complaints.<sup>189</sup>

### Other Measures of Fraud

The Australian Crime Commission estimates that more than 2,600 Australians have lost more than AU\$113 million to investment fraud.<sup>190</sup> It is believed that, due to a high level of under-reporting, the true extent of losses is far greater.<sup>191</sup>

## **9.3. United Kingdom**

The U.K.’s FCA publishes written information regarding their approach to enforcement.<sup>192</sup> It includes an overview of enforcement policy and process and its policy concerning specific enforcement powers including the prosecution of alleged criminal offences. Serious or complex fraud is normally handled by the Serious Fraud Office (“SFO”) (discussed below).<sup>193</sup>

<sup>186</sup> See <http://fraudresearchcenter.org/> for more information.

<sup>187</sup> NW3C, *About*, online: National White Collar Crime Center <<http://www.nw3c.org/about>>.

<sup>188</sup> ASIC Information Sheet 151, *ASIC’s Approach to Enforcement* (September 2013), online: Australian Securities & Investments Commission <[https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/INFO\\_151\\_ASIC\\_approach\\_to\\_enforcement\\_20130916.pdf/\\$file/INFO\\_151\\_ASIC\\_approach\\_to\\_enforcement\\_20130916.pdf](https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/INFO_151_ASIC_approach_to_enforcement_20130916.pdf/$file/INFO_151_ASIC_approach_to_enforcement_20130916.pdf)>.

<sup>189</sup> See for example, ASIC Annual Reports, *Annual Report 2012-2013*, online: Australian Securities & Investments Commission <[https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Annual-Report-2012-13-complete.pdf/\\$file/ASIC-Annual-Report-2012-13-complete.pdf](https://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/ASIC-Annual-Report-2012-13-complete.pdf/$file/ASIC-Annual-Report-2012-13-complete.pdf)>.

<sup>190</sup> *Serious and Organised Investment Frauds*, *supra* note 22.

<sup>191</sup> *Ibid.*

<sup>192</sup> Financial Conduct Authority, *The Enforcement Guide* (February 28, 2014), online: <[http://media.fshandbook.info/Handbook/EG\\_Full\\_20140228.pdf](http://media.fshandbook.info/Handbook/EG_Full_20140228.pdf)>.

<sup>193</sup> *Ibid.* at 127.

In late 2013, the FCA confirmed that it will be able to publish information about enforcement action against a firm at a much earlier stage than was previously permitted and, notably, before a firm or an individual has had an opportunity to formally challenge the case against them. Until 2010, the Financial Services Authority (“FSA”) (now the FCA) could only publish details about enforcement action against a firm or an individual when a final notice was published at the conclusion of a case (that is the stage at which the FSA’s Regulatory Decisions Committee had issued a decision notice but before the Upper Tribunal had made a decision).<sup>194</sup> In Canadian jurisdictions, securities regulators publish statements of allegations on their websites which detail the allegations made against a firm and/or individual prior to the commencement of proceedings. The FCA’s new power to publish information about enforcement warning notices is intended to create a more transparent enforcement process and to inform consumers and the financial services industry about the types of behavior it considers unacceptable at an earlier stage, which will strengthen its enforcement strategy of credible deterrence.<sup>195</sup>

In its most recent annual report on enforcement the FSA (now FCA) noted that

[w]e continue to scan the horizon for emerging trends in investment frauds. We have been particularly concerned by the growth of new alternative investment products such as carbon credits and rare earth metals, which fall outside current legislation; we have worked hard to raise consumer awareness about the risks posed by such products. In April 2012 we wrote to over 76,000 potential victims of investment scams, warning them that they might be targeted by fraudsters.<sup>196</sup>

The U.K.’s securities regulator also noted in its annual report that it must combat unauthorized investment businesses, including share frauds, landbanking<sup>197</sup>, and ‘get rich quick’ investment scams. The FSA received about 6,000 reports each year of potential unauthorized activity in the U.K.<sup>198</sup> It notes that “[w]e identify the most serious matters posing the greatest risk to consumers and seek to stop them through a combination of methods including bringing legal proceedings against the perpetrators, disruption tactics such as taking down websites, and publishing consumer warnings.”<sup>199</sup>

The report provides statistical data on the number of open cases as at the beginning of the fiscal year, those opened during the course of the year, closed during the year, and open at the start of the next fiscal year, as broken down by issue, including a category for money laundering controls and financial fraud, and unauthorized activities.

### **Serious Fraud Office**

The U.K.’s SFO is a government department in place to protect society by investigating and, if appropriate, prosecuting those who commit serious or complex fraud, bribery and corruption and pursuing them and others for the proceeds of their crime. During the 2012-2013 year the SFO completed twelve prosecutions of twenty defendants, with a conviction rate of 70%.<sup>200</sup> The SFO’s

<sup>194</sup> FCA News, *FCA Confirms How it will Use New Power to Publicise Warning Notices* (October 15, 2013), online: Financial Conduct Authority <<http://www.fca.org.uk/news/fca-confirms-how-it-will-use-new-power-to-publicise-warning-notices>>.

<sup>195</sup> *Ibid.*

<sup>196</sup> *FSA Enforcement*, *supra* note 130 at 12.

<sup>197</sup> The practice of buying land as an investment and holding it for future use.

<sup>198</sup> *FSA Enforcement*, *supra* note 130 at 11.

<sup>199</sup> *Ibid.*

<sup>200</sup> SFO Media, *Annual Report and Accounts 2012-13*, online: Serious Fraud Office <<http://www.sfo.gov.uk/media/256255/30597%20hc%209.pdf>>.

annual reports also provides other key performance indicators, including the number of trials undertaken during the year, the orders made, the average length of sentence for those convicted, and the average cost of cases.

### National Fraud Authority

The U.K. also has a National Fraud Authority which is a government agency in place to focus and coordinate the fight against fraud.<sup>201</sup> The National Fraud Authority publishes an Annual Fraud Indicator which estimates fraud losses in a variety of categories. None of the categories are specific to investment fraud, although investment fraud may be captured by several of the categories, including mass marketing fraud.

## 10. Recommendations

### 10.1. Collect Better Information

#### Fraud Statistics

It is recommended that the CSA and governments prioritize the collection of data regarding investment fraud complaints. A single, centralized reporting repository could be an efficient method of doing so and could increase reporting if it provided clarification to investors as to where to lodge their complaints.

The Supreme Court of Canada decision regarding the proposed Canadian *Securities Act* found that specific aspects of the proposed act were aimed at addressing matters of genuine national importance and scope, including national data collection.<sup>202</sup> This may support the idea of a national fraud agency, set forward in the recommendation at 10.8.

Information is crucial to ensure that limited regulatory resources are used in the most efficient and effective manner possible and a clear place to report fraud would allow for better data collection and the ability to analyze that data to better understand investment fraud in Canada. "A better understanding of reporting and under-reporting behavior may also help guide resources for consumers directly. ...Clarifying the proper reporting mechanism for consumers (akin to the recent creation of the National Fraud Authority in the United Kingdom) may be a valuable service in itself, and allow for a more accurate picture of fraud in the future."<sup>203</sup>

With increased reporting of fraud, there would be improved information regarding prevalence and incidence which could improve the identification of trends and inform prevention initiatives.

#### Victim and Fraudster Profile Research

As noted above in section 6.2, considerable research has been undertaken (particularly in the U.S.) regarding characteristics of fraud victims and potential risk factors that may make some individuals more vulnerable to investment fraud. Canadian research in this area is warranted. For example, an

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<sup>201</sup> NFA, *What We Do*, online: National Fraud Authority <<https://www.gov.uk/government/organisations/national-fraud-authority/about#what-we-do>>.

<sup>202</sup> *Reference Re Securities Act*, *supra* note 172.

<sup>203</sup> *Scams, Schemes & Swindles*, *supra* note 12 at 14.

examination of the types of products that seniors fall victim to in investment fraud cases seen by regulators in senior-related enforcement cases should be conducted.

Similarly, it may be helpful to conduct research relating to fraudsters who target Canadian investors, in order to inform the approach to deterring, detecting, and intercepting fraudulent activity. It is also recommended that further research be undertaken to determine why certain individuals who may be more vulnerable to investment fraud do not take steps to protect themselves.

### **10.2. Publicize Enforcement Reports on Complaints and Trends**

As noted above in section 5, the CSA's annual enforcement reports contain important and useful information. However, the information provided in these reports is not necessarily current and does not give a picture of the emerging trends that are developing. As noted in section 5.10, NASAA's enforcement reports identify top trends relating to enforcement by U.S. state securities regulators and outline top threats facing investors and small businesses.

It is recommended that the CSA develop similar information from Canadian securities regulators for inclusion in enforcement reporting. Some stakeholders did identify possible trends in the approaches fraudsters use in their jurisdiction to lure in investors. A more systematic review of possible trends and the publication of such information would be beneficial to all market participants. Alternatively, or in addition, it may be helpful to consider whether it would be practicable and useful for Canadian securities regulators to participate in NASAA's report in future.

### **10.3. Set and Coordinate Enforcement Priorities**

Stakeholder interviews revealed a lack of formal priority-setting on the part of regulatory enforcement departments. Given the apparent lack of data and analysis regarding investment fraud, clear enforcement priorities were not articulated. While the CSA's enforcement reports from 2012-onward reflect an increased prioritization of fraud (exemplified by the creation of a fraud category of offence for reporting purposes), interviews with stakeholders did not reveal a strategic, coordinated approach to enforcement priorities in some jurisdictions.

Different Canadian jurisdictions maintain that the most pervasive types of fraud varied by jurisdiction. A by-product of this is a lack of a coordination of enforcement priorities across Canada. While there may be nuances in different geographical regions, the hallmarks of fraud do not appear to vary widely.

We understand through stakeholder interviews that the CSA Enforcement Committee meets on a monthly basis and meets in person twice a year. It is recommended that this committee establish formal priorities with respect to investment fraud, if it does not already do so, and make those priorities transparent. A coordinated approach to enforcement against investment fraud across Canada could result in better information sharing, case coordination, and, most importantly, clear signals to the market that fraud is an enforcement priority in Canada.

### **10.4. Improve Detection**

It is recommended that those responsible for protecting the public from investment fraud (particularly securities regulators) undertake to determine why the rates of reporting investment fraud are so low and identify ways to increase reporting rates. Empirical research that suggests why people report fraud and why they do not would provide valuable information in designing systems to encourage increased reporting and thus better data. Better data from increased reporting would likely improve information regarding investment fraud prevalence and incidence, improve the

identification of trends and inform prevention initiatives, including those aimed at investor education.

Stakeholder interviews noted the importance of detection and of tracing the proceeds of fraud in deterring investment fraud. As noted in section 8.5, it is recommended that the Department of Finance Canada examine the possibility of requiring FINTRAC to disclose information to securities regulators in order to aid in detection and enforcement efforts and consider permitting such disclosure.

Further, it is noted that whistleblower programs have been demonstrated to be effective in other jurisdictions as they provide a new source of intelligence information. It is recommended that securities regulators examine the potential for, and ideal structure of, a whistleblower program.

### ***10.5. Regulators to Obtain Recourse for Investors***

Given that an investment fraud victim's priority is to recover their losses, and the fact that they are at a significant disadvantage in recovering funds from the perpetrators of the fraud, there is a role for regulators to play in acting as a catalyst or facilitator to help investors in recovering their losses. As noted above in section 6.3, some, but not all, provincial regulators have the power to order disgorgement and restitution. While cases involving fraud in administrative proceedings may involve a disgorgement order, it appears that securities commissions rarely collect the money so ordered. Regulators are encouraged to seek ways to improve this aspect of the system in the interests of investor protection.

Academic research has found that a robust and effective system of both public and private enforcement mechanisms is essential to an effective regime for the enforcement of securities legislation. Private mechanisms may provide as much deterrent value as public ones. Therefore, it is important that regulators and governments ensure that effective private and public enforcement of securities laws work in tandem in the interests of investor protection and capital market integrity.

### ***10.6. Comprehensive Registration Check***

Given the importance of registration verification in protecting investors from investment fraud, it is essential that investors be made aware of the importance of checking such registration (see our recommendation below regarding an awareness campaign).

It is also critically important that investors are provided with a user-friendly, comprehensive registration check system, which includes the registration information for any registered firm or individual in Canada, along with both concluded cases (criminal, administrative, SRO, or other relevant regulatory authority) and investor warnings issued. Given the complexity of securities regulation in Canada it is vitally important that this information is provided to consumers in a format that they are able to easily use and understand. While this may require cooperation and some effort on the part of regulators (including police and Crown prosecutors), it is in the interests of investors to have access to a user-friendly, complete registration and background check website. An element of such a system should also include a toll-free number for individuals who would prefer to use the phone rather than the website.

The CSA has identified a day in March as national 'Check Registration Day' each year. While it is essential that investors' attention be drawn to the importance of checking registration, the efficacy of this initiative in the absence an interface that is user-friendly and meaningful to investors appears limited.

We understand that the CSA intends to revamp the National Registration Search as part of a larger System Renewal Program “within the next few years”.<sup>204</sup> In our view, this intention does not reflect the importance of this element of the investor protection regime. A lack of attention to this investor interface may frustrate investors and deter them from future attempts to check registration. Prioritizing this initiative could enhance investor protection by increasing the percentage of investors who check registration before investing, thereby reducing the incidence of fraud.

To remedy this problem, it is recommended that Canadian regulators immediately take steps to provide an informative, comprehensive, “one-stop” national system for investors to check registration, background information (including proficiency and disciplinary history), SRO membership for all firms registered with securities regulators and members of SROs, and to identify non-securities licenses for individuals licensed under different regimes (such as insurance agents) with different sponsoring firms.

This system should include plain language explanations of the information provided and be searchable under business names as well as proper legal names. Additionally, it should provide assistance to investors who do not have access to the internet and those who are not computer-savvy. There should be one phone number where a consumer can call to have the relevant information explained. Additionally, it would be beneficial to incorporate CSA members’ investor alerts into such a system, to ensure the most current information available is provided to investors.

### **10.7. Awareness Campaign**

A general recommendation arising out of this report is for regulators to continue efforts to provide plain language information to investors and to coordinate the approach to fraud awareness. Much of investment regulation – and consequently investment marketing and practice – remains shrouded in verbiage incomprehensible to the average person. It is not realistic to expect investors to educate themselves when not enough is being done to de-mystify investments and their regulation through the use of language ordinary people can understand, delivered through information channels investors access. While many great resources have been produced for investors, we question whether these materials actually get into investors’ hands – and whether they are referenced during the time the decision-making process takes place. By determining where investors encounter fraudulent investment schemes (particularly ones where they are likely to invest), regulators would be better-placed to deliver the information needed.

It is recommended that securities regulators and governments focus attention on raising broader consumer awareness of common investment fraud tactics and teach financial consumers to recognize the signs of fraud. A national campaign to raise awareness of fraud, including persuasion techniques would be beneficial.

### **Registration**

Canadian securities regulators, including any future common regulator, should undertake a national campaign to raise investors’ awareness of fraud in Canada by non-registrants and relating to investments that are not qualified by a prospectus.

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<sup>204</sup> Bill Rice, *letter to Ermanno Pascutto (April 22, 2013) in response to FAIR Canada’s Open Letter “RE Checking Registration Essential but Consumers Need a Simplified Comprehensive National Database” (March 26, 2013)*, online: Canadian Foundation for Advancement of Investor Rights <<http://faircanada.ca/wp-content/uploads/2013/03/130326-letter-to-CSA-re-natl-check-registration-day.pdf>>.

Given that a proper registration check is one of the easiest ways (although not a guarantee) for retail investors to better protect themselves against fraud, it is recommended that awareness of the need to do so must be raised amongst Canadian investors. This recommendation complements the above recommendation for an improved system for checking registration.

### **Investor Warnings**

It is suggested that increased transparency about complaints received and the results of other detection tools could provide more timely warnings to investors about the types of fraud targeting Canadian investors at any given time. While warnings about specific cases may assist in reducing the number of victims harmed by a particular fraud, warnings about current trends could provide a more proactive investor warning tool to allow potential investors to protect themselves against fraud that has not yet been identified by regulators.

Investors should be warned against sending money offshore, as this is a warning flag of fraud (see 'Internet Fraud' in section 3.4).

### **10.8. National Fraud Agency**

As discussed in section 8.6, the poor perception of enforcement in Canadian securities markets warrants attention. IMET, for various reasons, does not appear to have garnered the expected results. Given the possibility of a common Canadian securities regulator, there may exist an excellent opportunity to design an optimal national fraud agency which could not only be a central place to report fraud (and thereby collect intelligence), but also to act as a central enforcement agency.

We understand that Quebec uses a joint unit committee model that evaluates incoming cases and determines the best unit to handle the case. It is recommended that this model be examined in determining best practices for a national fraud agency.

As noted above in section 10.1, the Supreme Court of Canada's decision in the Canadian Securities Act reference may support such an agency.

### **10.9. Examination of Exempt Market**

As noted above in section 8.3, the nexus between fraud and the exempt market appears to be an important area for further investigation. Research is required to determine whether the existence of the exempt market opens the door to fraud. Is there a net benefit to retail investors or does the existence of the exempt market cause more harm than good?

It is suggested that securities regulators consider gathering more data on the exempt market and on investment fraud perpetrated in Canada in order to determine the relationship (if any) between prospectus exemptions and investor protection against investment fraud with a view to developing better protection against fraud. For example, given that a friends and family exemption is premised on the theory that those close to the promoter can gauge that person's trustworthiness, if many cases that involve serious investor harm also involve perpetrators who defraud their own friends and family, the rationale for this exemption may merit closer review. It is essential to ask how retail investors can differentiate between legitimate prospectus-exempt investments and fraudulent investments. If this is not possible, tools to better protect investors should be developed, including clearer warnings about the correlation of fraud and exempt market investing and steps that retail accredited investors should take, in the absence of registration, to help protect themselves.

## 11. Conclusions

The disparate system for combating investment fraud in Canada makes it difficult to evaluate the efficacy of the current system. The results of our research did not provide comfort that the system for protecting investors against investment fraud is robust.

Of concern was the lack of data and analysis of fraud that is perpetrated on Canadian investors in any given time period. While we believe that enforcement departments at Canadian securities regulators and SROs are well-intentioned and proficient in their area of expertise, we were not assured that regulators are well-aware of how much fraud is perpetrated across Canada or in particular jurisdictions.

The most basic, and clearest, message we heard from various stakeholders and research was the need for investors to check the registration of individuals and firms with whom they invest, or intend to invest. However, data indicates that such checks are not being performed.

It is essential that the registration check tool be improved to allow investors to find all relevant information they need to protect themselves through one simple search.

It is suggested that a coordinated education initiative about fraud, including the need to check registration, background, credentials and other information, be struck and resources be leveraged across the country. While there are extremely helpful investor materials developed by various jurisdictions, there appears to be significant duplication of effort. While we heard that the types of fraud that are prevalent vary from jurisdiction to jurisdiction, we note that research shows that the hallmarks of fraud are not nearly as variable. The need to educate investors about persuasion techniques was identified as a priority area by numerous stakeholders; this is a topic that has been the focus of at least one regulator in Canada, which has developed exceptional materials that could be used in other jurisdictions.

Finally, it is essential to ask how retail investors can differentiate between legitimate prospectus-exempt investments and fraudulent investments. If this is not possible, tools to better protect investors should be developed, including clearer warnings about the correlation of fraud and exempt market investing and steps that retail accredited investors should take, in the absence of registration, to help protect themselves.

## 12.APPENDIX A – Commonly Used Acronyms

AMF	Québec Autorité des marchés financiers
ASC	Alberta Securities Commission
ASIC	Australian Securities and Investments Commission
BCSC	British Columbia Securities Commission
CAFC	Canadian Anti Fraud Centre
CSA	Canadian Securities Regulators
FCA	U.K. Financial Conduct Authority
FCAA	Saskatchewan Financial and Consumer Affairs Authority
FCSC	New Brunswick Financial and Consumer Services Commission
FINRA	U.S. Financial Industry Regulatory Authority
FINTRAC	Financial Transactions and Reports Analysis Centre of Canada
FSA	U.K. Financial Services Authority (now FCA)
IIROC	Investment Industry Regulatory Organization of Canada
IMET	RCMP Integrated Market Enforcement Team
IOSCO	International Organization of Securities Commissions
MFDA	Mutual Fund Dealers Association of Canada
MOU	Memorandum of Understanding
NASAA	North American Securities Administrators Association
NRS	National Registration Search
OSC	Ontario Securities Commission
RCMP	Royal Canadian Mounted Police
SEC	U.S. Securities and Exchange Commission
SFO	U.K. Serious Fraud Office
SRO	Self-regulatory organization (ex. IIROC and MFDA)