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

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Sent via email to: ccorlett@iiroc.ca

RE: Request for Comment – Enforcement - Alternative Forms of Disciplinary Action Proposed at IIROC

FAIR Canada is pleased to offer comments in response to IIROC's consultation to expand its portfolio of Enforcement Options to include a Minor Contravention Program ("MCP") and the use of Early Resolution Offers ("EROs") as set out in IIROC Notice 18-0045 dated February 22, 2018 (together with its Schedule A, referred to herein as the "IIROC Notice").

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a national voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. General Comments

1.1. The IIROC Notice states that it is considering the use of a MCP and EROs so as to have more tailored enforcement responses that are fair and proportionate and in order to create operational and procedural efficiencies. It indicates the desire to have more options in its enforcement tool kit in order to inspire confidence and deter wrongdoing.

1.2. FAIR Canada believes that robust enforcement is a key part of an effective investor protection framework and essential to the securities regulatory structure. We support IIROC in reviewing the effectiveness of its enforcement program in order to better fulfil its mandate of protecting investors and supporting healthy capital markets across Canada.

1.3. FAIR Canada urges all securities regulators, including IIROC, to improve the transparency and accountability of their enforcement efforts through better reporting

of the underlying data. It is difficult to measure the effectiveness of enforcement without key data points.

1.4. For example, on and before 2014, IIROC provided information in its Enforcement Reports or Annual Reports on the number of issued Warning Letters (or Cautionary Letters) but ceased to include that information in its Enforcement Reports as of 2015. For example, in 2014, IIROC received 1,350 complaints from all sources, and of those approximately 460 went to case assessment, 174 were sent for investigation and 102 (or 59%) were referred to prosecutions while 10 were sent Warning Letters and 62 were closed or referred to other agencies. According to the 2017 Enforcement Report, IIROC received 1,163 complaints from all sources, but the number of those sent to case assessment is not provided in the Enforcement Report (the Enforcement Statistics page on the IIROC website reveals that 460 went to the case assessment stage). Of those that went to case assessment, 127 were sent for investigation and 58 (or 46%) were referred to prosecutions while 69 were closed, sent to other agencies[1] or sent a Cautionary or Warning Letter (with there being 1 Cautionary Letter revealed on the Enforcement Statistics webpage and no mention of Warning Letters from either source).

1.5. It is difficult to meaningfully review and assess the effectiveness of enforcement and the current proposal to add an MCP and EROs in the absence of core data. **FAIR Canada recommends that key information or data be provided annually in the Enforcement Report and that the information be consistently reported each year.** We do note a trend downwards in the number of matters being referred to prosecutions.

1.6. The key issue is whether additional enforcement tools will strengthen deterrence and increase confidence in our capital markets, and if so, whether the MCP and EROs are the appropriate tools to choose out of all of the possible options for an enforcement toolkit.

1.7. Given limited resources, FAIR Canada has not had the ability to research other possible alternative tools or approaches that IIROC might have considered but rejected. **We recommend that IIROC provide a discussion of enforcement toolkit options it considered in a future IIROC Notice on this issue.**

1.8. The IIROC Notice indicates that Staff have reviewed its practices and comparable programs and approaches adopted by securities and other regulatory bodies.[1] However, Schedule A only provides a comparison of minor violation programs in other jurisdictions (not other jurisdiction's early resolution programs), chooses only selected jurisdictions (rather than providing robust information on all major jurisdictions and whether they have an MCP or not), and does not provide any commentary on their

[1] IIROC Notice at 2 and 4.

effectiveness. In addition, there is no explanation as to why certain jurisdictions were chosen while others were not and why Staff chose to include several regulators that oversee exchanges rather than regulators that oversee investment dealers and their representatives.

1.9. Additionally, it would be helpful to assess the efficiencies to be gained by the proposed MCP and EROs by providing information as to length of time on average for IIROC to process cases to the different stages of the enforcement process, how efficiencies would be gained and how fairness/proportionality would be enhanced. Moreover, fairness and proportionality must be assessed not simply vis a vis the firm or individual who is sanctioned but also vis a vis the investors or the integrity and fairness of our markets as a result of losses incurred or other harms that result from the misbehaviour and malfeasance.

2. MCP

2.1. The IIROC Notice indicates that Staff wish to have a regulatory response that is more serious than a Cautionary Letter but does not warrant the resources needed to initiate a formal disciplinary proceeding (a settlement or contested hearing) for minor contraventions of IIROC requirements. The MCP Notice would be sent to an Approved Person and/or Dealer Member which would specify the alleged contravention, and the facts relied upon. Individuals would be fined $2,500 and firms $5,000. If the Notice is agreed to, the individual or firm would admit to contravening the requirement. There would be no disciplinary record, and it would not be disclosed as part of the disciplinary history but could be relied upon in the event of a future disciplinary proceeding. Quarterly reports of MCPs would be issued on a no-names basis by IIROC.

2.2. Set out below are FAIR Canada's responses to the questions posed by IIROC regarding the MCP in the IIROC Notice.

Question 1: Do you believe that the proposed MCP would be useful?

2.3. We are unable to assess whether it would be useful given the limited information provided in the IIROC Notice and limited enforcement data that is publicly disclosed. We do seriously question whether it would improve deterrence given that the individuals or dealers who agreed to MCP Notices would not be made public. This lack of transparency is worrisome. We believe that the robustness of enforcement and its effectiveness as a deterrent will be increased with greater transparency and accountability built into the system rather than the opposite.

Question 2: Should a Dealer Member be eligible for the MCP?

2.4. FAIR Canada does not express support for the MCP based on lack of information in the IIROC Notice. In theory, both firms and individuals could be eligible for the MCP as they are for Cautionary Letters. However, in practice we observe that individuals are sanctioned much more frequently than firms even in instances of repeated wrongdoing by individuals which should have been detected by the dealer and/or suggests a lack of appropriate supervision. Therefore, we question whether firms should be eligible for the MCP.

2.5. We also believe if this program is to be implemented, the criteria for eligibility should not be vague and subjective but clear and objective. Therefore, we disagree with the following:

- That individuals with prior disciplinary records *will likely be* disqualified from being considered – they should be disqualified.

- That there should be eligibility in situations of "limited" harm to investors. FAIR Canada's observation is that individual losses may appear "limited" to a firm or Approved Person (for example, $50,000), but such losses may be relatively large to the investor relative to their overall financial assets. Moreover, financial losses often have negative mental and physical health implications for investors. While it may be "limited" according to the individual or firm perspective, it is not so to the investor. - To be eligible there should be no harm or loss to investors or if there was harm to investors (which must be modest in amount) it must have been compensated for fully including interest and fees.

- That there should be eligibility in situations of "limited" benefit to the firm or individual from the contravention. - Individuals and firms should not be able to gain at the expense of their wrongdoing and should be ineligible for a MCP in situations where they do so.

Question 3: What aspects of the proposed MCP, if any, should be public?

2.6. FAIR Canada rejects the idea that a MCP program would not have transparency as to the individuals or firms who agreed to MCP Notices. Retail investors should be made aware of any Cautionary Letters, Warning Letters or MCP Notices provided to and accepted by individuals or firms. There is unlikely to be any general deterrence in the absence of making this information public and, depending on their frequency of issue, such an approach could weaken the effectiveness of IIROC's enforcement program rather than enhance it.

Question 4: What legal or regulatory effect should acceptance of a MCP Notice have?

2.7. The acceptance of a MCP Notice should result in a formal disciplinary record that can be easily accessed by a retail investor or the public. It should therefore be admissible in any further regulatory proceeding or in a civil proceeding.

Question 5: Do you agree that the sanction should be a fixed amount?

2.8. FAIR Canada expresses no view given the limited benchmarking information provided at Schedule A to the IIROC Notice.

Question 6: Do you agree with the quantum of the proposed sanctions?

2.9. FAIR Canada expresses no view given the limited benchmarking information provided at Schedule A to the IIROC Notice. However, our initial reaction is that the fines are remarkably low.

3. EROs

3.1. FAIR Canada is concerned about whether EROs will be pursued in the absence of sufficient knowledge of the facts and circumstances to fully understand the nature of the misbehaviour or conduct unbecoming or breaches of IIROC's rules. Only once a sufficient understanding of the facts is known, can there be a reasonable assessment of the appropriate sanction.

3.2. FAIR Canada also suggests that hearing panels which are convened to determine if settlement agreements are reasonable and in the public interest should be open to the public in order to ensure transparency and accountability.[2]

3.3. We believe that settlements negotiated in private may keep key facts and details opaque which harms general deterrence and is not in the public interest. Several recent no-contest settlements and settlement agreements by securities regulators have had little factual details. FAIR Canada recommends that this issue be explicitly addressed by IIROC in its proposals. Misconduct should have a light shone upon it and expediency and efficiency should not be of sole importance. Otherwise, confidence in our markets is undermined and investor protection is compromised.

3.4. FAIR Canada also strongly believes that EROs should not be provided in the absence of full disgorgement of any profits made and full compensation of any investor losses,

[2] This has been suggested for SEC approval of settlements. See Urska Velikonja, The Yale Law Journal Forum, September 7, 2016, "Securities Settlements in the Shadows", at 134, available online at https://www.yalelawjournal.org/forum/securities-settlements-in-the-shadows.

including interest and fees incurred for negligent, unsuitable or wrongful advice or behaviour.

3.5. Set out below are FAIR Canada's responses to the questions posed by IIROC regarding EROs in the IIROC Notice.

Question 1: Do you believe that the Early Resolution Offers initiative is necessary? Will it meet its objective?

3.6. As indicated above, we do not believe enough information has been provided to provide a view on EROs.

Question 2: How can Staff best demonstrate the credit given for accepting an Early Resolution Offer?

3.7. FAIR Canada suggests that IIROC benchmark to other jurisdictions to assess how credit is given where EROs are utilized. For example, in the United Kingdom, early resolution is offered where different levels of penalty discount are applied depending on whether there is agreement as to facts, liability and penalty or whether penalty and/or liability or all issues are contested.

Question 3: To what extent should Staff factor internal discipline into the decision to make an Early Resolution Offer?

3.8. FAIR Canada is of the view that internal disciplinary measures may be a relevant fact but it depends on the particular facts and circumstances of a given case as to the relevance and weight to be given to the presence or lack of internal disciplinary measures. More importantly, FAIR Canada believes that internal discipline should not take the place of the public enforcement process.

Question 4: Are there other initiatives or programs that Staff should consider in order to provide more flexibility and options in addressing breaches of regulatory requirements in a fair and proportionate manner?

3.9. FAIR Canada suggests that IIROC continue to work closely and enhance its level of cooperation with other regulators, including securities commissions, so as to pursue proceedings in a manner which would permit compensation of losses to retail investors through the proceeding rather than requiring individuals to sue separately in court. FAIR Canada also suggests that IIROC take steps to ensure that breaches by firms of their regulatory obligations in the complaint reporting and complaint handling process, including their obligations at OBSI, are appropriately subject to disciplinary measures that are meaningful and provide specific and general deterrence.

3.10. We also reiterate our recommendation that IIROC benchmark to other jurisdictions to determine what other possible tools could be utilized to improve the enforcement program at IIROC and provide more complete data on relevant enforcement processes in order to allow for an assessment of their effectiveness and in the interests of transparency and accountability.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Please feel free to contact Frank Allen 647-256-6693/frank.allen@faircanada.ca or Marian Passmore at 647-256-6691/marian.passmore@faircanada.ca if you wish to discuss the foregoing.

Sincerely,

Canadian Foundation for the Advancement of Investor Rights