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Self-reporting, Credit for Cooperation and the OSC's New Enforcement Initiatives

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PRESENTERS

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Tom Atkinson, Director of Enforcement, OSC

Tom joined the Commission after an extensive career in securities regulation. His most recent position was as the founding president and CEO of Market Regulation Services Inc.

Prior to that, Tom held progressively senior positions at the Toronto Stock Exchange, including vice-president of regulation services and several positions within the investigations and enforcement division – director, chief counsel, and enforcement counsel. From 1993 to 1996, he was an assistant Crown attorney in Ontario.

PRESENTERS

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René Sorell, Partner, Business Law

Specialties: Securities Law

Mr. Sorell regularly represents clients in enforcement and other regulatory proceedings before the Ontario Securities Commission and other Canadian securities regulators. He has had responsibility for projects in all aspects of securities law, including securities offerings, contested take-over bids, proxy battles and shareholder disputes, public company mergers and reorganizations and the formation of equity and fixed income marketplaces.



Renee Reichelt, Partner, Litigation

Specialties: civil litigation areas including securities litigation, class action litigation, corporate/commercial disputes, shareholders disputes and oppression actions, negligence and contract disputes, creditor-debtor disputes, oil and gas litigation, land development disputes and environmental litigation.

Ms. Reichelt has trial experience in the Alberta Court of Queen's Bench, both the Alberta and British Columbia Court of Appeal and the Provincial Court of British Columbia. Ms. Reichelt represents clients at the Alberta Securities Commission and other related regulatory proceedings.

Voluntary self-reporting

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- ↪ Since 2002, the OSC has encouraged market participants “to **self-police, self-report, and self-correct** matters that **may** involve breaches of Ontario securities law or activities that would be considered contrary to the public interest” (OSC Staff Notice 15-702)
- ↪ Staff required that reporters:
 - ↪ “promptly and fully report” and “fully cooperate”
 - ↪ volunteer relevant records;
 - ↪ attend voluntary interviews; and
 - ↪ promptly and independently investigate and take corrective action.
- ↪ Examples of conduct not worthy of credit were:
 - ↪ placing the interests of the firm or its principals ahead of the firm's obligations to clients, shareholders, or Ontario's capital markets
 - ↪ withholding information that in light of the circumstances should be provided to staff of the OSC
 - ↪ arranging affairs to delay reporting

Voluntary self-reporting (cont'd)

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- indicating they are prepared to cooperate fully but will only provide information on a compelled basis
- undertaking to provide staff with books, records or information and then failing to
- misrepresenting facts
- destroying documents

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Market participants were reluctant to assist regulators by self-reporting

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- There is ... “a disconnect in expectations between [securities commission staff] and the market participants as to what is meant by co-operation”
OSC Staff Notice 15-704, October, 2011
- Market participants did not know:
 - how to take the initiative in reaching out to regulators
 - what the consequences of reaching out would be
 - how willing securities regulators would be to reward co-operation or what form the “reward” would take

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The CP Ships Example, 2005

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- ↪ In July 2005, the OSC applied Staff Notice 15-702 by issuing a warning letter to CP Ships regarding non-disclosure of a material change and insider trading, instead of instituting a proceeding.
- ↪ According to OSC Staff, four insiders of CP Ships sold CP Ships shares with knowledge that financial results would be materially below publicly disclosed estimates.
- ↪ Based on these and other alleged facts, OSC Staff could have proceeded against the individuals and the company.
- ↪ Proceedings were avoided and a warning letter was issued instead due to the following cooperation:
 - ↪ establishing a special committee to investigate the issues,
 - ↪ meeting with the staff of the OSC,
 - ↪ publicly disclosing that the OSC was conducting an investigation and that the trading by the insiders should not have taken place,
 - ↪ providing all relevant documents,
 - ↪ giving the OSC unlimited access to the special committee's advisors,
 - ↪ the restitution to CP Ships by the insiders of the amount representing the loss avoided on their trades (C\$1.4 million), and
 - ↪ reviewing and revising its insider trading and corporate disclosure policies.
- ↪ Reputational and out-of-pocket costs were still significant.

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Timeline of 2014 OSC Credit for Cooperation Policy

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- ↪ First OSC Credit for Cooperation Policy introduced in 2002
- ↪ New 15-702 Credit Cooperation Policy proposed in July, 2011
- ↪ Comment period for industry consultation 2012
- ↪ Hearing June, 2013
- ↪ Notice issued March 11, 2014 of OSC enactment of new 15-702 policy

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Questions for Discussion by Panel

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Question 1

15-702 is a far-reaching policy about self-reporting and self-correcting action by market participants. There was a policy on this for over 12 years before the OSC changed it. There was also a period beginning in 2011 when comment was invited from the public about revamping aspects of the settlement process in Ontario.

Can you talk about the factors that convinced Staff the old policy need to be changed?

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Question 2

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15-702 puts the onus on market participants such as public companies and registered securities businesses to self-report and self-correct problems they encounter. How serious does a problem have to be to engage this expectation?

Compare paras 4 and 8. Unlawful activity is one thing but the language extends to activity that may affect investors or may “cast doubt on the integrity of the capital markets”.

What does this phrase mean?

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Question 3

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How much latitude do market participants have to report but to delay correcting until they discuss with the regulators?

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Question 4

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Self-reporting must be both prompt and full. Yet full reporting implies investigation before reporting and that can take some time.

Can you comment on that tension between fast self-reporting and full investigation and the Staff attitude to this?

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Question 5

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Self-reporting to the OSC has traditionally been scary for market participants because evidence of misconduct is being disclosed on a with prejudice basis with no certainty about the outcome.

Can you comment on the new features of the notice that mitigate the with prejudice nature of self-reporting (para 24)?

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Question 6

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Suppose a public company discovers and promptly corrects an error in its financial statements or continuous disclosure. Suppose that investigation reveals the error to be inadvertent.

Does the fact of the error require market participants to also rigorously review their system of controls as a part of the self-correction process?

Presumably everything turns on the facts?

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Question 7

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Please comment on the statement in the notice that the market participant should provide “compensation, as appropriate” to any investors that may have been harmed (para 10).

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Question 8

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The Notice lists “Staff Expectations” and also explains what it views as failing to cooperate.

Is it correct that failing to meet Staff expectations does not necessarily mean that a market participant has failed to cooperate? (paras 4-10 vs paras 11-12).

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Question 9

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Let's discuss an example. If there is a failure to compensate because the reporting issuer does not regard this as appropriate, how is this viewed? (para 10)

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Question 10

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Misrepresenting facts is an obvious example of non-cooperation but people can make errors or their understanding of a situation can evolve so that there was no intended misrepresentation.

Does the Staff recognize this?

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Question 11

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Suppose a market participant voluntarily reports a problem but the OSC disagrees with the characterization of the problem.

Does the participant still get credit or is the participant at risk for missing the issue the Staff considers to be the “real issue”?

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Chapter 1

Notices / News Releases

1.1 Notices

1.1.1 OSC Staff Notice 15-702 Revised Credit for Cooperation Program

OSC STAFF NOTICE 15-702 REVISED CREDIT FOR COOPERATION PROGRAM

Purpose of the Notice

1. This notice relates to the compliance policy of the Ontario Securities Commission ("Commission") that market participants and others participating in the capital markets (collectively, "persons") should be encouraged to self-police, self-report and self-correct matters that may involve breaches of Ontario securities law or other types of misconduct that would be considered contrary to the public interest.
2. The results of cooperation by a person with Staff of the Commission in accordance with the following guidelines may lead to Staff recommendations which:
 - (a) narrow the scope of the allegations set out by Staff in connection with the commencement of an enforcement proceeding against the person;
 - (b) reduce the sanctions recommended by Staff in connection with an enforcement proceeding against the person;
 - (c) propose the resolution of the matter on the basis of a settlement agreement including, in limited circumstances, a settlement agreement in which the respondent makes no admissions of fact or liability; and
 - (d) in limited circumstances, result in Staff agreeing to take no enforcement action against the person.
3. This notice sets out the particulars aimed at encouraging persons to cooperate with Staff.

Staff's Expectations of Market Participants

4. A market participant that identifies a problem in respect of its systems of internal control, the reporting of financial results, misleading or incomplete disclosure, illegal or improper trading or any other inappropriate activity that has affected (or may affect) investors or cast doubt on the integrity of Ontario's capital markets, should promptly and fully self-report to the appropriate regulatory or law enforcement agency.
5. Market participants should fully cooperate with Staff, or any other regulator, when they are asked to provide assistance or information and should promptly and fully respond to all production orders and summonses.
6. When a matter is reported to Staff, a market participant should provide all necessary books and records required to assess the matter and any reports or analyses prepared by experts retained by the market participant or its counsel.
7. When a matter has been reported to a regulator, a market participant and its employees, officers and directors should make themselves available for interviews to allow Staff to assess the situation.
8. When a market participant has identified a breakdown of its system of internal controls, the market participant should promptly investigate, take corrective action and implement new systems of control, as appropriate.
9. A market participant that is aware that an employee, officer or director may have acted in a manner that is contrary to Ontario securities law, should fully investigate the matter and, independently of whatever action a regulator may take, deal with the matter promptly and appropriately.
10. A market participant should provide compensation, as appropriate, to any investors that have been harmed by inappropriate conduct or by a failure of internal controls.

What is Not Viewed as Cooperation

11. In general, Staff will not give credit for cooperation to a market participant in situations where, during the course of an investigation, the market participant puts the interest of the firm or its officers, directors or employees ahead of its obligations to clients, shareholders or the integrity of Ontario's capital markets.
12. Specifically, no credit for cooperation will be given when market participants:
 - (a) fail to promptly and fully report serious breaches of Ontario securities law to Staff or to another regulator when the facts of the matter are known to them;
 - (b) withhold information that, in light of the circumstances, should be provided to Staff;
 - (c) arrange their affairs in such a manner as to delay reporting a matter that should be reported or to claim a privilege to avoid providing details of potential breaches of Ontario securities law;
 - (d) undertake to provide Staff with books, records or information and then fail to comply with the undertaking or fail to provide the required documents in a timely fashion;
 - (e) misrepresent the facts of a situation;
 - (f) destroy documents in an attempt to avoid production of the records;
 - (g) invoke legal advice as a defence, but refuse to disclose the advice;
 - (h) enter into settlement arrangements with employees, clients or shareholders that include an agreement not to disclose information to a regulator or an agreement to withdraw any existing complaints; and
 - (i) continue the inappropriate conduct or fail to correct internal control problems after the conduct or internal control problems have been identified to senior management and/or the board of directors.

Examples of Credit For Cooperation

13. In general, if a potential respondent acts in a responsible and cooperative manner during the course of an investigation and has self-policed, self-reported and self-corrected the matters under investigation, Staff may agree that it may be in the public interest to resolve the matter by:
 - (a) recommending that the matter not proceed by way of a quasi-criminal prosecution before the courts under section 122 of the *Securities Act* ("Act") and/or an application before the courts under section 128 of the Act;
 - (b) issuing a Notice of Hearing and Statement of Allegations in respect of an administrative proceeding before the Commission under section 127 of the Act that recognizes and gives credit for cooperation by narrowing the scope of the allegations;
 - (c) recommending the resolution of an enforcement proceeding before the Commission on the basis of a settlement agreement that recognizes and gives credit for cooperation by, for example, narrowing the description of underlying facts and including a joint recommendation respecting sanctions;
 - (d) not issuing a Notice of Hearing and Statement of Allegations in connection with an administrative proceeding before the Commission under section 127 of the Act but rather recommending that the matter be addressed by one or more of the following:
 - (i) placing terms and conditions on a potential respondent's registration; or
 - (ii) obtaining an undertaking from the person that, in the future, they will not violate Ontario securities law; or
 - (e) in appropriate circumstances, concluding the matter without taking any action against the potential respondent.
14. As a practical matter, greater cooperation during the course of an investigation will lead to reduced costs incurred by the Commission and Staff, and consequently, a reduction of the potential costs that might be assessed under section 127.1 of the Act.

15. During the course of the investigation, persons who have been less than cooperative up to a point in time, may decide thereafter to fully cooperate with Staff, and in these circumstances, such persons would normally receive partial credit for the cooperation.

Settlement Agreements without Admissions of Fact or Liability

16. In limited circumstances, having regard to the factors set out in paragraph 17 below, Staff may conclude that it is appropriate to recommend to a Commission hearing panel that an enforcement matter be resolved on the basis of a settlement agreement in which the respondent makes no admissions respecting facts or that it contravened Ontario securities law or acted contrary to the public interest, and which would include:
- (a) facts declared by Staff to be true based on its investigation and which are not denied by the respondent;
 - (b) the respondent's acceptance of the settlement agreement as a basis for resolving the proceeding; and
 - (c) the agreed sanctions in light of the conduct described in the settlement agreement.
17. Factors that Staff may consider in evaluating whether it may be appropriate to recommend to a Commission hearing panel the resolution of an enforcement matter on the basis of a settlement agreement that does not include admissions of fact or liability by the respondent include:
- (a) the extent to which the person provided prompt, detailed and candid cooperation during Staff's investigation;
 - (b) the degree and timeliness of the self-reporting undertaken by the person in light of the circumstances of the misconduct;
 - (c) the degree of investor harm caused by the person's conduct;
 - (d) the remedial steps taken by the person to address the misconduct;
 - (e) the agreement of the person to pay such amounts as may be appropriate in the circumstances including, where appropriate, a payment for the benefit of third parties (such as compensation to persons affected by the misconduct) and costs of the investigation;
 - (f) the agreement of the person to cease the underlying conduct and undertaking to refrain from re-offending in the future;
 - (g) the deterrent effect of the settlement agreement on the future conduct of the person and others in the capital market; and
 - (h) the agreement of the person to pay monetary amounts, if any, contemplated by the settlement agreement contemporaneously with the approval of the settlement agreement.
18. Staff emphasize that they will continue to hold persons appropriately accountable for their misconduct.
19. Staff note that the Commission's Rules of Procedure respecting the consideration and approval of settlement agreements apply equally to settlement agreements in which the respondent makes no admissions of fact or liability and, accordingly, any such proposed resolution of an enforcement matter will be subject to the adjudicative discretion of an independent Commission hearing panel whether to approve any such settlement.
20. Notwithstanding the foregoing, a no-contest settlement agreement would not be available in any of the following circumstances:
- (a) the person has engaged in abusive, fraudulent or criminal conduct;
 - (b) the person's misconduct has resulted in investor harm which has not been addressed in a satisfactory manner; and
 - (c) the person has misled or obstructed Staff during its investigation.

No Enforcement Action Agreements

21. In limited circumstances Staff may, in the exercise of its prosecutorial discretion, conclude that it is appropriate to refrain from taking enforcement action against a person, including through entering into a no enforcement action agreement with the person. Factors informing the availability of this form of credit for cooperation include:
- (a) proactive self-reporting, cooperation with Staff and self-remediation;
 - (b) misconduct that reflects an inadvertent technical and/or isolated breach of Ontario securities law;
 - (c) the degree of investor harm caused by the person's conduct and related remedial steps taken to address that harm;
 - (d) the cessation of the underlying conduct by the person and undertaking to refrain from re-offending in the future;
 - (e) the agreement of the person to pay such amounts as may be appropriate in the circumstances, including, where appropriate, a payment for the benefit of third parties (such as compensation to persons affected by the misconduct) and costs of the investigation;
 - (f) the deterrent effect on the future conduct of the person; and
 - (g) in circumstances involving multi-person misconduct, a commitment by the person to provide Staff with active and ongoing cooperation respecting Staff's investigation and prosecution of other persons.

How to Contact Staff to Self-report and Offer Cooperation

22. A person may contact Staff to self-report and/or offer his/her cooperation in a number of ways:
- (a) persons are encouraged to directly contact Enforcement Staff as well as the OSC Contact Centre;
 - (b) market participants that are the subject of a compliance review by Staff are encouraged to directly provide their information to Compliance Staff; and
 - (c) persons may contact Staff indirectly through their legal counsel as a step toward providing information.
23. Staff will generally require a person that is self-reporting and/or offering to provide cooperation to disclose particulars about their conduct and the circumstances so that Staff may evaluate the information and the potential benefits of cooperation, including possible credit. For example:
- (a) a fact witness can forward documentation to Staff and attend an interview with Staff to provide further particulars and respond to questions; or
 - (b) a person who has failed to comply with Ontario securities law or acted contrary to the public interest can contact Staff directly (or through his/her legal counsel) to propose a meeting during which the person can provide particulars about his/her misconduct and discuss the prospect of offering cooperation to Staff respecting an investigation into the conduct of other persons.
24. At the discretion of Staff, a meeting with a person who may have engaged in misconduct may be held on the understanding that statements made by the person to Staff during the meeting would not be used against the person in subsequent enforcement proceedings by the Commission; however, the Commission and Staff could use statements made during the meeting for other purposes, including:
- (a) as a source of leads to discover additional evidence;
 - (b) for impeachment purposes if the person makes later statements that are inconsistent;
 - (c) in a prosecution for perjury, obstructing justice and/or the giving of contradictory evidence; and
 - (d) sharing the information with another securities, derivatives or financial regulatory authority or self-regulatory body or organization.

Disclosure of Credit Granted for Cooperation

25. For the assistance of persons that may be considering self-reporting and offering to cooperate with Staff, Staff will disclose examples of credit that have been granted for cooperation in actual cases. This enhanced transparency will include:
- (a) ensuring that hearing panels when considering sanctions are informed about the cooperation provided by a respondent and the corresponding credit recommended by Staff;
 - (b) ensuring that settlement agreements and/or related news releases include particulars as to any credit that may have been granted for cooperation provided by the respondent; and
 - (c) periodically reporting, on a generic basis, describing circumstances in which Staff has determined not to initiate an enforcement action against persons.