A Call for Sentencing Enforcement Reform in Ontario Securities Regulation:
Restorative Justice, Pyramids and Ladders.

by

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ABSTRACT

A Call for Sentencing Enforcement Reform in Ontario Securities Regulation: Restorative Justice, Pyramids and Ladders.

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This paper is intended, first, to look at the deterrence versus compliance debate, and the various punishment principles that exist in securities regulation. Secondly, a brief overview of the experiences and complexities of securities regulation and sanctioning in Ontario and Canada will be presented. Third, I introduce and apply the “Responsive Regulation” model and the “enforcement pyramid” as posited by Ian Ayres and John Braithwaite to securities enforcement. I advocate for adoption of a three stage enforcement reform process that incorporates restorative justice through an enforcement pyramid and an “enforcement priority ladder”. The expert reports and statistics are used to develop the argument that the OSC is hindered in its enforcement mandate, ultimately, from a lack of sound enforcement guidelines. The end goal is to provide useful recommendations to the OSC and other Canadian securities regulators in achieving a more self-sustaining and investor focused securities regulatory environment.
ACKNOWLEDGMENTS

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<tr>
<td>ASIC</td>
<td>Australian Securities &amp; Investments Commission</td>
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<td>CSA</td>
<td>Canadian Securities Administrators</td>
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<td>FSA</td>
<td>Financial Services Authority</td>
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<td>IIROC</td>
<td>Investment Industry Regulatory Organization of Canada</td>
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<td>IMET</td>
<td>Integrated Market Enforcement Team</td>
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<td>LCO</td>
<td>Law Commission of Ontario</td>
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<td>LRCC</td>
<td>Law Reform Commission of Canada</td>
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<td>MFDA</td>
<td>Mutual Fund Dealer’s Association</td>
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<td>MOU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>OSA</td>
<td>Ontario Securities Act</td>
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<td>OSC</td>
<td>Ontario Securities Commission</td>
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<tr>
<td>RCMP</td>
<td>Royal Canadian Mounted Police</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<tr>
<td>SCC</td>
<td>Supreme Court of Canada</td>
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<td>SRO</td>
<td>Self-Regulatory Organizations</td>
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I. INTRODUCTION

...while the state of sentencing for regulatory offences in Canada may not be in "chaos", it certainly appears that there is in the courts a lack of uniformity, and marked inconsistency, in applying sentencing purposes and principles to such offences. Indeed, how could it be otherwise, one might wonder, given the absence of any legislative rationale or guiding principle in sentencing provisions for most regulatory offences.1 – Justice Rick Libman

Justice Rick Libman wrote an exhaustive analysis of “Sentencing Purposes and Principles for Provincial Offences” for the LCO. He equates the current lack of uniformity and marked inconsistency in applying provincial sentencing purposes and principles to the criminal courts prior to the 1996 amendments to the Criminal Code. Post 1996, a statement of sentencing purposes and principles was enacted for the first time within section 718 of the Criminal Code. Justice Libman concludes that the law of provincial sentencing is in need of reform. As part of the federal initiative to deter serious capital market fraud, Parliament amended the Criminal Code to increase maximum sentences for relevant offences.2 In addition, it added sentencing instructions with respect to those offences. Rather than simply relying on the usual standard, that a sentence should be appropriate to the offence and the offender, Parliament has specified the factors to be considered: the aggravating circumstances that must be taken into account,3 and the non-mitigating factors which must not be considered.4 It would seem that the courts are provided with ample guidance when it comes to capital markets sentencing. Penalties for offences under the Ontario Securities Act, have also been substantially increased, but with no equal consideration as to sentencing guidelines. Not only the courts, but regulators are also lacking the uniformity and consistency in applying sentencing and principles. The Ontario Securities Act does not contain a statement of the purpose or principles of sentencing. The courts have had to fill in

2 Maximum prison terms for existing offences of fraud and fraud affecting the public market were increased from 10 to 14 years. The maximum prison term for fraudulent manipulation of stock exchange transactions was increased from 5 to 10 years. The maximum prison term for the new offence of insider trading was set at 10 years. Criminal Code of Canada, ss. 380(1) & (2), 382, 382.1
3 Criminal Code of Canada, s.380.1. (1)
4 Criminal Code of Canada, s.380.1. (2)
the gap through case law. This approach has been criticized since the judiciary makes policy decisions on securities sentencing, arguably a task that is better suited for legislature and securities regulators. The issue then remains, what is stopping the implementation of sentencing guidelines? The answer is unclear, perhaps it is the result of a lack of political will, or perhaps securities regulators and the courts do not feel the need for additional policy guidelines to fetter their discretion. Regardless of the reason, the benefits of a sentencing guideline remain clear. A public enforcement sentencing policy ensures transparency, fairness, proportionality, and accountability in the penalization of securities regulatory non-compliance.

The recommendations proposed in this paper are driven by the commitment to the following three goals:

(i) A uniform sentencing guideline for the enforcement of securities laws should be specified within the Ontario Securities Act.

(ii) The role of the OSC needs to evolve from deterrence-based enforcement efforts to one that equally embraces strategies for developing “compliance cultures” within market participants in order to be more effective, such as restorative justice sanctions.

(iii) A uniform sentencing guideline and a balanced deterrence-compliance enforcement regime should be adopted and harmonized across Canada and with securities regulators around the world.

The current securities enforcement regime is not in a state of failure by any means. However, it is argued that the lack of a sentencing guideline and the reliance on deterrence-
based enforcement efforts will not be conducive to achieving a self-sustaining regulatory environment. The current preoccupation with harsher deterrent measures merely reinforces the adversarial nature of securities regulation, engaging in an “us versus them” mentality. A more effective and self-sustaining enforcement regime should focus on “softer” measures such as denunciation and restorative justice strategies at the first instance of violation. These strategies encompass the principles of reparation, rehabilitation, restitution and compensation, which appeals to reputation, public education initiatives, and a firm’s internal environment. These soft threats are arguably more effective in coaxing compliance as opposed to hardline deterrence and incapacitation sanctions, such as a cease trade or a resignation order. However, both methods are needed in order to facilitate an effective sentencing framework. For too long, Canadian securities regulators have been guided solely by punishment objectives premised behind a classical criminological deterrence model. There has been a disproportionate disregard for the role of the capital market victim. This is in line with a general shift in criminological thinking within criminal law, which evolved from the reform and rehabilitative ideals of positivist criminology in the 1950s and 1960s to a renewal and prominence of the classical school of thought in the mid-1970s, which focuses on deterrence and incapacitation. Our regulatory environment has somehow adopted the classical criminological deterrence thinking from the criminal law sphere, despite criminal and regulatory law having significantly opposing objectives. An emphasis on the principles of denunciation, rehabilitation, and reparation needs to take place if we are to make any headway in the protection of investors, instilling confidence in the credibility of securities regulators, and achieving a self-sustaining regulatory environment. The beginnings of this topic revolve around whether a deterrence or compliance approach would serve capital markets best. This ongoing debate between punishment and persuasion will continue until it can be shown that either a rule enforcement approach or a communitarian style of self-regulation better promotes compliance. The effects of deterrence and compliance approaches within securities regulation is unclear, with mixed
results depending upon the type of statistics one looks at - if there are any at all, as this area of research is plagued by a lack of clear, accessible and transparent statistical enforcement data. In light of this, it is premised that an approach that combines the two in an optimal manner would exceed any benefits gained by each on its own.

With the end goal of attaining a self-sustaining, cooperative regulatory environment in mind, this paper calls for an evaluation of the current model of securities enforcement in light of a “responsive regulation” lens as proposed by Ian Ayres and John Braithwaite⁵. This paper puts forward the recommendation that the OSC consider the adoption of a three stage enforcement reform process that will contribute towards achieving the three overarching goals as presented above:

(i) Stage one, the adoption of an “enforcement pyramid” that prioritizes “soft law” sanctions, which emphasizes compliance before deterrence. This enforcement pyramid will provide a concrete escalation guide for securities regulators.

(ii) Stage two, the incorporation of a restorative justice mandate as championed by John Braithwaite. This is to ensure that the harm done by offenders is properly resolved with input from all stakeholders involved. This restorative justice mandate will also contribute dramatically towards improving a compliance culture within firms.

(iii) Stage three, the implementation of an “enforcement priority ladder” as a subset of the “enforcement pyramid”, which contributes towards the reinforcement of restorative justice principles at vital stages of the enforcement pyramid.

The structure of this paper will be as follows. First, we will delve into the theoretical context of the deterrence versus compliance debate within securities enforcement to understand the interplay between *ex post* deterrence and *ex ante* compliance, and gain an understanding of the five punishment principles as it relates to securities enforcement. Secondly, a brief history of securities regulation and enforcement in Canada will be provided, along with a look at the current state of enforcement in Ontario and Canada in order to set the tone for the paper. Thirdly, the "responsive regulation" theoretical framework will be presented, and we will discuss the main assumptions of this paradigm, the enforcement pyramid and my contribution of the enforcement priority ladder. Lastly, we will take a snapshot look at securities enforcement at home and abroad, through the enforcement data of the OSC and the FSA. The relevance of the enforcement data within the proposed enforcement pyramid will then be explained.

II. PHILOSOPHIES OF PUNISHMENT AND SENTENCING

As this paper is proposing reforms to the enforcement regime, our analysis will benefit from a basic understanding of sentencing principles and their relevance to securities regulation. In addition, an understanding of the traditional debate between adopting a regulatory system of deterrence or compliance is directly relevant to whether we continue on the current path of deterrence-based sanctions or not.

**Deterrence versus Compliance: To Punish or to Protect?**

There exist a long history of dispute between regulation scholars and regulatory agencies regarding whether the proper role of a regulator should be a “hardline” deterrence approach, accompanied by tougher sentences and higher fines, or a moderate compliance approach, utilizing persuasion techniques to coax business compliance. Traditional
“rationalist” models focused on deterrence and enforcement as a means to prevent and punish non-compliance by changing the actor’s calculation of benefits and costs. Proponents of the deterrence regime argue that it will succeed because individuals or firms are rational profit-maximizers, and “violations will occur when the perceived benefits of noncompliance exceed the anticipated cost of sanctions.”6 “Normative” models focus on cooperation and compliance assistance as a means to prevent non-compliance. Proponents of the compliance regime premise their argument on individuals or firms being generally law-abiding and prepared to follow the compliance route, which is that “legitimate regulation…ought to be followed.”7

The rationalist theories follow the logic of consequences, assuming that regulated firms are rational actors that act to maximize their economic self-interest. Consequently, these theories emphasize enforcement and deterrence to change a firm’s calculations of costs and benefits. The influential work of Gary Becker on domestic compliance and enforcement theory addressed the enforcement of criminal law. His basic understanding was that potential offenders respond to both the probability of detection and severity of punishment if detected and convicted. Thus, deterrence may be enhanced either by raising the penalty, by increasing monitoring activities to raise the likelihood that the offender will be caught, or by changing legal rules to increase the probability of conviction.8 Deterrence theory extends the Becker model to corporate non-compliance and maintains that there must be a credible likelihood of detecting violations; swift, certain, and appropriate sanctions upon detection; and a perception among the regulated firms that these detection and sanction elements are present.9 In the corporate context, the view of costs would incorporate more than monetary

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7 Ibid, at 455.
costs, including sanctions directed at moral stigma and loss in reputation. Behavioural decision theory incorporates a deeper angle to rationalist theories by acknowledging the role that people’s cognitive biases can play in their rational calculations. It also highlights the importance of factors such as how a particular choice is framed or how probabilities of detection, prosecution, and punishment are presented.10

The normative theories of domestic compliance follow the logic of appropriateness, viewing regulated entities as good-faith actors that want to obey the law but cannot. These theories suggest that compliance occurs, or does not occur, largely because of the regulated entities’ “capacity” - knowledge of the rules, and financial and technological ability to comply - and “commitment” - determined by norms, perceptions of the regulators, and incentives for compliance.11 Accordingly, these theories call for a more cooperative approach to ensuring compliance, with the full range of compliance assistance strategies such as dissemination of information, technological assistance, and inspections designed to enable inspectors to provide compliance advice.12 The complexity critique, although more about bureaucratic and administrative limitations than about norms, focuses on the “capacity” of the regulated firm, charging that environmental regulations are “(1) too numerous, (2) too difficult to understand, (3) too fluid, or ever-changing, and (4) too hard to find.”13 Proponents of this critique allege that firms do not know what constitutes perfect compliance and so cannot achieve it. This is particularly relevant for small businesses, which generally lack the resources to stay apprised of complicated, changing regulatory requirements. The role of a regulated firm’s “commitment” is illustrated when considering a firm’s perceptions of the

12 Supra, note 26 at 10245-46.
legitimacy of the regulatory authorities, which is influenced by how fairly the regulations are created, implemented, and enforced.\textsuperscript{14} With securities regulation in Ontario, there are arguments that attack the legitimacy of the OSC because of their wide and discretionary public-interest power.\textsuperscript{15}

There has been a collection of recent socio-legal research that suggests that deterrence-based enforcement strategies are ineffective as a motivator of individuals and firms. Experience in the non-securities regulatory context showed that the dissemination of information among industry participants about “signal cases,” which deterrence-based sanctions were applied, was not sufficiently widespread to be the source of compliance with law.\textsuperscript{16} Thornton, Gunningham and Kagan discovered that more important than either specific or general deterrence is what they term “‘implicit general deterrence’ where the outcome of sustained inspection and enforcement activity is to inculcate a ‘culture of compliance’ in which it was the regulations themselves rather than enforcement action that had a direct impact on compliance behaviour.”\textsuperscript{17} The study showed that “company managers were not closely attentive to or knowledgeable about the penalties assessed against violators, generally underestimating them.”\textsuperscript{18} Taken at face value, it would suggest that the establishment of proactive standards, rather than reactive enforcement, is more important in influencing regulatory compliance. Of course, the relationship between business behaviour to regulatory enforcement and sentencing is complex, with evidence supporting both sides. However, as this paper firmly believes, deterrence on its own as a

\footnotesize{\textsuperscript{14} Supra, note 21 at 468-469.  
18 Ibid, at 282.}
philosophy of either criminal or regulatory sanctioning has limited success as a motivator of “good” behaviour among members of an industry or business sector. Malloy states that a major reason for this is because insufficient attention is directed towards how a “firm’s internal environment can affect managers’ decisions about compliance.” Malloy argues that the immediate firm environment in which employees operate is more consequential for the issue of compliance or noncompliance than external regulatory influences. If the organizational incentives surrounding employee behaviour emphasize individual competitiveness or the suppression of negative information, it will be difficult for legal sanctions to be an effective counterweight. Applied in a securities setting, if an environment where managerial compensation is tied to the price of the issuer’s shares or where a high share price is essential to influence a firm’s future business activities, it will make legal sanctions less effective. Both rationalist and normative models provide useful insights into behaviour that leads to compliance. Contrary to conventional understanding, these models are not mutually exclusive, but rather are different lenses for viewing and understanding influences on compliance behaviour. Both are constantly engaged in regulatory enforcement and compliance decisions.

To look more closely at this debate, the balance falls between whether priority should be given to *ex ante* or *ex post* systems. Regulatory officials have a choice between imposing prior restraint by way of a licensing regime (*ex ante*), or using an offence regime to redress harm that occurs after the fact (*ex post*). Regulatory offences tend to follow a basic *ex post* model, wherein a regulation or statute set the standard, and if one breaches that standard, they will be prosecuted after the fact. The *ex ante* system tries to prevent harm from occurring in the first place by regulatory supervision and control through prior approval, inspections, and proactive evaluation. Advantages of an *ex ante* system is that guidelines

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19 *Supra*, note 21 at 457.
20 *Supra*, note 21 at 456.
may be developed, which will promote equality of treatment and serve to educate the public and the regulated in advance. In addition, an administrative tribunal will develop a set of decisions that will set a type of precedence and will be available to the public for guidance. Disadvantages of an *ex ante* system will arise where economic markets are concerned, because it is very hard, if not impossible, to predict market outcomes before the fact. An *ex ante* system increases the risk of discouraging legitimate competition, as prior approval may lag behind technological progress of capital markets and generally slow down the fast paced nature of the buying/selling of securities. Subsequently, an *ex post* model is more efficient in that it is only required to investigate firms that result in complaints and the laying of charges. An *ex ante* system arguably requires an active and large commitment of resources. It is unknown which system should be in place in respect to securities regulation. Ayre and Braithwaite argue that the balance between *ex ante* and *ex post* systems should adhere to two overarching principles. Firstly, governments and regulators ought to focus on prevention of harm and the serving of human needs in the order of their priority. Secondly, the regulatory state should offer multiple models that reflect the different needs and interests at stake within both the *ex ante* and *ex post* world.

Malcolm Sparrow argues that regulators should focus on fixing big problems that cause the most harm by developing strategies that operate at the operational risk level. Sparrow identifies five properties of harm that are common to many disciplines: invisible harm, harms involving conscious opponents, catastrophic harm, harms in equilibrium, and performance-enhancing risks. Invisible harm may be invisible in design, like white-collar crimes, or may be due to a lack of reporting will or mechanisms. For industries where there are reporting problems, an *ex post* system based on complaints may not be completely

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22 Ibid, 1:60.
23 Ibid.
appropriate, *ex ante* regulation seems more relevant. Conscious opponents refer to harms that are perpetrated by those with clear intentions, such as securities fraudsters. As it is difficult to predict the intentional conduct of opponents, an *ex ante* system may fail to capture those intent on defeating it. Methods of fighting this type of harm are traditionally found in the *ex post* criminal justice system in the use of surveillance, informants, and confessions. Catastrophic harms are rare events with very serious consequences. With capital markets, this would most likely point to systemic risks dealing with financial crises and recessions, such as the recent asset-backed commercial paper fiasco. Given the magnitude of the harm, an *ex ante* system will generally be preferred. Harms in equilibrium correlate to the imbalance that may be created in a competitive industry from varying levels of compliance. Within the securities field, a company that desires to be compliant will be put at a disadvantage from a cost perspective relative to its peers who are non-compliant. Enforcement of securities laws in this regard levels the playing field and makes good business sense. Vigorous *ex post* enforcement of both *ex ante* and *ex post* rules will achieve this. Lastly, performance-enhancing risks relate to the organization’s performance goals. The reduction of performance-enhancing risks correlates directly to compensation. Compensation should be related to levels of compliance in addition to levels of economic gain. However this has not been the reality in capital markets. The idea that corporate compliance will be implemented in an environment that promotes it, through compensation and attitude change, has been tested in the insurance market with relative success. Managing this harm is *ex post* in nature. The main harms that securities regulation currently focuses on are with harms in equilibrium, invisible harms, and conscious opponents. For the purposes of this paper, our preoccupation is with harms in equilibrium, and the vigorous *ex post* enforcement of both *ex ante* and *ex post* rules. Our challenge is to determine the most efficient and effective method of approaching this *ex post* enforcement so that the securities regulatory regime moves towards a self-sustaining regulatory environment. This
discussion of harms will come into play when we discuss the basic tenants of restorative justice.

A further issue with regulatory sanctioning is to decide what the regulator’s true role should be in practice when it comes to sentencing. For securities regulators, their sanctioning powers derive from the understanding that they are vital for it to fulfill its overall statutory mandate. Specifically, this means that the exercise of sanctioning powers is legitimate as long as they contribute to the goal of protecting investors and capital markets from the harm caused by a variety of “unfair, improper or fraudulent practices.”

This distinction between punishment and protection falls under grey area, and is illustrated in the nature of sanctions available to the OSC under section 127 of the OSA. An example is with administrative penalties, they can serve to deter for the sake of protecting the markets from future infractions, but also as a punitive measure for the individual. This state of confusion is further exacerbated by the OSC’s heavy reliance on deterrence as the guiding principle for making public interest-based orders. The SCC in Cartaway accepted the idea that deterrence can be both the basis for severe punishment by courts and a method for regulators to protect the capital markets. Justice Lebel further illustrates this point when he said “it is reasonable to view general deterrence as an appropriate, and perhaps necessary, consideration in making orders that are both protective and preventative.” This seems to dilute the distinction between the role of courts and regulators in sanctioning market participants, effectively giving regulators the power to sanction in a penal and protective nature. An easy way to realign this convergence could be to rethink our commitment to deterrence in section 127 towards improving compliance cultures and outcomes. This trend would indicate that the OSC has been underusing certain administrative orders under their

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24 Supra, note 6, s 1.1.
26 Ibid, para 60.
public interest power. Currently, the OSC has been utilizing registration suspensions, cease trades, monetary administrative penalties, and orders for disgorgement. However, powers such as the requirement for market participants to submit to a review of practices or procedures and to institute appropriate change, and the imposition of terms and conditions on existing registrations or recognitions has rarely been used. Regulators should be affording “soft law” strategies more attention than “hard law”. Note that “hard law” and “soft law” should be seen as existing on a continuum, rather than in pure form. Whereas many definitions of soft law exist, for comparative purposes, Kirkton and Trebilcock provide the defining features as follows: first, in a soft law regime the formal, legal regulatory authority of government is not relied on; second, there is voluntary participation in the construction, operation, and continuation in the regime of a particular party; third, there is a strong reliance on consensus-based decision making for action and institutional legitimacy; and, fourth, there is an absence of the authoritative, material, sanctioning by the State. Soft law is gaining increasing attention for securities enforcement in a globalized world. However, one could generally say that soft law has not been the model for securities enforcement in North America, especially after the financial crisis of 2008.

This paper contends that a synthesis of the two theories of deterrence “rational model” and compliance “normative model” presents a more realistic picture of enforcement and compliance as it actually occurs. A proper balance of the two models is a compliance enforcement system that actively encourages the norms and incentives that lead to voluntary compliance, while maintaining the bedrock foundation of enforcement and deterrence to alter the calculations of those less inclined to voluntarily comply. Essentially

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27 Supra note 6, s 127 (1)(4).
28 Supra, note 6, s. 127 (1)(1).
the end goal is to have “voluntary co-operation in a coercive system."\textsuperscript{30} The enforcement pyramid and enforcement priority ladder as proposed in chapter four recognize this balance, along with the need for vigorous \textit{ex post} enforcement of both \textit{ex ante} and \textit{ex post} rules only after compliance efforts have failed. The punishment or protection discussion has affirmed the need to emphasize our initial enforcement efforts on improving compliance cultures and outcomes through “soft law” in order for the securities regime to become a self-sustaining regulatory environment. The role of regulation should be to foster a compliance culture that is clear-sighed about the tendencies of internal incentives to undermine legal rules, and to design enforcement regimes that are much more particular in their attempts to educate and shape organizational behaviour. This brings us back to our discussion on compliance and deterrence. As \textit{ex post} enforcement revolves around punishment, an understanding of each punishment principle will assist us in this regard.

\textbf{Punishment and Sentencing Principles}

There are generally six principles that are understood to guide a court, judge and regulatory authority in punishment and sentencing, and they are: deterrence, incapacitation, denunciation, rehabilitation, reparation and retribution. Although distinct in their own ways, there is always considerable overlap between these principles. Punishment has traditionally been the mandate of the courts, whereas for regulators it is merely ancillary to their compliance mandate. As our previous discussion had pointed out, a securities regulator’s punishment sanctioning powers are legitimate as long as they contribute to the goal of protecting investors and capital markets. With this said, it is not uncommon for certain regulatory sanctions to exhibit multiple punishment objectives. For example, a public notice or warning could serve as a form of deterrence and denunciation. A temporary cease trade order could be seen as incapacitation and deterrence. Each principle should be seen as

\textsuperscript{30} HLA Hart, The Concept of Law, 2\textsuperscript{nd} ed (Oxford, Oxford University Press, 1994) at 198.
complementary to each other; one principle should not necessarily dominate. In our discussion of the various punishment and sentencing principles, we will not be dealing with retribution. Retribution holds that punishment is justified by the moral requirement that the guilty make amends for the harm they have caused to society. It is not directly relevant to securities regulation as it is mainly premised on moral justifications. It seems more relevant to criminal law where courts often engage in safeguarding the moral conscience of society. However, retribution is not completely overlooked in our analysis. It is included through its manifestation in the proportionality principle, the most vital sentencing guideline for courts and judges. The principle maintains that the severity of a punishment should be proportionate to the gravity of the offense. The remaining five principles remain the most relevant in our development of a sentencing guideline for securities regulation.

The Importance of Restorative Justice

As one of the proposals is the adoption of “restorative justice” within the enforcement regime, the reader should note that restorative justice merely represents a label for an alternate paradigm that is a collection of alternatives to the punitive model. Restorative justice in this sense is an amalgamation of the rehabilitation and reparation principles. Restorative justice is a philosophy that views harm and crime as violations of people and relationships. It is a holistic process that addresses the repercussions and obligations created by harm with a view to putting things right. When compared with current models of punishment, restorative justice requires a paradigm shift in thinking about reactions to harm. Restorative justice is different from retributive justice. It is justice that puts a focus on the future, not into what is past. It focuses on what needs to be restored or repaid and what needs to be learned and strengthened in order for the harm to not re-occur. The concept

of restorative justice has been commonly utilized with adult and youth offenders, in communities, schools, and prisons. Restorative justice can easily be implemented in a regulatory non-compliance setting, both formally and informally. As we have established, the basic principles of restorative justice are focused around harm and relationships. A common definition of restorative justice is that it is “a process whereby those most directly affected by a wrongdoing come together to determine what needs to be done to repair the harm and prevent a reoccurrence.”\(^{32}\) As was discussed previously, Malcolm Sparrow identified five properties of harm that are common to many disciplines: invisible harm, harms involving conscious opponents, catastrophic harm, harms in equilibrium, and performance-enhancing risks. We derived that the three harms most relevant to securities regulation are: harms in equilibrium, invisible harms, and conscious opponents. When relating this finding to the definition of restorative justice, we find that there needs to be a consensus between all those most directly affected by the wrongdoing to deal with these three harms.

Certain central values of restorative justice are important to keep in mind when deciding on whether restorative justice is applicable in a certain circumstance, or whether it is even possible. These values are:\(^{33}\) (1) Healing rather than hurting - Restorative justice focuses on providing ways to remedy the harm caused to the victim rather than focusing on punishing the offender. (2) Offenders taking responsibility - Exposing the offender to the consequences of their behaviour is vital for the offender to gain an understanding of the impact of their actions. Bridging that gap between actions and consequences makes it easier for the offender to develop empathy for the victim and increases the willingness to


It is important to note that pleading guilty in the criminal justice system may not mean that the offender has accepted responsibility or will change their method of operation. (3) Victims’ Restoration – Restorative justice allows for all the injuries and damage a victim suffers to be acknowledged and addressed. Victims are empowered by the process as they get to speak for themselves on how they have been harmed and how they can be remedied. In cases where the victims of a securities offence are unclear, the securities regulator can step in in lieu of the actual victims as per their mandate. (4) Community Participation – Restorative justice emphasizes the role of the community and of social networks as part of delivering justice. A company that places heavy reliance on their reputation may feel a greater responsibility for its actions, and being accepted by the business and wider community may be a desirable outcome. This provides a chance for the community to take strength out of dealing with the offence where otherwise it might be weakened by fear and mistrust and be excluded from the process. This also ensures that companies become aware that they are not operating in a vacuum and have some responsibility towards the community of which they are a part.

Considerable empirical evidence around restorative justice within the regulatory context has led to three general findings: (1) restorative justice restores and satisfies victims better than existing criminal justice practices, (2) restorative justice restores and satisfies offenders better than existing criminal justice practices, and (3) restorative justice restores and satisfies communities better than existing criminal justice practices. A restorative justice approach views sentencing as partially performing an educational function that prevent future problems. Hope Babcock argues that any sanction that is imposed must have some

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35 Supra, note 49 at 45.
The concept of restorative justice is most prevalent within environmental regulatory enforcement. Restorative justice underlies the recent case of *Conservation Halton v Salgter Construction*, where the prosecution opted to seek restorative work rather than a fine. The defendant corporation was ordered to remove the development – which was large amounts of fill pushed into an environmentally sensitive valley – in order to bring the property back to its original state. The benefits of restorative justice for securities regulation can be summed up in three points. Firstly, restorative justice will produce better outcomes. For both victims and offenders, advocates of the restorative justice approach suggest that it achieves good outcomes in the longer term. Victims have greater satisfaction through the restorative justice process, and many studies suggest that the re-offending rate of offenders is lower if they have undergone a restorative process. In the field of regulatory non-compliance, firms may not have the same awareness of the harm caused by their failure to comply when working within the traditional criminal justice system, as the criminal justice system keeps the parties apart and is more adversarial in its style. Secondly, a restorative justice process is a flexible response. As there is no standard template of what “restoration” is, restorative justice is a dynamic process that reflects the needs and capabilities of the stakeholders involved. Thirdly, restorative justice is focused on restoring the harm. The traditional criminal justice system and the system adopted by securities regulators are more concerned with fault and punishment. In contrast, restorative justice is focused on the harm caused and on what can be done to make things right. Lastly, the practice of executives being forced to acknowledge responsibility for serious consequences seems to be a potent driver of culture change in organisations. This is

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37 [unreported, November 16, 2009, Ont. C.J., Burlington, Ontario].
39 *Supra*, note 53.
especially important in the area of regulatory non-compliance where changing corporate behaviour can deliver better outcomes and improved compliance.

The adoption of restorative justice sanctions is not without concerns. The obvious criticism is that it remains a “soft option” and an inappropriate response to criminal actions. Proponents of this argument point to the need for deterrence and accountability. We address this criticism through the proposed enforcement pyramid and the division between deterrence and compliance. A further criticism is that it leads to “softer” sentencing decisions and therefore can be a gateway to lesser penalties or sentences. These concerns are addressed by the offenders’ accountability to the community as well as the victim. Where the court or regulator defers sentencing for a restorative justice process to take place, it will receive a report on the outcome of the process. However, if the offender fails to cooperate they can be brought back before the court or regulator and their failure to comply may be taken into account in the final sentence.

Returning back to the punishment principles, it is contended that the five principles can be structured to provide a spectrum of response escalation that can guide securities regulators in dealing with sanctions.

**Deterrence**

Deterrence is one of the main objectives of punishment and sentencing, and is premised on a rational thought process and promoted by regulation scholars. Because it is built on a rational ability to calculate, deterrence seems to be at odds with blue-collar crime, but well suited towards white-collar or regulatory crime. The basic theory is that by making the costs of offences more onerous than the derived benefits, individuals will be deterred from committing crimes. This dichotomy between deterrence and compliance has generally been
considered by securities regulators as a thing of the past. To truly understand the Ayre and Braithwaite’s responsive regulation approach, we need to take a more detailed look at deterrence and its application to securities regulation.

Securities regulators have increasingly been pursuing deterrence measures through the use of sanctions such as fines and licence suspensions. Fines remain the predominant deterrence tool for securities regulators. The case that is the foundation of regulatory sentencing is the decision by the Ontario Court of Appeal in *R v Cotton Felts Ltd.* The court underlined the central focus behind fines as deterrence, namely that the fine must be substantial enough to warn others that the offence will not be tolerated. In addition, the fine must not appear to be a “mere license fee” for illegal activity. Fines may be more likely to become licence fees in cases where the violation has not resulted in any actual harm. A court may be tempted to hand out a lower fine on the basis that no actual harm resulted. This would be a mistake. The regulatory process is designed to prevent the harms as discussed above. A circumvention of the process ought to be punished accordingly. This principle was recognized in *R v Abbott,* where the court rejected the suggestion that the fine should only be twice the licensing fee. The court recognizes that sufficient deterrence is required to force persons to adhere to the permit system with all of its review, which the accused had circumvented. The problem of a fine being viewed by industry as a licence fee underlines the normative difficulty that society has with treatment of regulatory law as a business proposition. Deterrence in the corporate regulatory sector has been developed in general cases to encompass factors such as the relative size and sophistication of the particular accused corporation. In *R v Safety-Kleen Ltd.*, the defendant described itself as the largest waste management company in the world with annual sales of $1 billion.

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41 (2005) 18 CELR (3d) 133.
resulting in the court stating that “the size of the company and its operation indicates consideration of a substantial fine to motivate it to increase its efforts to ensure compliance with the legislation.” With regard to whether a fine should always correlate with a corporation’s size, a more precise analysis may be found in targeting the profit generated to the company from the particular violation. In circumstances where the harm had not generated any profit, the targeting of expenses or opportunity costs of spending resources to solve the problem seem more relevant.

There are two forms of deterrence geared towards corporate offenders: specific and general deterrence. Specific deterrence is based on the assumption that the punishment will deter the particular offender from repeating the same kind of offence in the future. All specific deterrence examples in the regulatory setting assume that the offender engages in a rational cost-benefit analysis prior to a violation of securities law. In most cases, the mere fact of detection and apprehension followed by a public appearance in court may achieve deterrence of specific individuals. This seems to lend support for an increased use of compliance techniques. General deterrence is based on the theory that the legal sanction imposed on offenders will discourage other potential offenders in the community. This theory requires an effective communication of the penalty imposed, which is commonly achieved by regulators and courts alike through news releases and public notices. It can generally be observed that news of regulatory misfeasance will spread quicker in regulated industries than it will in the general public. Different types of offenders and offences will vary in the extent to which they are responsive to general deterrence. General deterrence should be reserved for those offences that are likely to be affected by a general deterrence effect,
such as with large scale commercial fraud and the imposition of a longer imprisonment term\textsuperscript{43}.

In regards to regulatory violations by corporations, it is often argued that they should be treated separately from the principles governing individual offenders. Corporations can be seen as rational actors engaging in the pursuit of increasing profit. John Scholz, one of the leading political scientists addressing regulatory enforcement, set out the rational factors in regulatory/corporate environments as four assumptions: (1) Corporations are fully-informed utility maximizers; (2) Legal statutes unambiguously define misbehaviour; (3) Legal enforcement provides the primary incentive for corporate compliance; (4) Enforcement agencies optimally detect and punish misbehaviour, given available resources\textsuperscript{44}. Professor Poonam Puri of Osgoode Hall Law School argues that a cost-benefit model is well suited to corporate crimes\textsuperscript{45}. Large corporations have regulatory and compliance departments that keep the company appraised to the relevant laws, and duly recommend adjustments to corporate activity. Once again, assuming that the profit motive is the primary motivator for corporations, which would imply that they respond to economic incentives, fines should be the main tool in sentencing corporations. To deter corporations effectively, a fine should be set at a minimum level wherein it is equal to the expected profit or loss resulting from the misconduct. In essence, the expected cost should be equal to or exceed the expected benefit. However, the reality is that a fine set exactly equal or even above the corporate profit does not actually deter the parties concerned unless there is certainty of getting caught in every incident of non-compliance. To compensate for this, a fine must be factored accordingly. Although the corporations would respond to economic incentives, it is argued that post Enron and the current financial crisis, reputation is an equally important motivator.

\textsuperscript{43} R v Drabinsky [2009] OJ No 1227.
\textsuperscript{45} Ibid, 5:50:10.
The most effective deterrent against corporations would therefore mirror that of individual corporate offenders; a mixture of fines and reputation threats can yield better results.

**Incapacitation**

Incapacitation is considered a subset of deterrence. At the stage of sentencing, it must be assumed that cooperative approaches outside of the legal system have previously failed. Incapacitation refers to the effect of a sentence in terms of positively preventing an offender from future offending; it does not aim to rehabilitate the offender. Regulatory incapacitation would mean two things: imprisonment and licence revocation for individual offenders, and license revocation for corporations. With regulatory offences, jail is used sparingly. With regulatory crimes, a prison sentence may be too severe, and reinforce anti-social peer group pressure. The Canadian Centre for Justice Statistics, as cited by the Ontario Court of Appeal in *R v Wismayer*\(^{46}\) concludes that in some cases, prison is counterproductive by actually increasing recidivism. There is a possibility of “reactance” with white-collar criminals, which is the psychological reaction against coercion, and the subsequent refusal to alter behaviour. Having said this, the use of prison in a regulatory context is not completely comparable to the experience in other areas like traditional criminal law and it would benefit from further empirical analysis. In 1976, the LRCC recommended the elimination of jail as a sanction for regulatory offences, citing that in the absence of moral condemnation and stigmatization there is no place for imprisonment\(^{47}\). It continues to state that prison must be restricted to real criminal law and only used where necessary, such as where offenders are “too dangerous to leave at large, too wilful to submit to other sanctions, or too wrongful to be adequately condemned by non-custodial sentences. In other cases

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\(^{46}\) (1997) 33 OR (3d) 225.

\(^{47}\) *Supra*, note 49 at 12:40.40.
courts should use more positive kinds of penalty.” With respect to actual practice, securities regulators only use jail as a last resort. Harry Glasbeek argues that the treatment of regulatory offences as “not a crime” leads to lax penalties being imposed, partly because the conduct in issue is often part of ordinary business, as opposed to the illegal behaviour of real criminals. In addition, as mens rea is not the focus of regulatory prosecutions, it may serve to demote the use of imprisonment. As a general trend, jail sentences are increasing under securities acts that parallel the Criminal Code. In 2010, the current OSC Chair, Howard Weston, said that he wants the Commission to seek more jail terms for securities offenders where appropriate. As with many others, it is believed that there is scope for imprisonment within securities regulation. However, they must be reserved for the most heinous securities infractions. The problem that many people have with this idea, amongst them the LRCC, is attributable to the lack of moral condemnation and stigmatization of corporate misfeasance. In line with this overarching theme, society needs to be educated about the harms of securities violations and publicly condone such behaviour in order for corporate misfeasance to be seen in a new light. With regard to license revocation, it is also used sparingly by regulators as there are potential issues revolving around a regulator’s heavy-handed intrusion into the markets. However, compared with imprisonment, this option experienced a lot more usage.

**Denunciation**

Denunciation communicates society’s condemnation of a particular offender’s conduct. Denunciation is closely related to the concept of retribution, as recognized by the SCC in *R

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v M (CA). The sentencing principles of denunciation and retribution are not in the forefront of regulatory offences. The reason for this is that often, society is the victim of regulatory offences rather than a specific person. Even where the victim is identifiable, the nature of the offence is usually not one that evokes emotions that dictate condemnation through denunciation. In *R v Virk*, the court supports the proposition that only those regulatory offences that carry a *mens rea* requirement should utilize denunciation as there is a sense of moral blameworthiness involved. However, it is argued that denunciation shall not necessarily be restricted to “true crimes” or those that require proof of *mens rea*. In determining whether there are aggravating factors that warrant a denunciatory penalty, the focus should be on the conduct of the offender rather than on the offence itself. Factors to consider would be deliberate or reckless conduct such as ignoring regulatory officials, repeated failures to act with due diligence, whether compliance with the regulation could have been achieved cheaply or easily, or if the risk of harm was high. Denunciation may also be appropriate for an offence that has resulted in death or widespread and long-term impacts. However, actual harm, while relevant, should not be a prerequisite to the use of the denunciation penalty. Sherie Verhulst argues that denunciation should be used with restraint so there is more room for remedial and rehabilitative sanctions. Widespread use of denunciation would undermine non–adversarial approaches to enforcement. The enforcement pyramid and enforcement priority ladder proposal will utilize denunciation merely as a gateway for more intrusive sanctions.

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51 (1996), 105 CCC (3d) 327 (SCC).
52 [2002] OJ No 4102 (QL) (CJ) [Virk]
53 Virk, note 100 at para 57.
Rehabilitation

Rehabilitation is conceptually linked to specific deterrence; if a specific offender is rehabilitated, he or she is not likely to repeat an offence. The premise behind rehabilitation is that people are not permanently deviant and that it is possible to restore an offender to a useful life. Rather than punishing the offender, rehabilitation seeks to bring them into an attitude which would be beneficial to society through education or therapy. Rehabilitation is rarely seen in regulatory law, and it has fallen out of favour within criminal law due to its perceived failure in altering personality. Rehabilitation of a person or organization is the subject of many debates within criminology. A court may use the rehabilitation principle under the *Provincial Offences Act* to impose creative sentencing options through the mechanism of probation. These orders range from requiring restitution, funds to be made available to local environmental groups,\(^{55}\) publication orders advising of the offence, or even community service where the financial means of the defendant were limited.\(^{56}\) Under securities laws in Canada, there are currently no provisions for rehabilitation, perhaps owing to the traditionally criminal persona of this principle. However, in regulatory offences or corporate crime, the future of rehabilitation seems brighter there. Organizations are capable of implementing value shifts in a systemic manner. Archibald, Jull and Roach proposed the implementation of a court order that State regulatory inspectors are to be placed within a convicted corporation to supervise compliance for a period of time.\(^{57}\) The salary of these government inspectors would be included in the court order. These kinds of proposals are innovative, harness the inherent benefit of rehabilitation, and are arguably more useful than fines as a deterrent. Rehabilitation is the aspect of restorative justice that emphasizes reintegrating the offender back into the community and the promotion of education and awareness.

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57 *Supra*, note 36 at 5:50:40.30 “The Role of an Imbedded Auditor”.

Reparation

Reparation is the idea of putting a victim and the community back in the position prior to the violation. It is a replenishment of a previously inflicted loss by an individual or corporation to the victim. Reparation funds such as the Canadian Investor Protection Fund and the MFDA’s Investor Protection Corporation illustrate this principle in action, albeit outside of the sentencing context. Both funds protect investors’ assets up to coverage limits in the event that financial firms go bankrupt. Reparation impacts both the individual victim and the wider communities affected by refocusing on the restorative. The most common misconception is that reparation is synonymous with financial compensation. Although compensation is indeed a common form of reparation, it is not the only existing form that reparation can take. Reparation may take on a number of forms, including: restitution, compensation, rehabilitation, and satisfaction and guarantees of non-repetition. With regard to restitution and compensation, they are examples of “compensatory community sanctions”. Although they seem the same, there are small nuances between the two. Compensation is monetary payment to redress property loss whereas restitution is financial reimbursement for either property damage or for physical injury. The LRCC commented that restitution “challenges the offender to see the conflict in values between himself, the victim, and society;” in particular, it “invites the offender to see his conduct in terms of the damage it has done to the victim’s rights and expectations.” Currently, securities regulators do not have the power to order restitution or compensation to the victims as this is strictly the realm of the provincial/territorial courts. Securities regulators must refer a case to the courts in order for victims to receive this protection. It is argued that for securities regulators to be fully effective, they need a full range of powers. This includes being able to

59 Ibid, at 353.
61 Supra, note 6, s. 128.
make orders that ensure offenders take responsibility for their actions, while providing an
effective means of redress to victims.

III. SECURITIES REGULATION IN CANADA

The Ontario Experience

The objectives of securities regulation in Ontario are enunciated in the Ontario Securities Act ("OSA"): "To protect investors and foster fair and efficient capital markets." The OSC constantly strives to achieve these two objectives through active compliance and enforcement efforts. From 1998 to 2005, former OSC Chair, David Brown, recognized the failing nature of the Ontario regulator’s enforcement regime and turned his mind to strengthening the regulator’s arsenal of potential sanctions. This was largely achieved through the public interest-based sanctioning power of section 127 of the OSA, quasi-criminal action of section 122 of the OSA, and the possibility of civil remedies under section 128 of the OSA. During this time, the OSC had significantly expanded the role and importance of enforcement through a number of improvements. Through the increase of funding and enforcement personnel, pursuance of complicated enforcement proceedings (ie. Insider trading\(^{63}\), mutual fund trading practices\(^{64}\), inadequate prospectus and secondary market disclosure\(^{65}\)), and the use of alternative sanctions such as the administrative penalty option\(^{66}\). The OSC had also made efforts to systemize and rationalize initial regulatory consideration of which enforcement matters to pursue, through sorting potential offences


\(^{65}\) *Re YBM Magnex International Inc* (2003), 26 OSCB 5285.

\(^{66}\) *Re Cheung* (2005), 28 OSCB 4685.
into various categories. This seemingly “aggressive enforcement policy” was carried on by the succeeding OSC chair, David Wilson, from 2005 to 2010. Through the implementation of its specialized Boiler Room Unit to the increased use of administrative financial penalties, the OSC reinforced their commitment on protection and deterrence. Current OSC chair, Howard Wetson, has pledged to seek harsher sentences - including jail time - for market manipulation and other serious breaches of securities laws. Mr. Wetson says that enforcement tools in the form of immunity agreements, whistle-blower programs and settlement agreements are being considered because they could help secure heavier sanctions for more serious offenders. Mr. Wetson reaffirms the OSC’s continued “aggressive enforcement policy” trend by stating: “Our goal is to bring forward meaningful cases that have a strong deterrent impact in order to protect investors and the markets.”

The National Regulator Dilemma

The current securities regulatory structure in Canada is fragmented, spanning thirteen provincial and territorial securities regulators accompanied by numerous SROs. Our enforcement system is equally disjointed, with thirteen enforcement departments of each commission, the IMETs of the RCMP along with other police forces, the enforcement department of various SROs, federal and provincial judges and prosecutors. Among the criticisms lodged against our enforcement regime, a key complaint is the complexity and inefficient allocation of resources that our duplicative and fragmented enforcement system causes. In addition, there are concerns regarding the effectiveness of the current system in place. Canada’s capital market is too small to be governed in such a fragmented system.

70 Ibid.
There are diverse discrepancies in enforcement experience and capability from one province to another. Some provinces lack the expertise and resources to commence investigations and prosecutions of complex securities cases. In major provincial capital markets such as in Ontario, British Columbia, Alberta and Quebec, there is a continuing “need for more specialization at every stage of the enforcement process to combat the increasing complexity of securities violations”. One dilemma is that securities regulators are severely limited in their enforcement powers, according to the way securities regulation is governed in Canada. The *Constitution Act, 1867* and the *Canadian Charter of Rights and Freedoms* effectively complicate the realm of securities regulation and who can enforce which aspect.

The long power struggle between the federal and provincial governments for the regulation of securities rests on the interpretation of section 91(2) “trade and commerce” of the *Constitution Act, 1867*. On December 22, 2011, the SCC released its advisory opinion and held that: “The *Securities Act* as presently drafted is not valid under the general branch of the federal power to regulate trade and commerce under section 91(2) of the *Constitution Act, 1867*.”\(^72\) The magnitude of this decision cannot be stressed enough. While a full discussion of a national securities regulator is beyond the remit of this paper, the importance of this decision will be presented briefly. For 76 years, there has been a continual push for national securities regulation in Canada, but all proposals were rejected. The failure of each proposal essentially hinged, among other things, on the problem of how to maintain and respect the constitutional division of powers between the federal and provincial governments. From the Porter Commission, CANSEC proposal, Atlantic provinces MOU, Wise Persons’ Committee, Crawford Panel, and most recently the Hockin

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Panel, a substantial amount of work went into pursuing a single national securities regulator. Some would argue that all the previous proposals and research are now wasted. On the contrary, all the previous research provides a solid backdrop for cooperation between the federal and provincial governments to develop a national scheme voluntarily. Consequently, this is exactly what the SCC had in mind: “While the proposed Act must be found *ultra vires* Parliament’s general trade and commerce power, a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing parliament to deal with genuinely national concerns remains available.”\(^{73}\) It is with optimism that a national scheme of regulation be established, as this is debatably the only way in which the two principles of securities regulation can truly be achieved in an optimal manner within Canada. While the three stage proposal in this paper is fully applicable to securities regulators independently, the efficacy of models will be maximized if Canada can harness a unified approach to enforcement. This paper agrees with the Wise Persons Report in their finding that “more centralized enforcement would allow for development and deployment of specialized staff throughout the country”.\(^{74}\) A national prosecution program with a staff of experienced, capable and committed experts would meet the challenge of prosecuting capital market offences. The idea of a model for common enforcement in Canada has been floating around within academia for some time. Among the various proposals, the most recent proposal calls for the creation of two new institutions: the Canadian Capital Markets Enforcement Agency, which would be responsible for both criminal and regulatory investigations and prosecutions, and the Canadian Securities Adjudicative Tribunal, which would judge matters referred to by the above agency.\(^{75}\) The Honourable Peter Cory and Marilyn Pilkington also proposed a similar

\(^{73}\) Ibid, para 130.


idea, in that a nationally co-ordinated prosecution service is established for the prosecution of criminal capital markets offences.\textsuperscript{76} A single national enforcement task force with regional operations could develop specialized experience and skill in the investigation of a wide range of securities matters and utilize that skill and knowledge where it is needed. While this concept is not a full harmonization of securities regulation in Canada, it is perhaps worth considering as an alternative. While the current federal government establishment of the IMETs is a significant step in approaching a national enforcement regime, it is not enough. Its efficiency is hampered by their accountability to federal authorities and not regulatory experts, and their lack of staff consistency due to the RCMP’s internal promotions structure.

The Mighty Public Interest Power

By far, the most powerful weapon within the Canadian securities regulator’s arsenal comes in the form of a discretionary enforcement power wielded in the name of the public interest. The public interest power has been praised as a much needed tool for Canadian securities regulators. However, it has also been heavily criticized for lacking transparency in its process, arbitrary in results, and is a nightmare for securities litigators and their clients.\textsuperscript{77} The three stage enforcement reform process as posited by this paper relies heavily on the creativity of securities regulators in making public enforcement orders to achieve restorative justice and responsive regulation goals, the public interest power gives them this discretion to do so. In 2003, Mary Condon prepared a research study for the Wise Persons’ Committee discussing the use of public interest enforcement orders by securities regulators.


\textsuperscript{77} David Hausmann, “Sources and issues relating to the public interest jurisdiction”, Securities Law in the Adversarial Setting, University of Toronto Faculty of Law, Toronto, 12 January 2012.
in Canada. The purpose of this study was to examine the use of discretionary enforcement powers by securities regulators in Canada, in order to assess the implications of multiple regulators for the enforcement of securities law. This study yielded interest results for the purposes of understanding the issues with sanctioning in a multiple regulator setting, and the meaning of “public interest”. The findings of the study can be summarized in three points:

- There was significant variation in emphasis across the provinces in relation to infractions pursued to an enforcement hearing.

- There was notable consistency across the provinces in the articulation of the public interest that was the basis for making orders, linking more to goals of maintaining public confidence in, and integrity of, capital markets than to those of market efficiency.

- There was some unevenness in the application of contextual sanctioning factors to individual respondents, in order to justify specific types and quantum of penalties. Some consistency did result from reliance on two regulatory precedents – one each from British Columbia and Ontario – enumerating factors relevant to the individual sanctioning decision.

Several of the Ontario regulatory and court decisions linked the idea of the public interest to the achievement of the goals of securities law. Looking at all the decisions however, it is possible to see that more attention tended to be allocated to the idea of protecting the integrity of the capital markets and confidence in those markets than to provide protection to investors from unfair, improper or fraudulent practices. There was considerable agreement that the predominant purpose of making these orders was to protect the integrity

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80 *Belteco Holdings Inc* [1998] 51 OSCB 7743.
of the provincial capital market, and to engage in a future-oriented analysis of the respondent’s likely behaviour, with sanctions being applied if necessary to achieve the goal of maintaining public confidence in the market’s ongoing integrity.\textsuperscript{81} This paper contends that there needs to be a significant rebalancing of priorities towards investor protection in order to achieve a self-sufficient regulatory state. Despite this, the surprising consistency in “public interest” as the basis for making discretionary enforcement orders lays a solid foundation for a national collaboration on securities enforcement. One key issue would be whether or not there would be a single decision-maker applying a uniform set of administrative enforcement powers. Fewer decision-makers may enhance efforts at a consistent approach to the use of these discretionary factors. The present uniformity around the definition of the public interest suggests no particular hindrances to developing an articulation of a national public interest to be protected by securities enforcement efforts.\textsuperscript{82}

Currently the public interest sanctions imposed in Ontario are guided by \textit{Belteco},\textsuperscript{83} which enumerates various guiding factors as per this passage:

“we have been referred to decisions of this Commission which indicate that in determining both the nature of the sanctions to be imposed as well as the duration of such sanctions, we should consider the seriousness of the allegations proved; the respondent’s experience in the marketplace; the level of a respondent’s activity in the marketplace; whether or not there has been a recognition of the seriousness of the improprieties; and whether or not the sanctions imposed may serve to deter not only those involved in the case being considered, but any like-minded people from engaging in similar abuses of the capital markets”.\textsuperscript{84}

When interpreted alongside the \textit{Eron Mortgage}\textsuperscript{85} decision in British Columbia, there is clearly a disparity in consistency with sanctioning factors to individual respondents across Canada, with the rest of the provinces following either case. This is a further indication that a comprehensive nationwide sentencing policy needs to be discussed before we end up

\textsuperscript{81} \textit{Supra}, note 78.
\textsuperscript{82} \textit{Ibid}.
\textsuperscript{83} \textit{Supra}, note 80.
\textsuperscript{84} \textit{Ibid}.
\textsuperscript{85} \textit{Supra}, note 79.
with a dual sentencing purposes and principles system solidifies. Table 1 taken from the research study illustrates this disparity.

Table 1: Sanctioning Factors

<table>
<thead>
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<th>Aggravating / Mitigating Circumstances</th>
<th>BC</th>
<th>AB</th>
<th>SK</th>
<th>MB</th>
<th>ON</th>
<th>QC</th>
<th>NB</th>
<th>NS</th>
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<td>Deliberate / unintentional violation of Act</td>
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<td>Knowing violation of Commission decision</td>
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<td>Incompetence</td>
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<td>Degree of culpability</td>
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<tr>
<td>Harm to investors</td>
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<td>●</td>
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<td>Making good on client losses</td>
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<td>Amount of money lost</td>
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<tr>
<td>Involvement of unsophisticated investors</td>
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<tr>
<td>Knowledge of securities markets</td>
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<td>●</td>
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<tr>
<td>Proportion of overall transactions involved (insider trading)</td>
<td>●</td>
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The public interest powers remains to be the most instrumental tool in making sure that Canadian securities regulators have the necessary discretion to put forward creative enforcement orders. But it is apparent that this discretionary power needs to be tempered with a uniform and consistent approach in order for investors across Canada to be adequately protected.

IV. THE RESPONSIVE REGULATION MODEL

Restorative Justice and Responsive Regulation

In 2002, John Braithwaite published his book “Restorative Justice and Responsive Regulation”, encouraged by his 1992 book “Responsive Regulation” with Ian Ayres. In “Restorative Justice and Responsive Regulation”, Braithwaite argues that restoring victims, offenders, and communities is more effective than punitive practices for deterring, incapacitating, and rehabilitating offenders. This is particularly true when the restorative justice system is embedded in a responsive regulatory framework that opts for deterrence only after restoration repeatedly fails, and incapacitation only after escalated deterrence fails. The responsive regulation proposal emphasizes an equivalent retaliation strategy of responses to industry behaviour based in game theory. For each action or inaction that the regulated industry or firm takes the regulator will respond rationally to the situation. On this assumption, the authors introduce their notice of the “Benign Big Gun,” the idea that

86 Supra, note 49 at 29.
“regulators will be more able to speak softly when they carry big sticks (and crucially, a hierarchy of lesser sanctions).”\(^8\) The idea here is that if regulators possess a range of enforcement options, including extremely severe sanctions (“Benign Big Guns”), they will have greater ability to deal with the regulated firm or industry on more agreeable terms.

Ayres and Braithwaite list key behavioural assumptions that guide the design of a regulatory regime. First, regulatory agencies pursue their objectives through separate, segregated levels of the corporate actor (industry, firm, individual).\(^8\) Second, certain corporate actors will only adhere to the law if it is economically prudent for them to do so.\(^9\) Third, a regime that relies solely on persuasion and self-regulation will be exploited when actors are motivated by economic rationality.\(^9\) Fourth, “a strategy based mostly on punishment will undermine the good will of actors when they are motivated by a sense of responsibility.”\(^9\) Fifth, “punishment is expensive; persuasion is cheap.”\(^9\) Lastly, a regime focused mainly on punishment will contribute towards a business subculture of resistance to regulation.\(^9\) The restorative justice and responsive regulation framework appeals to the responsible “virtuous” corporate self as opposed to resorting to the “unaffordable, unworkable and counterproductive” natures of default punishment strategies that is against the regulated.\(^9\)

The Responsive Regulatory Pyramid ("Enforcement Pyramid")

Braithwaite’s empirical research demonstrates that active deterrence, under the dynamic regulatory pyramid that is a hallmark of the restorative justice system he supports, is far more effective than the passive deterrence that is notable in the stricter "sentencing grid" of

\(^8\) Ibid, at 19-20.
current criminal justice systems. The pyramid is representative of the intended proportions and order for the responsive, escalating regulatory actions. Business regulatory authorities are slowly adopting the idea of the responsive regulatory pyramid. Institutions such as the United Nations Environmental Program have seen the benefits of the pyramid, and duly adapted it in their “Manual on Compliance with and Enforcement of Multilateral Environmental Agreements”. It is a novel and convincing idea because it is a method of reconciling the conflicting empirical evidence regarding the efficacy of punishment and persuasion techniques. For the purposes of our analysis, this initial pyramid will be considered the first stage of the progression in sentencing guideline reform. Figure 1 is an example of a responsive regulatory pyramid.

**Figure 1: Stage One, Responsive Regulation Pyramid (“Enforcement Pyramid”)**

![Responsive Regulation Pyramid](image)


From the enforcement pyramid, it is evident that persuasion should be the forum in which most exchanges between a regulator and the regulated ought to occur. Subsequently, licence revocation and suspension act as the Benign Big Guns. In theory, most of the
regulatory action will take place at the bottom because the more severe punishments at the top are harsh to the regulated industry. Ayre and Braithwaite note that the ability to escalate enforcement responses up the pyramid is reliant on the credibility of the regulator. Possessing a range of enforcement tools does not guarantee regulatory compliance. It can be analogized to a simple sword that becomes a powerful weapon only when harnessed by the most willing and trained fighter, the amalgamation of these parts results in a superior threat. A person of lesser determination and training returns the sword back to being a plain sword, likewise with the fighter. Credibility is garnished through the ability to deliver reliable, positive enforcement outcomes. Assuming that Canadian securities regulators have this credibility, it is held that the implementation of the enforcement pyramid may also assist in further promoting a regulator's credibility. However, this assumption regarding our securities regulators retaining this credibility have been hotly debated. Some say that regulators like the OSC lack credibility as evidence by their inability to pursue big cases and to pass out appropriate sanctions. On the proposal of enabling regulators to utilize restorative justice sanctions, we move onto the second stage. Stage two draws on the basic tenants of the stage one pyramid, but provides an overarching theme for various segments of the enforcement pyramid. Figure 2 illustrates which segment each punishment principle should occupy.

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This design responds to the fact that restorative justice, deterrence, and incapacitation on their own are ineffective and flawed theories of compliance. The pyramid aims to cover the weaknesses of one theory with the strengths of another. The intention behind the current ordering of punishment principles is guided on considerations starting the process with the least costly, least coercive, and more respectful options. This serves a dual purpose of ensuring that when coercive control is utilized, it is seen as more legitimate, especially after all other forms of dialogue and persuasive have failed to control the offender. In regards to the principle of denunciation, it is contended that this principle needs to be inherent in each stage of the pyramid so as to continually act as general deterrence to capital market participants. Ayres and Braithwaite have created three general segments of the pyramid, with each segment focusing on one core principle. Although well-structured and operable on its own, the premise behind this model is that a person who violates regulations could only be either a virtuous, rational or incompetent/irrational actor. At most, this model implies that one could escalate from being a virtuous actor all the way to being an incompetent/irrational actor. I find that this model on its own lacks a form of flexibility that
must be present if the purpose of these sentencing guidelines is to promote a compliance culture within firms.

The Enforcement Priority Ladder

My proposal would essentially be stage three of this enforcement guideline reform. I advocate for the adoption of an enforcement priority ladder that will complement this enforcement pyramid within the bottom and middle segments of the enforcement pyramid. Figure 3 illustrates the escalation of considerations within those enforcement pyramid segments.

Figure 3: The Enforcement Priority Ladder

![Diagram of Enforcement Priority Ladder]

The imagery of a ladder and the pyramid brings to mind a upward climb towards an end goal. However, in this case the peak is not an accomplishment of sorts, but rather a final
The purpose of this metaphor is to encourage the "climber", who is the offender, to disembark from the ladder as soon as possible. Figure 4 completes this metaphor in an illustration that combines stages two and three.

**Figure 4**: Stage Three, Integration of the Enforcement Priority Ladder

While it may seem complicated to comprehend how these various principles can co-exist, one must remember that although distinct in their own ways, there is always considerable overlap between these principles. As previously discussed, a securities regulator's sanctioning powers are legitimate as long as they contribute to the goal of protecting investors and capital markets. With this said, it is not uncommon for certain regulatory sanctions to exhibit multiple punishment objectives. The main principles of restorative justice, deterrence, and incapacitation remain the overarching purpose of their respective segments. The restorative justice segment begins any action with a purely restorative justice focus. This would entail strategies that assist a firm's development of an internal compliance culture and also providing relief for the victim(s) of the non-compliance. If regulatory infractions continue, denunciatory sanctions with regard to the overarching
purpose would follow. This may involve strategies that appeal to a firm’s reputation, while incorporating methods of recompensing victims, such as ordering a firm to create a victims’ relief fund. Once the restorative justice segment ceases to be effective, the regulator would start to engage in measures that have an overarching deterrent purpose. However, sanctions must start with a restorative justice approach that incorporates deterrence. It may seem hard to differentiate between a deterrent sanction with a restorative justice purpose, and vice versa. This aspect of stage three is not an exact science, as with many of the proposed reforms to sentencing guidelines. This may be an area that requires further fine tuning and guidance. However, this is where the discretion of the regulator comes into play. As an example, the recommendation of implementing an internal auditor to a deviant firm would appear to be a heavy handed deterrent. Nevertheless, the sanction appears to hold a restorative justice element in that it is helping the firm build on risk controls and a compliance culture. This sanction would appear to be a restorative justice – deterrent within the second segment. The fact that the enforcement priority ladder appears at the deterrence segment is aimed at the understanding that restorative justice principles should continue to occupy the minds of the regulator and those that violate the law. It serves a continuing education function for those that disregard the rules, and ensures that the role of the victim is constantly at the forefront of the regulator and offender’s considerations. Having the role of the victim in mind is beneficial for the protection of the markets as it will allow future victims to benefit from the precedence of sanctions implemented. There are a number of ways in which the restorative justice process can be initiated:

(a) Restorative justice as a pre-court diversion

When a regulator has gathered its evidence and makes a decision on whether or not to prosecute, it should suggest a restorative justice process if appropriate. If the stakeholders agree to this process, then the regulator can defer criminal proceedings in lieu of the
restorative justice process. The regulator would be present during the restorative justice process to ensure that the regulatory non-compliance was addressed, and that it was content that the outcomes of the restorative justice process were adequate. In addition, the regulator could make sure that no further sanction was required. The regulator may also play a role in ensuring that the offender abides by the terms of the restorative justice process and undergoes the changes that were agreed upon. Obviously, if this process fails, the regulator may resort back to formal prosecution.

(b) Restorative justice in lieu of a monetary administrative penalty

When a regulator has gathered its evidence and makes a decision to apply a monetary administrative penalty, the regulator should consider suggesting a restorative justice process as an alternative if appropriate. If the stakeholders agree to this process, then the regulator can defer the imposition of a monetary administrative penalty in lieu of a restorative justice process. Like with the previous option, if restorative justice fails, the regulator could apply the monetary administrative penalty as initially intended.

(c) Restorative justice in the criminal justice system

Where a regulator pursues a criminal prosecution, crown attorneys or crown court judges could also recommend a restorative justice process at the pre-sentencing and sentencing stages during the criminal proceedings. During the pre-sentencing, the judge could suggest that the parties meet for restorative justice proceedings in advance of any sentencing. This is similar to the parties achieving a plea bargain. Under the existing provision for defining sentences, the courts might want a restorative process to take place first and then receive a report of the outcome. The court has no direct involvement with the process or management of the outcome. As a sentencing option, the judge could include restorative
just proceedings as something that could be entered into as part of the sentencing, but this would require evidence that a restorative justice process was appropriate and the parties were willing to participate.

These are merely options on how restorative justice could be implemented in accordance with the enforcement pyramid and enforcement priority ladder. In order to get to this stage, we need to evaluate whether the OSC is suitable to commence stage one first. We move now to an application and analysis of the OSC enforcement statistics.

V. APPLICATION AND ANALYSIS

OSC Enforcement Statistics, 2005 - 2011

The statistics that we will be using at present are from the OSC because of the vast enforcement experience they possess, and the key role that they play in the harmonization of enforcement in Canada. We will survey the OSC’s enforcement statistics to see whether they can suitably adopt stage one of the enforcement pyramid. If so, we can consider the progression towards stage two and three.

The OSC is the largest securities regulator in Canada, and is considered the most sophisticated and capable when it comes to enforcement. Ontario is Canada’s largest capital market, housing also the largest stock exchange in Canada, the Toronto Stock Exchange. It is anticipated that with any potential enforcement harmonization efforts, the OSC experience and the OSA will have a major contribution to a national regime. It is therefore in our interests to look at the experience of the OSC more closely so as to see whether the proposals set forth would be feasible, and whether the results of such can be
extrapolated on a national basis. The CSA enforcement statistics were considered when deciding which set of data to analyze. The major downfall of the CSA’s statistics was that they lacked the detail that is necessary for a thorough analysis, especially into what sorts of sanctions regulators imposed, their frequency, and associated criminal proceedings. When one also considers that the CSA is merely a voluntary umbrella organization that aims to facilitate harmonization, it becomes clear why this is the case. The current lack of comprehensive national statistics on enforcement is a major push factor for a national enforcement regime. There may be arguments that SROs are better suited to influence a change in compliance culture within firms because of their proximity to the regulatory subjects. However, self-regulation exists only for certain sectors of the financial services industry rather than reporting issuers in general. Even if there was SRO presence in certain sectors, there is still an overarching need for policy-level guidance and oversight by the OSC as the arms-length agency tasked with furthering the statutory mandate. As a minor digression, it should be noted that certain SROs have shown commendable initiative in the area of sentencing guidelines. IIROC has published disciplinary sanction guidelines and general principles, sanction guidelines for dealer members, and sanction guidelines for the Universal Market Integrity Rules. These guidelines somewhat mirror the criminal sentencing guidelines in section 380 of the Criminal Code of Canada. Regulators would benefit from consultation with SROs in pursuing any initiatives to enact sentencing guidelines.

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We will focus on reviewing enforcement data provided in the annual reports of the OSC. The absence of consistent disclosure of specific, ongoing enforcement data in past reports will limit this review to the Annual Reports from 2005 to 2011. In the last seven years, the OSC consistently provided statistics on concluded settlement and contested hearings before the Commission. Proceedings have been categorized into individual and corporate respondents up until 2008. To avoid any confusion, only the total respondent numbers are analyzed here. Six categories of administrative sanctions are laid out, they include: cease trade orders; exemptions removed; director and officer bans; registration restrictions; administrative penalties, disgorgement orders, settlement amounts imposed; and costs imposed. Table 2 shows a seven-year comparison of these statistics.
### Table 2: Concluded Settlement and Contested Hearings before the Commission

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<td>Number of Proceedings</td>
<td>25</td>
<td>30</td>
<td>22</td>
<td>13</td>
<td>21</td>
<td>16</td>
<td>36</td>
<td>+20 (56%)</td>
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<tr>
<td>Total respondents</td>
<td>36</td>
<td>55</td>
<td>37</td>
<td>20</td>
<td>46</td>
<td>32</td>
<td>109</td>
<td>+77 (71%)</td>
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<tr>
<td>Sanctions include:</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Cease Trade Orders</td>
<td>18 (38%)</td>
<td>17 (28%)</td>
<td>18 (37%)</td>
<td>10 (34%)</td>
<td>23 (28%)</td>
<td>18 (31%)</td>
<td>82 (30%)</td>
<td>+64 (78%)</td>
</tr>
<tr>
<td>Exemptions removed</td>
<td>7 (15%)</td>
<td>11 (18%)</td>
<td>14 (29%)</td>
<td>7 (24%)</td>
<td>18 (22%)</td>
<td>17 (29%)</td>
<td>88 (32%)</td>
<td>+71 (81%)</td>
</tr>
<tr>
<td>Director and Officer bans</td>
<td>12 (26%)</td>
<td>21 (35%)</td>
<td>12 (24%)</td>
<td>8 (28%)</td>
<td>29 (35%)</td>
<td>18 (31%)</td>
<td>56 (21%)</td>
<td>+38 (68%)</td>
</tr>
<tr>
<td>Registration restrictions</td>
<td>10 (21%)</td>
<td>11 (18%)</td>
<td>5 (10%)</td>
<td>4 (14%)</td>
<td>12 (15%)</td>
<td>6 (10%)</td>
<td>45 (17%)</td>
<td>+39 (87%)</td>
</tr>
<tr>
<td>Total</td>
<td>47</td>
<td>60</td>
<td>49</td>
<td>29</td>
<td>82</td>
<td>59</td>
<td>271</td>
<td>+212 (78%)</td>
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<td>Administrative penalties, disgorgement orders, settlement amounts imposed</td>
<td>N/A</td>
<td>N/A</td>
<td>$1,372,650</td>
<td>$3,419,000</td>
<td>$85,809,868</td>
<td>$35,967,173</td>
<td>$82,307,662</td>
<td>+$46,340,489 (56%)</td>
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<td>Costs imposed</td>
<td>N/A</td>
<td>N/A</td>
<td>$285,749</td>
<td>$1,730,282</td>
<td>$3,103,191</td>
<td>$951,500</td>
<td>$1,633,193</td>
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<td>Total</td>
<td>N/A</td>
<td>N/A</td>
<td>$1,658,399</td>
<td>$5,149,282</td>
<td>$88,913,059</td>
<td>$36,918,673</td>
<td>$83,940,855</td>
<td>+$47,022,182 (56%)</td>
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The OSC explained that their dramatic increase in numbers in 2011 was due to their intensifying efforts to detect, prevent, and disrupt abuse that harms investors, especially fraud, illegal distributions of securities and illegal insider trading. In particular, enforcement staffs initiated more proceedings before adjudicative panels of the Commission. As the 2011 results differ greatly from previous years, it is difficult to spot longitudinal trends based on the numbers alone. However, when one looks at the sanction numbers in proportion to the total, a general trend becomes much more apparent. Cease trade orders, as well as director and officer bans have shown a gradual decline to 30% and 21% respectively. Much more interesting is the significant increase in exemptions removed and registration restrictions, which stands at 32% and 17% respectively. Administrative penalties, disgorgement orders, settlement amounts imposed, and costs imposed also increased an aggregate of 56%. It seems that the OSC is not shying away from the use of monetary penalties. However, the extent of these amounts going back to aggrieved investors is unclear. The OSC also provides data regarding enforcement timelines, specifically the number of cases that make it through to the intake, investigations and litigation stage. Table 3 shows a seven-year comparison of these statistics.
### Table 3: Enforcement Timelines (Ontario Securities Commission)

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<tr>
<td><strong>Intake Units</strong></td>
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<tr>
<td>Number of Files/Cases Assessed</td>
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<td></td>
<td></td>
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<tr>
<td>Transferred to Investigations</td>
<td>34 (13%)</td>
<td>51 (13%)</td>
<td>50 (12%)</td>
<td>58 (12%)</td>
<td>49 (11%)</td>
<td>25 (7%)</td>
<td>-8 (-32%)</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>263</td>
<td>400</td>
<td>421</td>
<td>499</td>
<td>446</td>
<td>467</td>
<td>348</td>
<td>-119 (-34%)</td>
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</table>

| **Investigation Units** |         |         |         |         |         |         |         |                         |
| Number of Files |         |         |         |         |         |         |         |                         |
| Transferred to Litigation | 20 (57%) | 20 (63%) | 16 (39%) | 16 (33%) | 18 (31%) | 26 (57%) | 35 (63%) | +9 (26%) |
| Closed* | 15 (43%) | 12 (38%) | 25 (61%) | 32 (67%) | 41 (69%) | 20 (43%) | 21 (38%) | +1 (5%) |
| Total | 35 | 32 | 41 | 48 | 59 | 46 | 56 | +10 (18%) |

*Intake units conduct initial analyses on all matters referred to the Branch. The criteria to determine which enforcement matters are pursued through full investigations are set out in OSC Staff Notice 11-719 A Risk-based Approach for More Effective Regulation. Factors considered include whether there is evidence that securities laws were breached and the losses involved. Other matters are referred to the appropriate investigative agency or closed.*

The total number of files/cases assessed has gradually declined from 2008, leading to a 34% drop from 2010. The number of files/cases transferred to investigations has also shown a gradual decline, from 13% in 2005 to 7% in 2011. There seems to be an increasing trend in the proportion of files passing through to litigation at the investigation stage, currently 63% of the files are transferred.

Analysis

Before I attempt to apply the OSC data to the responsive regulation enforcement pyramid, one must bear in mind the difficulty in converting the sanctions data into an exact representative portion of the enforcement pyramid. However, an attempt will nonetheless be provided so as to justify this conversion.

In 2010 - 2011, the use of severe deterrence and incapacitation sanctions, namely cease trade orders and director and officer bans, has shown a significant decline. The more lenient deterrence sanctions, namely exemptions removed and registration restrictions, increased in usage frequency. With regards to the high amount of administrative penalties, disgorgement orders, settlement amounts imposed, and costs collected by the OSC, these amounts indicates various conclusions. One is that the OSC is not shy to impose the maximum monetary fine of $5 million. Second is that we are seeing an increased usage of less intrusive sanctions. Figure 3 is a potential demonstration of an Ayres and Braithwaite pyramid for OSC’s sanction data from 2005 – 2011. There are aspects of enforcement that are beyond the jurisdiction of the OSC, including RCMP criminal prosecution and SRO rules. However, the proposals outlined in this paper are directed solely towards a “responsive regulation” reform of securities regulators. Therefore only OSC sanctions will
be discussed. A greater study involving the sanctions of the courts and SROs may yield interesting results.

**Figure 5:** Ontario Securities Commission 2005 – 2011 Enforcement Pyramid

As expected, the more severe sanctions occupy a relatively smaller area on the top, while softer persuasive methods account for the bulk of regulatory activity at the bottom. This is apparent when one compares the total intake files to the total litigation transfer files in Table 2. The general depiction of OSC enforcement appears to fit the Ayres and Braithwaite paradigm. The explicit adoption of a responsive regulation enforcement pyramid makes sense at the provincial level and at the national level. However, an enforcement pyramid that incorporates restorative justice would further the efficacy of the enforcement pyramid. Currently, the only instance of restorative justice in Ontario’s securities law is within section 128 OSA, which allows the Superior Court of Justice (upon an application by the OSC) to make restorative orders such as compensation and restitution,\(^\text{100}\) as well as general and

\(^{100}\) *Supra*, note 6, s. 128 (3) (13).
punitive damages. The incorporation of mandatory rehabilitative and reparative sanctions will ensure that offenders will get the necessary reintegration support, and current and future victims are given full consideration. Business regulatory studies have empirical evidence showing that: (1) restorative justice works best when it is backed up by punitive justice in those individual cases where restorative justice fails, and (2) trying restorative justice first increases perceived justice. Securities regulators should have the power to utilize restorative justice tools, instead of passing it onto the courts. Of course, there is the traditional argument that reserves restorative justice initiatives solely to the courts. However, given the expansive scope of the OSC’s public interest power and the important role they play, it only makes sense to allow the OSC to govern with all necessary tools. With creativity, securities regulators can come up with alternative sanctions. Here are a few examples of alternative sanctions that could be adopted:

(i) Corporate rehabilitation orders

This would involve provisions to enable a court to require a company to undertake specific actions or activities during a specified period (such as one or two years). The activities specified in the order could include training of personnel in regulatory related matters, the adoption and implementation of action plans to address regulatory non-compliance or taking steps to remedy the harm caused by regulatory non-compliance. The regulator could monitor compliance with this order. Failure to comply with the order would lead to the company being brought back to court and sentenced in an alternative way. This type of a sanction would seek to rehabilitate the firm and to be a forward looking tool in order to

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101 Supra, note 6, s. 128 (3) (14).
102 Supra, note 49 at 54 – 70.
improve the company’s capacity and willingness to comply in the future. This sanction utilizes rehabilitation and deterrence

(ii) Community projects

The court or regulator would have the power to order an offender to complete a relevant community improvement project within a specified period and for a specified value related to the underlying harm or benefits that had been caused or obtained by the offender. This could be used in addition to another sanction such as a fine. With regard to securities regulation, the community project could involve an education or training campaign. This sanction utilizes rehabilitation, deterrence, and some could argue denunciation to a lesser extent.

(iii) Publicity orders

Reputation is an important asset to many businesses. Some would argue it is the most important factor in determining a business’ success or failure. A publicity order provision would enable a court or regulator, in addition to any other sentence imposed, to order that a notice (with wording agreed between the business and the regulator) be placed in an appropriate publication such as a trade publication, local or national newspaper or another media outlet such as radio or television, or in a company’s annual report within a specified period. This type of sanction would have a strong deterrent element for many businesses and may be more meaningful than a financial penalty for a firm that has access to many financial resources. The idea of an adverse publicity order is already available in Australia in the areas of environment, health and safety, and Consumer Protection and Competition Law.\(^\text{104}\)

(iv) Conditional cautions for corporate offenders

\(^{104}\) *Supra*, note 91 at 93.
A caution is a formal alternative to prosecution, and is commonly used to resolve cases where full prosecution is not seen as the most appropriate solution. Extending the application of this sanction to corporate offenders may be of value where it is in the public interest for offenders to have specific conditions attached to the caution, rather than be prosecuted. The conditions must help rehabilitate the offender and/or ensure that the offender makes reparation for the consequences of the regulatory non-compliance on the victim or wider community. Offenders who fail to comply with the conditions of the caution could be prosecuted for the original offence. This type of sanction is more focused on rehabilitation and reparation rather than punitive elements of sanctioning.

(v) Mandatory audits

This type of provision could be used in the case of businesses where there is a deficiency in the business management and where systemic organizational change would help better achieve future compliance. Bringing in external expertise could get the business the help it needs in identifying ways in which it could improve its operations and meet its regulatory requirements.

International Comparison, the FSA in the UK

The experience of the OSC indicates that an adoption of the enforcement pyramid is possible without much change, given their current compliance and enforcement data. As these proposals are not restricted to Ontario or Canadian regulators, it would be beneficial for us to see the enforcement statistics of foreign regulators and whether they would be suitable for a similar adoption. For this segment, The FSA’s enforcement statistics will be looked at. The FSA’s enforcement statistics were chosen as a main comparison because of their detailed coverage of administrative sanctions and consistent categorical reporting. It cannot be stressed enough the benefits of having detailed and comprehensible
enforcement statistics in order to evaluate and propose reforms. I have excluded the SEC from this selection as their enforcement data lacks a breakdown of their administrative sanctions, and generally the public enforcement statistics provided was too convoluted in bulk annual reports. It is recognized that this topic would benefit from a complementary analysis into the SEC’s enforcement experience. The enforcement statistics from ASIC were also considered, however ASIC has only recently started to publish detailed statistics on their enforcement efforts. Their existing data was not detailed enough for the analysis at hand.

We will focus on reviewing enforcement data provided in the annual reports of the FSA. Note that the absence of consistent disclosure of enforcement categories and data in past reports will limit this review to the Annual Reports from 2005 to 2011. In the last seven years, the FSA has provided statistics on the number of cases before FSA that required the use of powers (civil, administrative, criminal), and those that did not. The FSA has also provided a comprehensive breakdown of the various categories of administrative sanctions, they include: prohibitions, criminal outcome, civil outcome (injunction/restitution), financial penalty, fines, variation/cancellation of authorization/approval/permissions, prohibitions revoked, and public censures. As with the OSC, there is also a breakdown of the relevant costs and fines. Table 4 shows a seven-year comparison of these statistics.
### Table 4: FSA Use of Powers

<table>
<thead>
<tr>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Proceedings</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of cases with use of powers</td>
<td>79 (39%)</td>
<td>81 (36%)</td>
<td>110 (50%)</td>
<td>153 (54%)</td>
<td>243 (66%)</td>
<td>266 (67%)</td>
<td><strong>280</strong></td>
<td>+14 (5%)</td>
</tr>
<tr>
<td>Number of cases without use of powers</td>
<td>121 (61%)</td>
<td>146 (64%)</td>
<td>109 (50%)</td>
<td>133 (46%)</td>
<td>128 (34%)</td>
<td>130 (33%)</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Total number of cases</td>
<td>200</td>
<td>227</td>
<td>219</td>
<td>286</td>
<td>371</td>
<td>396</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Sanctions include:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prohibition</td>
<td>9 (8%)</td>
<td>7 (7%)</td>
<td>10 (7%)</td>
<td>30 (17%)</td>
<td>48 (16%)</td>
<td>57 (18%)</td>
<td><strong>65 (18%)</strong></td>
<td>+8 (14%)</td>
</tr>
<tr>
<td>Criminal Outcome</td>
<td>0</td>
<td>3 (3%)</td>
<td>1 (1%)</td>
<td>0</td>
<td>1 (0%)</td>
<td>5 (2%)</td>
<td>3 (1%)</td>
<td>-2 (67%)</td>
</tr>
<tr>
<td>Civil Outcome (Injunction/Restitution)</td>
<td>3 (3%)</td>
<td>5 (5%)</td>
<td>3 (2%)</td>
<td>1 (1%)</td>
<td>7 (2%)</td>
<td>11 (4%)</td>
<td><strong>10 (3%)</strong></td>
<td>-1 (10%)</td>
</tr>
<tr>
<td>Financial Penalty</td>
<td>26 (23%)</td>
<td>18 (18%)</td>
<td>28 (19%)</td>
<td>20 (11%)</td>
<td>55 (18%)</td>
<td>41 (13%)</td>
<td><strong>74 (20%)</strong></td>
<td>+33 (81%)</td>
</tr>
<tr>
<td>Fines</td>
<td>31 (27%)</td>
<td>17 (17%)</td>
<td>32 (22%)</td>
<td>21 (12%)</td>
<td>57 (19%)</td>
<td>46 (15%)</td>
<td><strong>83 (23%)</strong></td>
<td>+37 (80%)</td>
</tr>
<tr>
<td>Variation/Cancellation of Authorization/Approval/Permissions</td>
<td>44 (39%)</td>
<td>45 (46%)</td>
<td>65 (45%)</td>
<td>99 (57%)</td>
<td>122 (41%)</td>
<td>142 (46%)</td>
<td><strong>109 (30%)</strong></td>
<td>-33 (30%)</td>
</tr>
<tr>
<td>Prohibition Revoked</td>
<td>0</td>
<td>1 (1%)</td>
<td>1 (1%)</td>
<td>1 (1%)</td>
<td>0</td>
<td>2 (1%)</td>
<td>5 (1%)</td>
<td>+3 (150%)</td>
</tr>
<tr>
<td>Public Censure Only</td>
<td>0</td>
<td>2 (2%)</td>
<td>4 (3%)</td>
<td>2 (1%)</td>
<td>10 (3%)</td>
<td>8 (3%)</td>
<td><strong>14 (4%)</strong></td>
<td>+6 (75%)</td>
</tr>
<tr>
<td>Total number of sanctions</td>
<td>113</td>
<td>98</td>
<td>144</td>
<td>174</td>
<td>300</td>
<td>312</td>
<td><strong>363</strong></td>
<td>+51 (16%)</td>
</tr>
<tr>
<td><strong>Total value of fines (£M):</strong></td>
<td>£22.25</td>
<td>£17.43</td>
<td>£14.66</td>
<td>£4.45</td>
<td>£27.50</td>
<td>£33.60</td>
<td><strong>£98.50</strong></td>
<td>+£64.9 (193%)</td>
</tr>
</tbody>
</table>

Disregarding the lack of 2010-11 numbers for the cases without use of powers and total number of cases, in the two years past there has been a trend of more cases requiring the use of powers. This could mean that the FSA is taking a more active role in enforcement, or that emphasis is being detracted from compliance efforts which do not require regulatory power. The breakdown of the various sanctions illustrates the plethora of punishment principles at play, from denunciation in the form of public censures to incapacitation in the form of a prohibition. At first glance, the data indicates that the enforcement pyramid would be applicable for the FSA. The bottom of the pyramid would consist of the majority of the compliance work, with the sanctions of variation/cancellation of authorization/approval/permissions being utilized more frequently. This would indicate a willingness on the part of the FSA to resolve issues without utilizing the “Benign Big Guns”.

However, there still lacks any form of restorative justice sanctions that would lead to the development of a compliance culture. A better segmentation percentage would see these sanctions receiving at least 45% of the overall proportions. Moving up the pyramid, financial penalties and fines, along with civil outcomes would occupy the middle section. This section would be entering the start of the deterrence stage, where the FSA could begin to utilize their wide discretion in determining punishments. This is also the stage wherein more restorative justice sanctions could take place. To this end, it would have been better to see the civil outcome sanction, which contains the power of restitution, occupy a larger proportion. Lastly, the “Benign Big Guns” sanctions of prohibition and criminal outcome (which may include incapacitation sanctions) occupy the tip of the pyramid. It is worrying to see that prohibition occupies nearly 1/5th of the pyramid, wherein an efficient enforcement pyramid would ideally only occupy a minor percentage and is used only as a last resort. However, this may just be an indication that the FSA is not afraid to utilize harsh measures when left with no choice. This reinforces the legitimacy of the regulator, and may persuade market participants of the seriousness of reaching the top of the pyramid. The increasing
total value of fines may be an illustration of how a fine should not operate as a license fee, and it should effectively deter as opposed to treating regulatory law as a business proposition. An application of the FSA data to the enforcement pyramid can be seen in Figure 4.

**Figure 6**: Financial Services Authority 2005 – 2011 Enforcement Pyramid

This rough application of Braithwaite’s enforcement pyramid indicates that the compatibility is not restricted to just the OSC, but potentially to all international securities regulators. The one issue that remains is the lack of attention to restorative justice. If it is to be understood that achieving a more self-sufficient regulatory environment means improving compliance cultures within firms, it is only logical to utilize restorative justice sanctions so as to provide opportunities for firms to change and to promote investor focused solutions.
VI. CONCLUSION

Canadian securities enforcement as it stands is not performing to its potential, partly because of the lack of guidance in sentencing principles. A clear strategy needs to be devised in order to pursue the vigorous ex post enforcement of both ex ante and ex post regulatory rules in place. A balance needs to be struck between the virtues of deterrence and compliance, where the latter occupy the majority of a regulator’s attention at the first instance of a violation. This paper has advocated for an enforcement policy reform of the OSC through the adoption of three comprehensive stages of progression. These three stages emphasize the need for a compliance focused enforcement regime that embraces soft law, and the beneficial implications of restorative justice sanctions. The analysis of the OSC enforcement statistics reveals that the regulator can adopt the stage one enforcement pyramid with ease as current practice is congruent with the enforcement pyramid’s sectioning. Embracing the principles of restorative justice as presented in stage two and three remains the main hurdle. There must be a dramatic shift in the way securities regulators view enforcement priorities. Securities regulators need to be bold and experiment with ways of influencing a firm’s internal compliance culture. Only in this way can we begin a dialogue on whether the OSC is serving the public interest properly. The formal adoption of the enforcement pyramid, the enforcement priority ladder, and the power to impose restorative justice focused sanctions would greatly enhance the effectiveness of the OSC and promote a more self-sustaining and cooperative regime for capital market participants. Even with foreign regulators such as the FSA, these proposals are equally applicable. An international adoption of a common set of sentencing guidelines and principles could facilitate greater cooperation and understanding between securities regulators and courts. For now, we remain hopeful for these proposals make their way to the OSC, and later a national regime where Canadian capital markets as a whole may benefit.
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