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Canada and the United States Join Hands to Hunt Down Securities Fraud: Double Exposure for Companies and Their Executives?

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Companies facing the recent surge of regulatory change in the United States, particularly under the Dodd-Frank Wall Street Reform and Consumer Protection Act, now may have Canadian regulators to worry about as well. On June 14, 2013, Canada's largest securities regulator, the Ontario Securities Commission ("OSC"), announced that it has created a new division to criminally prosecute securities fraud, including activities like market manipulation, Ponzi schemes, and other illegal "boiler-room" activity. The OSC plans to develop a specialized unit to prosecute insider trading as well.

The commitment to securities reform on both sides of the border — coupled with the close regulatory relationship between the U.S. Securities and Exchange Commission ("SEC") and the OSC — has significant consequences for Canadian and American companies and their executives. Assuming the regulators collaborate as extensively as anticipated, information gathered by the OSC using its stronger investigation tools will be provided to the SEC, and *vice versa*. Likewise, Dodd-Frank, which gives the SEC wide latitude in bringing enforcement actions against foreign defendants for certain non-domestic activity, will inevitably impact both American and Canadian entities and their representatives. These factors mean double exposure for the many companies subject to regulation on both sides of the border.

This article discusses Canada's historical approach to securities enforcement and the OSC's newly announced initiative to take a more aggressive role. It also considers the potential consequences for companies and their executives in light of the SEC's ever-increasing extraterritorial authority under Dodd-Frank. In short, recent developments mean the SEC could be reaching deep into Canada, with substantial assistance from the OSC.

Securities Enforcement in Canada, Until Now

Unlike the United States and major European and Asian countries, Canada does not have a national securities regulator. Instead, the Royal Canadian Mounted Police, Canada's federal police force, is authorized to prosecute criminal corporate misconduct, and each of

Canada's 12 provinces has its own securities regulator. Ontario's regulator, the OSC, has jurisdiction over the Toronto Stock Exchange and the TSX Venture Exchange. It is by far the most influential securities regulator in Canada. Its decisions impact the country's mutual funds, pension funds, and brokerages.

For years, the OSC and other Canadian regulators have been criticized for their tepid securities enforcement efforts, particularly with respect to insider trading and other corporate crimes. For instance, the OSC may bring cases either before an administrative tribunal, which may issue fines and injunctions, or the Ontario Court of Justice, where judges may impose jail terms and fines. But the OSC generally has pursued its cases at the tribunal level, where the burden of proof is lower, the process is less cumbersome, and the penalties are less severe. Perhaps as a result of this approach, the OSC has not secured a single major corporate conviction for securities fraud. The same holds true for other Canadian regulators and prosecutors.

The OSC's New Securities Enforcement Tools

In an effort to strengthen the OSC's enforcement activity, the OSC has created a new investigatory division, the "serious offenses" unit. This unit is empowered to use aggressive investigation and prosecution methods that have become familiar in U.S. criminal fraud cases. For example, it will work closely with the Ontario police and have authority to use search warrants, wiretaps, and undercover surveillance. To deter future crime, it will seek strict criminal penalties, including jail time.

Information collected by the serious offenses unit will likely have implications beyond criminal actions in Canada. Not only may such evidence be used in parallel Canadian civil investigations and actions, but it is also foreseeable that U.S. regulators will gain access to this evidence and use it in investigations and litigation in the United States.

The SEC's Expanding International Role

American and Canadian securities regulators have a history of sharing information collected pursuant to their enforcement efforts. In June 2010 — a month before President Barack Obama signed Dodd-Frank into law — the SEC and the OSC, along with other Canadian regulators, signed a Memorandum of Understanding (the "MOU"), under which the regulators agreed to cooperate in supervising dually regulated financial entities. The SEC and the OSC committed to sharing information, including compelled testimony obtained through examinations, investigations and litigation, to be used to enforce securities laws in both countries.

The precise number of cases in which the SEC and Canadian regulators have coordinated their investigations is unknown. But since signing the MOU, the SEC and the OSC have not shied from publicly extolling their close, cooperative relationship and their focus on cross-border coordination. For example, on May 1, 2013, the chairman of the SEC highlighted the relationship between the SEC and the OSC and referenced the regulators' respective settlements with Richard Bruce Moore, the Toronto-based investment banker whom the SEC charged with insider trading and the OSC charged with improper trading conduct in April 2013. Moore paid approximately U.S.$850,000 to both regulators and accepted injunctions in both countries. Commenting on the settlements, Scott W. Friestad, associate director of the SEC's Division of Enforcement, cautioned "that those who choose to engage in international insider trading should expect to face consequences across the globe."

With the SEC and the OSC intent on collaborating across borders, companies and their executives that are subject to regulation in Canada and the United States should be prepared for the increased potential for exposure in both countries. Aided by the MOU, U.S. securities regulators are certain to take interest if the OSC commences investigations and enforcement actions against entities that may also be subject to U.S. jurisdiction.

Likewise, the OSC may benefit from the SEC's increasingly global reach. Dodd-Frank contains numerous provisions that govern foreign entities, opening the door for the SEC to pursue investigations and enforcement actions against foreign entities that fail to comply with Dodd-Frank.

Canadian entities are particularly exposed to the SEC for several reasons:

Broad Jurisdictional Reach

Dodd-Frank specifically gives U.S. district courts jurisdiction over cases brought by the Department of Justice or the SEC under Section 10(b) of the Securities Exchange Act of 1934 against foreign entities and individuals for certain activity that "has a foreseeable substantial effect within the United States." Considering this broad jurisdictional language, the SEC has a relatively small burden to pursue fraud actions against foreign entities under Dodd-Frank. Canadian entities are especially susceptible because more than 2,000 Canadian companies are listed on both U.S. and Canadian exchanges, including the over-the-counter ("OTC") exchange. (By comparison, only about 150 French companies, 350 Japanese companies, and 350 Mexican companies trade on U.S. and their own country's exchanges.) The large number of cross-listed companies means Canada is particularly exposed to SEC regulation.

Cross-Border OTC Derivatives Trading

Dodd-Frank authorizes the SEC to regulate the trading of cross-border OTC derivatives, and the SEC recently announced proposed rules related to this regulation. The sheer number of Canadian companies trading derivatives on the OTC exchange suggests that this regulation and the SEC's rules will impact Canadian businesses.

The Volcker Rule

The controversial Volcker Rule, which prohibits banks from proprietary trading, will apply to American subsid-

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iaries of Canadian banks. Although the Volcker Rule does not apply to Canadian parent banks, the parent bank is nevertheless responsible for ensuring that its American subsidiary complies with the rule. The Canadian parent also must ensure that its accounts remain separate from the subsidiary's accounts to avoid exposing itself and the subsidiary to scrutiny in the United States.

Whistleblower Rules

Canadian companies that are cross-listed in the United States or subject to SEC regulation are also affected by the SEC whistleblower rules, which provide that company whistleblowers who report original information to the SEC that leads to the recovery of more than U.S.$1 million may receive 10 percent to 30 percent of the recovery. It is unclear whether information that whistleblowers report to the SEC will be shared with the OSC or other Canadian regulators, or at what stage such sharing may take place.

Energy Industry Disclosure Requirements

Dodd-Frank contains disclosure requirements for oil, gas, and mining companies, as well as new regulatory requirements for the energy derivatives market. Because the energy industry is a major component of the Canadian economy, these Dodd-Frank requirements will impact the Canadian market. Failure to comply could result in increased SEC enforcement activity against Canadian energy companies.

As the Bank of Nova Scotia's chief executive officer, Rick Waugh, recently commented, the "great move toward globalizing and standardizing the regulatory regimes is very fraught right now."

Thorny Legal Issues to Consider

Considering the probable impact of Dodd-Frank on Canadian companies and the prospect of increased cross-border sharing of evidence, companies and executives subject to regulation in Canada and the United States will need to grapple with various thorny legal issues, including:

- whether a witness whose statements are immunized from self-incrimination in Canada will receive the same benefit in the United States;
- whether information that U.S. authorities obtain through criminal investigations, including conversations and evidence gathered through wiretaps, undercover surveillance, or other judicially sanctioned means, may be shared with Canadian regulators;
- whether companies' directors and officers liability insurance policies are sufficient to cover the potential exposure that may arise from increased cross-border pursuit of securities fraud investigations and prosecutions; and
- whether companies' internal policies and procedures are sufficient to comply with the still-evolving requirements under Dodd-Frank for whistleblowers, proprietary trading, cross-border OTC derivatives trading, and disclosure of oil, gas and mining operations.

Addressing these weighty topics will become critical in the upcoming months, as U.S. regulators finalize their rules under Dodd-Frank and the SEC and the OSC pursue their own collaborative enforcement agenda.

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