Stikeman Elliott

RECENT TRENDS IN SECURITIES ENFORCEMENT:
THE EVER-EXTENDING REACH OF THE PUBLIC INTEREST

Canada's securities regulators are increasingly willing to bring enforcement proceedings against reputable market players in matters that, 10 or 20 years ago, would not have been considered serious enough to merit this type of scrutiny. A recent insider trading action by the Ontario Securities Commission ("OSC") exemplifies this trend, raising some challenging compliance issues for companies and professional services firms.

Internal Policies as a Benchmark of Acceptable Market Conduct

It has long been a best practice, under Canadian securities regulations, for reporting issuers to adopt Codes of Conduct for their directors, officers and employees. These codes typically include, or are supplemented by, an Insider Trading Policy that sets out blackout periods during which insiders are not to trade in the issuer's securities (unless explicitly granted permission to do so by a designated senior officer). Other market players and professional services firms that interact with reporting issuers have also adopted policies aimed at ensuring that their own partners and employees do not trade in a reporting issuer's securities in situations where undisclosed material information could potentially be known to them.

These Insider Trading Policies often have a wide scope that goes well beyond conduct that is prohibited by law. While such broad wording undoubtedly reflects good faith on the part of companies and professionals, it can sometimes have unintended and undesired consequences. The reason is that, under their public interest jurisdiction, Canada's securities commissions have (on more than one occasion) taken the view that failure to abide by an internal policy can constitute conduct contrary to the public interest that warrants enforcement proceedings and administrative orders. There are reported cases in which insiders who failed to abide by such a policy were found to have engaged in conduct contrary to the public interest, even though no laws had been broken. Significant sanctions, including penalties and restrictive orders on the insider, have resulted in some of these cases.

The Recent OSC Action

A recent settlement decision from the OSC exemplifies this trend. Penalties were imposed on a partner of a large corporate law firm who had traded in a client's securities in violation of the firm's "Global Practices Standards Policy." This Policy was similar to those adopted by many firms: firm members were required, first, to report any knowledge of material undisclosed information concerning a reporting issuer so that the company in question could be added to the firm's "restricted list" and, second, to obtain pre-clearance prior to any purchase or sale of securities of any reporting issuer on that restricted list. Unaware that the reporting issuer client was on the restricted list, and not actually possessing any material undisclosed information, the lawyer failed to seek pre-clearance as required by the Policy.

Although OSC staff recognized that the lawyer's trades did not violate the *Securities Act,* the OSC nonetheless pursued the matter, relying on its public interest jurisdiction to make orders even where no violation of the Act has been demonstrated. The eventual settlement included a reprimand, a voluntary payment of $10,000, costs of $20,000 and an 18-month prohibition, with limited exceptions, on trading securities or derivatives in Ontario. In approving the settlement, the OSC tribunal noted the lawyer's failure to "read, understand and comply with" the firm's insider trading policy and stated that his actions had consequently been contrary to the public interest and that he had thus "failed to adhere to the high standard of conduct expected of him."

Lessons Learned

The obvious lesson is that everyone should understand and follow the internal company policies that apply to them, particularly those policies that deal with trading in securities. At a deeper level, however, this case highlights an interesting quandary for companies and professional services firms. On the one hand, in an effort to foster a culture of compliance, they may wish to adopt strict, bright-line insider trading policies that protect their reputations by strongly discouraging directors, officers and employees from engaging in potentially risky market conduct. To meet these objectives, these policies may prohibit conduct that does not constitute a violation of securities laws. On the other hand — as the recent Ontario case shows — the very existence of such policies may give securities regulators the jurisdictional hook they need to pursue enforcement actions for policy infringement on "public interest" grounds.

While there is no easy solution to the quandary, this recent case (and others like it) should serve as a wake-up call for all players in the Canadian securities market. Even where there has been no violation of securities law, a failure to follow internal compliance policies could lead to enforcement proceedings and serious sanctions.

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