

CAPITAL MARKETS ENFORCEMENT

A dynamic year for capital markets enforcement



Despite ongoing pandemic-related slowdowns, 2021 saw significant capital markets enforcement activity from regulators and prosecutors, including notable criminal and quasi-criminal proceedings. Much of this enforcement activity has been directed at emerging industries, particularly legalized cannabis and crypto markets.

Other developments in 2021 have the potential to shape the enforcement landscape for years to come, including the publication of a draft Ontario *Capital Markets Act* which, if enacted, will replace the *Securities Act* and the *Commodity Futures Act*. Other significant changes include the announcement of a beneficial ownership registry and the adoption by the Investment Industry Regulatory Organization of Canada (IIROC) of early resolution offers.

Continuing impact of COVID-19

This year, the fallout from the sudden pandemic-induced transition to virtual regulation and enforcement continued. Regulators and market participants were required to pursue and respond to virtual investigations and hearings. Regulators were also tasked with responding to a rise in fraudulent schemes that attempted to capitalize on the widespread pandemic-related uncertainty.

In general, regulators have adjusted well to the pandemic. While enforcement activity slowed, it has continued without significant disruption. As previously reported in our blog post on [osler.com](#), [CSA releases Annual Enforcement Report for fiscal year 2020–2021](#), and discussed in more detail below, the [Canadian Securities Administrators \(CSA\) Annual Enforcement Report for fiscal year 2020–2021](#) (the Enforcement Report) highlights the steps taken by capital markets regulators in the face of these unprecedented challenges. Addressing these challenges mandated a high degree of cooperation and coordination among CSA members and law enforcement, self-regulatory organizations, federal counterparts (including the Bank of Canada, the Office of the Superintendent of Financial Institutions and Finance Canada) and foreign regulators.

As the restrictions imposed by the pandemic loosen, it will be interesting to see how much of the switch to virtual enforcement remains, including whether there will be pressure to continue with virtual investigations and hearings and whether that will be resisted by the market participants' bar. We anticipate that virtual interviews will remain common post-pandemic and that more straightforward hearings will continue to be held virtually. We also expect the increased collaboration between CSA members to continue, given the obvious benefits to promoting prompt and coordinated investigations and prosecutions of multijurisdictional securities law violations.

We anticipate that virtual interviews will remain common post-pandemic and that more straightforward hearings will continue to be held virtually.

Enforcement activity

Administrative enforcement matters

The Enforcement Report, released on June 22, 2021, details a slow-down in enforcement activity in the 2020–2021 fiscal year relative to the prior reported period, likely because of postponements due to COVID-19. CSA members imposed a collective \$20.3 million in penalties and sanctions, a significant decrease from the \$45 million and \$77 million imposed in the 2018–2019 and 2019–2020 fiscal years, and the lowest annual total since 2008.

However, other enforcement metrics saw significant upticks. The CSA reported an increase in whistleblower tips received (461 this year, compared to 291 last year) and a 140% increase in investor warnings and alerts. Six individuals received jail terms, ranging from five months to four and a half years, and 49 respondents received interim cease-trade and asset-freeze orders. The number of new cases commenced (52) is in line with prior years, with the majority of new matters involving illegal distribution, registrant misconduct and fraud.

The Enforcement Report also highlights a large number of COVID-19-related investment scams. The CSA participated in the North American Securities Administrators Association "Sweep" to identify and remove fraudulent websites

and advertising on social media and digital marketplaces. The “Sweep” uncovered more than 150 fraudulent schemes, 64 of which were identified by Canadian regulators. Uncertainty and volatility create fertile ground for fraudulent schemes to flourish and the advent of widespread use of social media as a means of influencing market changes (such as the Reddit-driven frenzy over GameStop) is still relatively new. Accordingly, the pandemic may prove to be a crucible in which regulators’ ability to identify and address fraudulent activity is tested.

As we previously discussed in our blog post on [osler.com](#), [Québec Financial Markets Administrative Tribunal’s long reach](#), the Court of Appeal of Québec rendered a [decision](#) related to the territorial jurisdiction of the Financial Markets Administrative Tribunal (the FMAT) on September 15, 2021. In the context of an alleged transnational “pump and dump” scheme, the Court ruled that FMAT has jurisdiction over the alleged wrongdoing despite the fact that the applicant resides outside of Québec. The decision confirmed that the FMAT must have jurisdiction over transnational matters when there is a real and substantial connection with the province. The Court emphasized the role of the FMAT, which is to protect Québec investors and to ensure the efficiency of Québec’s securities market and public confidence therein.

In the U.S., the newly-appointed Chair of the United States Securities and Exchange Commission (SEC), Gary Gensler, has suggested that sweeping new changes are on the horizon. These include more aggressive use of prophylactic remedies for securities laws violations, adjustments to the SEC’s current no-admit, no-deny settlement policy (which will make it more difficult for defendants to settle claims without admitting or denying wrongdoing) and amendments to the SEC’s whistleblower program and insider trading rules. Canadian issuers with U.S. securities exposure will need to carefully consider these changes.

Criminal and quasi-criminal enforcement

The Ontario Securities Commission (OSC) published its [2021 Annual Report](#) on September 2, 2021, which details the 11 cases investigated and two charges laid by the Quasi-criminal Serious Offences Team during the 2020–2021 fiscal year. While no federal *Criminal Code* proceedings were initiated in the 2020–2021 fiscal year, several such proceedings were initiated shortly after the fiscal year’s end:

- In June 2021, [charges were laid](#) against three former directors of CannTrust Holdings Inc., one of Canada’s first billion-dollar cannabis companies, including former CEO Peter Aceto. The three directors were charged with securities law violations following a sweeping investigation into CannTrust’s failure to disclose unlicensed growing by the OSC’s Joint Serious Offences Team, which includes representatives of the OSC and the Royal Canadian Mounted Police. All three directors are charged with misrepresentations while two of the directors face additional insider trading charges. In July 2021, CannTrust emerged from *Companies’ Creditors Arrangement Act* protection having settled significant securities misrepresentation lawsuits against the company.

- In June 2021, husband and wife duo Marc and Helene Brunet were [convicted](#) of quasi-criminal charges under the Ontario *Securities Act*. The allegations involved the sale of more than \$800,000 worth of securities in MultiCast Networks Holdings Inc. to Ontario investors between 2010 and 2016.
- In October 2021, Stephane Gagnon [was charged](#) with fraud and using a forged document. The OSC alleges that Mr. Gagnon collected more than \$20 million from investors across the country by promising them immediate access to their locked-in retirement savings accounts, but instead, using investor funds for personal expenses.
- In the same month, the OSC also [announced](#) the arrest and extradition to Ontario of Bernard Justin Sevilla, a U.K. resident charged with orchestrating from the U.K. a complex international fraud targeting Ontario investors. The alleged scheme involved purchasing airtime on Ontario radio stations to solicit investments in a foreign exchange arrangement called Trans-Atlantic Direct (TAD). The scheme encouraged interested investors to register an account and send their investment funds to offshore bank accounts for foreign currency trading. Approximately 100 Ontario investors directed almost \$5.2 million to TAD.

These pursuits reflect the growing priority enforcers are giving to combatting white-collar crime in a visible manner. As of October 2021, the OSC Enforcement Branch has pursued a total of 54 quasi-criminal and criminal matters involving 78 accused.

As of October 2021, the OSC Enforcement Branch has pursued a total of 54 quasi-criminal and criminal matters involving 78 accused.

Enforcement activity relating to crypto trading platforms

Canadian securities regulators began pursuing enforcement activity against crypto market participants. This follows on the heels of 2020's first ever settlement between the OSC and a cryptoasset trading platform (CTP).

The enforcement activity is largely driven by new registration requirements for CTPs. As we reported in our blog post on [osler.com](#), [Three week countdown for Canadian digital asset trading platforms to start getting registered under securities laws](#), these new requirements were jointly published on March 29, 2021 by the CSA and IIROC. At the same time, the OSC [imposed an April 19, 2021 deadline](#) for CTPs serving Ontario residents to contact the OSC to discuss registration. Other new regulatory requirements described in our [Decoding crypto – Providing regulatory clarity to cryptoasset businesses](#) article are likely to also drive a new wave of enforcement activity.

[More than 70 CTPs](#) have begun the registration process with the CSA. To date, OSC staff have published Statements of Allegations (SOA) commencing enforcement proceedings against four CTPs that failed to do so:

- [Poloniex](#), a Seychelles-based CTP (May 25, 2021)
- [KuCoin](#), a CTP based in the Seychelles and Singapore (June 7, 2021)
- [Bybit](#), a CTP based in the British Virgin Islands (June 21, 2021)
- [OKEx](#), a Seychelles-based CTP (August 19, 2021). Interestingly, the OSC pursued enforcement against OKEx in August notwithstanding the fact that, as acknowledged in the SOA, Ontario was listed as a restricted jurisdiction in the OKEx terms of service in June

The OSC alleges that each of the CTPs in question (i) are available to, and in fact used by, Ontario residents; (ii) engage in the trading of securities without prospectuses or prospectus exemptions; and (iii) have failed to engage in the CSA's registration process.

Interestingly, the OSC appears to have pursued this enforcement activity without definitively taking the position that the cryptoassets traded on the CTPs are securities. Instead, the SOAs each state that the "instruments or contracts" created when cryptoassets are deposited into the CTPs' custody are "securities or derivatives."

Internationally, this year has also seen increased enforcement activity against crypto market participants. In the U.S., the Department of Justice announced the formation of a [National Cryptocurrency Enforcement Team](#) to identify and pursue cases against cryptocurrency exchanges. The SEC has also brought a flurry of enforcement activities, including actions against unregistered crypto issuers and exchanges. Other jurisdictions also appear to be preparing to take regulatory action against unregistered crypto markets, with the U.K., Japan and the Cayman Islands issuing notices stating that Binance is not authorized in those countries.

Canadians scrutinized by foreign regulators

A number of Canadian entities faced regulatory scrutiny from the SEC in 2020–2021. For example, Sean Wygovsky, a trader at a major Canada-based asset management firm, was [charged](#) in July 2021 with fraud in connection with a front-running scheme through which he is alleged to have earned over US\$3.6 million.

Canadian cannabis company, CanaFarma Hemp Products Corp., and its founders were also [charged](#) with fraud in October 2021. The company is alleged to have raised approximately US\$15 million from investors and then misappropriated a significant amount of the raised funds for personal use and other unrelated purposes.

OSC guidance on enforcement investigations and document production

In July 2021, the OSC published guidance on enforcement investigations and document production to assist individuals and companies participating in enforcement assessments and investigations. This guidance included [OSC Staff Notice 15-707 Enforcement Investigation Guidance](#) and [OSC Staff Notice 15-708 Document Production Guidance](#). Through this, the OSC clarified the processes and timelines that individuals and companies can expect in enforcement assessments and investigations and provided insight into enforcement staff's expectations. The resources also described the Enforcement Branch's preferred production methods and provided information about how to respond to requests for records and other documents.

2020–2021 IIROC Enforcement Report

The IIROC 2020–2021 [Enforcement Report](#) revealed that IIROC Enforcement received just under 1,400 complaints in 2021. Nearly a third of these complaints related to unsuitable investments, while unauthorized and discretionary trading, misrepresentation and supervision concerns made up almost half of the remainder. With the majority of its investigations taking place in Ontario and in British Columbia, IIROC referred 25% of its files to prosecutions by the end of the fiscal year. In 29 cases, prosecutions were completed, of which 21 were cases against individuals and eight against firms. Individuals were most often disciplined for improper handling of client accounts and discretionary trading charges, while firms faced discipline largely for supervision faults. In total, IIROC imposed over \$950,000 in sanctions against individuals and \$1.2 million in sanctions against firms and collected 31% and 100% of sanctions imposed respectively. A series of appeals were ongoing across Ontario, British Columbia and Nova Scotia as of the date of the report's publication.

In addition to enforcement statistics, the IIROC report highlighted several key themes that emerged over the course of the year, including adequacy of supervision, internal control failures and non-compliance of IIROC-regulated firms. IIROC also specifically noted the increased importance of protecting seniors and vulnerable clients, which comprised a quarter of the completed prosecutions against individuals throughout the year.

Additionally, as [announced](#) in April 2021, IIROC adopted the use of early resolution offers (EROs) to resolve cases more efficiently. EROs allow targets of disciplinary actions to secure lighter punishments, including a reduction of up to 30% for dealers and representatives on the sanctions IIROC would otherwise seek in a settlement agreement. The reduction could apply to monetary penalties and to the length of a suspension. In offering the reduction, IIROC staff will consider the extent to which there has been proactive and exceptional cooperation, remedial measures implemented and compensation paid. IIROC also announced that it would withdraw one of its other [previously proposed options](#), the Minor Contravention Program, which had sought to address minor rule violations with standard penalties and no public disclosure. The withdrawal followed concerns expressed by public commenters that the suggested program would not serve the public interest.

In total, IIROC imposed over \$950,000 in sanctions against individuals and \$1.2 million in sanctions against firms and collected 31% and 100% of sanctions imposed respectively.

Enforcement-related legislative and regulatory developments

As we reported in our blog post on [osler.com](#), [Ontario Capital Markets Modernization Taskforce Final Report: A set of thoughtful ideas or a blueprint for change?](#), on January 22, 2021, the Ontario Capital Markets Modernization Taskforce published its final report (the Final Report), which presented a broad range of recommendations that, if adopted, would significantly rework capital markets enforcement. On October 12, 2021, based on the Taskforce's recommendations, the Ontario government released a proposed [draft Capital Markets Act](#) (Proposed CMA) which, if enacted, would restructure the OSC and replace both the Ontario *Securities Act* and the *Commodity Futures Act*.

The changes in the Proposed CMA are driven by a number of trends identified by the Taskforce, including the decline of primary markets; the rise of private markets; noticeable exempt market activities; the decline in active independent investment dealers; increased investor interest in environmental, social and governance (ESG) factors; increased shareholder activism; the COVID-19 pandemic's impact on markets; and the suspension of the Cooperative Capital Markets System (CCMR) initiative.

- **OSC structure:** Some of the most sweeping changes proposed in the Final Report and reflected in the Proposed CMA relate to the structure of the OSC, such as expansions to the OSC's mandate to include fostering capital formation and competition in the markets. If enacted, the Proposed CMA would also separate the OSC's regulatory and adjudicative functions. Decisions previously within the purview of the "Director" and "Executive Director" would instead be assigned to the "Chief Regulator." Accordingly, the Chief Regulator would possess sweeping powers, such as the ability to make recognition orders and decisions related to recognized entities in the public interest and the ability to revoke and vary decisions. Enforcement proceedings for offences under the Proposed CMA would only be commenced with the Chief Regulator's consent.
- **Increased penalties:** The Taskforce recommended that the maximum monetary penalties be increased for the first time since 2003 to bring Ontario into line with international jurisdictions. The Proposed CMA reflects this recommendation and proposes increases to the maximum administrative monetary penalty from \$1 million to \$5 million and the maximum fine for quasi-criminal offences from \$5 million to \$10 million.
- **Automatic recognition of orders:** The Taskforce recommended that the OSC should automatically (without the need for a hearing) reciprocate the orders of other Canadian securities regulators and streamline the reciprocation process for orders made by other bodies. This would support a consistent national approach to the enforcement of orders and settlements and reduce the use of OSC resources on reciprocation. These recommendations are reflected in the Proposed CMA, which provides for automatically reciprocating sanction orders, cease trade orders and settlements from other Canadian securities regulators. It also creates a streamlined process by which the OSC may reciprocate orders and settlements from Canadian courts, self-regulatory organizations, exchanges and foreign capital markets regulators.

- **New remedial measures:** Under the Proposed CMA, if the Chief Regulator is satisfied that an issuer has not complied with capital markets law, they may make a number of compliance orders, including cease trade orders or orders revoking exemptions. The Chief Regulator would be required to provide the issuer and, in certain cases, persons named in the order, the opportunity to be heard before making such orders. Interestingly, with respect to orders in the public interest, the Proposed CMA intends to expand the enumerated list in the *Securities Act* to include prohibitions against promotional activity; advising in connection with activities in capital markets; acting in management or consultative capacities; and voting or exercising any other rights attaching to a security at a specified meeting. In an effort to facilitate the enforcement of these new and revised offences, the Proposed CMA empowers the provincial court to issue capital markets production orders.
- **More extensive liability for exempt market participants:** The Proposed CMA would also expand civil liability recourse for investors in the exempt market by extending possible liability for misrepresentations in offering memoranda and other “prescribed offering documents” beyond issuers, including to directors, promoters and underwriters (similar to liability for misrepresentations in a prospectus).

At the time of writing, the Proposed CMA has been made available for public comment until January 21, 2022.

Greater corporate transparency through announcement of beneficial ownership registry

As we wrote in our blog post on osler.com, [Canada’s budget introduces long-awaited beneficial ownership registry to combat money laundering](#), and as discussed in our [White-collar defence: Increasing risks and enforcement activity](#), the Canadian government, in its April 2021 annual budget (the Budget), announced dedicated funding to Innovation, Science and Economic Development Canada to build and implement a publicly accessible corporate beneficial ownership registry by 2025. The measure is intended to better “catch those who attempt to launder money, evade taxes, or commit other complex financial crimes” and follows similar approaches that have been taken in other jurisdictions, including the United Kingdom and United States.

As the government’s announcement suggests, the ability to identify the parties behind the curtain of complex corporate structures is seen as a way to make it harder to engage in financial misconduct. Coupled with a high degree of international cooperation (which has been an ongoing project for many years, but is far from fully realized), beneficial ownership registries would make it harder for bad actors to hide their assets from securities regulators and tax authorities. However, having a registry that makes details of individuals’ financial affairs a matter of public record also raises important privacy and other concerns. It may itself be used as a means to do harm, including “naming and shaming” people who have engaged in legitimate asset protection or tax strategies. The Paradise Papers, Panama Papers and most recently the [Pandora Papers](#) have generated tremendous media attention but, at least in Canada, very little tax or securities enforcement litigation. That may be, as some claim,

Coupled with a high degree of international cooperation, beneficial ownership registries would make it harder for bad actors to hide their assets from securities regulators and tax authorities.

because Canada is a laggard when it comes to enforcement. On the other hand, it may also be because, however interesting the details of individuals' financial affairs may be, the formation of offshore accounts may be lawful in practice.

The past year has set the stage for 2022 to be even more significant for Canadian capital markets enforcement. We will continue to report on the proposed legislative amendments and pending prosecutions, which have the potential to fundamentally alter the enforcement landscape in Canada.

AUTHORS



Lawrence E. Ritchie
Partner, Litigation
Chair, Risk Management
and Crisis Response
lritchie@osler.com
416.862.6608



Alexander Cobb
Partner, Litigation
acobb@osler.com
416.862.5964



Sonja Pavic
Associate, Litigation
spavic@osler.com
416.862.5661



Simon Cameron
Associate, Litigation
scameron@osler.com
416.862.6430



Sarah Firestone
Associate, Litigation
sfirestone@osler.com
416.862.4727



Jayne Cooke
Associate, Litigation
jcooke@osler.com
416.646.3948