

# **“Real-Time Enforcement of Crime in the Capital Markets”**

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# Capital Markets Crime in Canada – The Past and Present

In the past few years, western countries have experienced a heightened level of concern for capital markets crime - concern that stems, at least in part, from the ever growing number of scandals plaguing our capital markets.

In 2002, we witnessed the collapse of a few large corporate entities in the United States with devastating effects on mutual funds and the retirement savings of citizens spanning the globe. This occurred amidst media reports that organized crime groups were using Canadian markets to launder their ill-gotten proceeds. All of this was harmful to Canada's reputation as a safe place to invest and do business.

In Canada, we share the growing global concern for capital markets fraud and, in particular, the effect on our general economy. We all know that cases of this type of fraud can lead to a general loss of market confidence. Worldwide, governments are of the realization that there will be a number of consequences if we allow these scandals to continue.

In previous years at earlier symposiums, I have reported on steps taken by the Canadian Government to enhance the protection of commercial and financial institutions against capital markets crime. The Government of Canada noted that Investor confidence was critical to the vitality of Canada's capital markets and to the Canadian economy as a whole. Our Government further asserted that it takes corporate fraud seriously and was committed to removing criminal activity from the markets and ensuring investor confidence.

In June 2003, the Solicitor General of Canada announced the creation of Integrated Market Enforcement Teams (IMETs), to be located in Toronto, Vancouver, Montreal, and Calgary. The writer was personally involved in the implementation of a new initiative entitled "Integrated Market Enforcement Teams" or "IMETs" as the national Director of that program.

The teams are composed of investigators, investigative assistants, major case managers, analysts, legal advisors, and forensic accountants, drawn from the RCMP and its partners. The teams are intended to enhance the ongoing efforts of other RCMP units, to detect and prevent corporate and market crime. The defining feature of the IMETs is their adherence to an integrated approach to investigations.

A case selection profile ensures that IMETs undertake only those cases which fit within well defined parameters. They are supported by resources dedicated to intelligence gathering, profiling, training and international liaison; all aimed at reducing the time for investigations and enhancing their quality.

All of the IMET positions were staffed using an innovative process, based on a competency model. Competencies have been used within the RCMP for some time, generally under the label of knowledge, skills, and abilities. Competency profiles were developed for IMETs by a panel of experts, including RCMP members and external partners, and these profiles were used to write the work descriptions and to establish selection criteria for staffing and promotion.

In addition, a “staffing to level” regime was implemented that permitted investigators to obtain promotions while remaining in an IMET. This was intended to facilitate the continuity and retention of expertise. All promotions have been based on individual performance, assessed against the designated competency profiles.

All of this was done with an appreciation that we had to produce police officers with highly specialized skills in order to effectively deal with the ‘high end’ criminal activity relative to sophisticated capital markets crimes.

Not wanting to focus this article on this particular subject, suffice it to say that the Royal Canadian Mounted Police and the Government of Canada remains very much committed to protecting investors against all types of capital markets crime. We remain equally committed to the vision behind the integrated approach as part of the strategic solution.

The Government of Canada reiterated its commitment to the IMET program in March of this year and announced that they were prepared to invest an additional \$10 million annually to make further enhancements to the IMET program. That funding is scheduled to become available in early 2008. Our Government also appointed a senior expert advisor to our program to help develop a plan to improve our overall effectiveness.

Despite all of these positive developments, challenges remain.

Firstly, it is important to note that it remains a monumental task to attract and retain investigative expertise. While the IMET program continues to demonstrate some success in attracting expertise, we now have an appreciation for how quickly we can lose that same expertise.

Secondly, despite some of the success we have had with our IMET program, we continue to have difficulty in satisfying key stakeholders. Some may recall that last year I spoke of media reports that tended to criticize the role of law enforcement in capital markets crime and often portrayed law enforcement as being either controversial or insufficient, or sometimes even incompetent. I have to tell you that these reports continue and criminal law continues to often be portrayed as weak and reactive in this regard. The media refuse to let go of old financial scandals as they impatiently wait for promised change in the form of more aggressive prosecutions. Many stakeholders in the financial services and securities industry remain convinced of the limitations of law enforcement and criminal prosecutions in this area and are asserting that significant further changes are required. For example, a report this past year by a Task Force to Modernize Securities Legislation in Canada had the following recommendation:

“The Task Force recommends that every effort be made to enable IMETs to complete current investigations expeditiously and in a focused manner.”<sup>1</sup>

Needless to say, our country continues to seek out new ways to further enhance the role of criminal enforcement. The common investor, and the entire business world behind them, is demanding that these crooks be treated like criminals and that there is indeed a genuine threat of investigation, prosecution and subsequent incarceration.

While a lot of these issues may seem like old news to some, it needs to be reiterated in order to set the tone for several points I wish to make today.

In summary then, the fact remains that investors, both private and institutional, continue to find capital markets abuses offensive and continue to demand that the government and police act more aggressively.

What is new is that all stakeholders have now become quite impatient and are demanding to see some significant criminal prosecutions. They are unhappy with long-term investigations and are demanding something that our colleagues from

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<sup>1</sup> - Task Force to Modernize Securities Legislation in Canada paper, *Canada Steps Up*, Oct, 2006, Recommendation 42

the United States refer to as ‘real-time enforcement’<sup>2</sup>; investigations and prosecutions that are focused on bringing perpetrators to justice in weeks and months as opposed to years and decades.

This situation has placed extensive pressure on law enforcement and prosecutors to deliver the goods and to provide public evidence of speedy investigations, followed by dragging white collar criminals off to jail. I am not talking about probationary sentences or home sentencing programs with the use of electronic bracelets – but rather handcuffs, police cruisers and meaningful jail time.

I wish to focus on this concept of ‘real-time enforcement’.

Speaking as someone who has been directly involved in capital markets investigations for the past 20 years, I have to tell you that expeditious or ‘real-time’ enforcement can be very difficult should law enforcement have insufficient means to compel citizens to cooperate and assist in official investigations. Worldwide, our citizens almost always feel a moral obligation or social responsibility to notify police and cooperate in any subsequent investigation when they witness a violent crime or robbery. However, these same citizens tend to find it ‘dreadfully inconvenient’ when asked to assist in the investigation of capital markets crimes.

Some jurisdictions have the police authority to compel citizens to assist official investigations and submit to an interview to outline their knowledge of the affair. Other jurisdictions however, such as in Canada, have to rely on moral suasion to convince witnesses of capital markets crime to cooperate. As you might expect, moral suasion does not always work and can cause criminal investigations to drag on for years. In fact, there is a much stronger motive, based on a threat of potential civil litigation, to not cooperate in any manner whatsoever.

In the current era of great concern for abuses of human rights, in many countries there are civil libertarians interested in putting further restrictions on the authorities and powers of police. In those jurisdictions, something like ‘real-time’ enforcement can be a bit overly optimistic. That said, I would suggest that those countries that do enjoy such special police authorities should strive to protect public confidence levels in them, use these authorities wisely, and go to great lengths to ensure there is no abuse. The complexity of capital markets

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<sup>2</sup> Speech by SEC Chairman Harvey L. Pitt - Remarks before the U.S. Department of Justice Corporate Fraud Conference, *U.S. Securities and Exchange Commission*, Washington, D.C... September 26, 2002

investigations brings its own unique challenges and we can not afford over-zealous investigators and prosecutors bringing superficial charges against innocent persons. The outcome might result in efforts to curtail the authority of police.

It is the opinion of this author that real-time enforcement will require additional authorities – not additional restrictions.

The key point here is that, should stakeholders involved in a capital markets crime strategy determine that real enforcement is a tenable goal, law enforcement may require additional authorities.

In looking at the future and identification of trends, last year I spoke of a positive trend aimed at making corporate fraud or capital markets fraud socially unacceptable. I remain convinced that this will continue but will take this decade and the next before reaching a significant level. Pursuant to this trend, we should now expect to see the judiciary bow to public pressure and bestow greater penalties and longer jail sentences on perpetrators of capital markets fraud. Those considering making some unethical decisions will find that such decisions have shifted from being immoral and unethical with relatively minor regulatory consequence, to downright illegal. The ramifications will be significant. We have now entered into that era where law enforcement is being pushed to weed out evil perpetrators of capital markets crime, and go to great lengths to ensure there is a genuine risk of investigation, prosecution and subsequent incarceration. I stand by my comments last year - capital markets crime has become socially unacceptable. Corporate criminals are no longer being romanticized and are now treated no better than the common thief.

A key point here is that it will be of greater value to have capital markets crime become socially unacceptable than it is to have it illegal. Quite frankly, public opinion carries more weight. Time has shown that, if a given crime is illegal but generally socially acceptable to the public, enforcement tends to have a tough time creating a credible threat to would be offenders. In those situations one is faced with overcoming unmotivated investigators and prosecutors, lenient judges, and general apathy from the public.

I would now like to focus my comments on western demographics for a minute. Firstly, please consider the impact of an aging population on a criminal enforcement strategy. We are all getting older and we all have greater disposable incomes. This will continue to cause significant human resource issues for the aging baby boomers – we all want to retire and we have insufficient expertise

available to replace our specialized skill sets.

Our seniors are also fed up with corporate insiders taking all of their hard earned money and making themselves rich - treating corporate treasuries like personal piggy-banks. Seniors definitely do NOT consider their hard-earned savings as disposal income! They want it well protected and insist that those who tamper with it are severely punished – ‘tarred and feathered’ if you wish. Senior investors want to avoid risk and are searching for solid, safe investments. The avoidance of risk is very relevant today in view of the current credit crisis occurring in the United States and being felt around the world.

What does this climate translate into for law enforcement and market regulators? Significant pressure to prevent and deter capital markets fraud from occurring in the first instance and, in those rare instances when capital markets fraud does occur (and it had better be rare) then, pressure to publicly demonstrate the most aggressive investigation and subsequent prosecution.

There are other immediate trends worthy of mention. All of us have been opining at this symposium for years on the threat stemming from the inability of law enforcement to keep up to the international flow of capital and relational international fraudulent schemes. We should also consider the impact of the current credit crisis affecting world economies. A traditional effect of down turns in the capital markets is for law enforcement to receive additional complaints of criminal fraud. People tend to complain when they lose money and the current crisis is causing many to lose. First will come extensive civil litigation followed soon thereafter by complaints of criminal fraud. I also expect we will receive increased complaints of real estate fraud relating to the high risk mortgages. Stakeholders will demand increased diligence by legislators and regulators when authorizing the creation of newly defined financial instruments.

We should also expect an increase in complaints of excessive executive compensation as investors watch their hard-earned savings disappear while corporate executives take home what might seem like exuberant salaries and performance bonuses.

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## **Conclusions**

In the past few years, law enforcement around the globe is being pushed to pursue capital markets fraudsters with greater diligence. Key stakeholders are now losing patience and are demanding some real time examples of arrests and prosecutions. Investigators and Prosecutors of capital markets crime also have to deal with key stakeholders who are unsatisfied with the length of time it is taking to bring offenders to justice. They are demanding real-time responses to financial disasters and when dealing with perpetrators caught with their hand in the cookie-jar.

In spite of increased resources and new innovative strategies, Law Enforcement often has difficulty in living up to stakeholder expectations. In some countries, there is little or no motivation for third party witnesses or facilitators of capital markets crime to cooperate with police investigations. Additional legislative tools may be necessary.

The aging population wants their hard-earned savings and investments protected and are demanding aggressive investigation and prosecution of persons suspected of capital markets crime.

Western countries are experiencing the retirement of the baby boomers resulting in key employees being in big demand. All currently are, or soon will be, having difficulty replacing experienced investigative personnel.

While the concept of 'Real-Time' enforcement is a tenable goal, we have much work to do if we wish to pose a sincere and genuine threat to would be perpetrators of capital markets crime; a threat of investigation, prosecution and incarceration.