A POLICY REVIEW

OF THE ROLE OF THE

ROYAL CANADIAN MOUNTED POLICE

IN

SECURITIES FRAUD ENFORCEMENT

by
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ABSTRACT

Securities markets play an important role in the Canadian economy as means of allocating savings to investment opportunities, spreading risk, and permitting redeployment of assets. The industry is currently going through a period of dramatic change, brought about by the driving forces of deregulation, new technology, and globalization.

One sector of the industry, the junior markets, has a reputation for fraud and corruption. There have been widespread media reports of unscrupulous stock promoters and company insiders unlawfully interfering with these 'free markets' and earning large profits at the expense of public investors. This perception of fraud is supported by the RCMP, the senior investigative body in Canada for securities fraud enforcement. RCMP investigators assigned to the securities fraud squads are generally frustrated by their lack of success in protecting the integrity of the public market place. There have also been very few convictions for securities fraud in the past several years.

There are a number of reasons for the ineffectiveness of the securities fraud enforcement strategy. There are problems with the criminal law relating to section 380(2) of the Criminal Code of Canada. There are also jurisdictional struggles between different levels of government and within governmental departments. Finally, there are a number of internal RCMP problems, in particular in the area of human resources policy. A survey of RCMP securities fraud investigators determined that for the most part they are not equipped to investigate major securities frauds. They are lacking in formal education, specialized training, and generally do not remain within the section long enough to become proficient and complete a major investigation.

It is recommended that the Federal Government review its securities fraud enforcement strategy and seek to restore the original powers and mandate of the squads. It is suggested that in order to effectively deter the perpetrators of securities fraud, there must be a genuine risk of being discovered, prosecuted, and incarcerated.

It is also recommended that the RCMP undertake a complete review of their human resources policy with respect to this highly specialized group of securities fraud enforcers. It is suggested that the Securities Fraud Squads need to be segregated from the general mainstream policing service and given increased autonomy over financial and human resources. They must also be effectively staffed with qualified investigators who are interested in making a career of securities fraud enforcement. This highly specialized field cannot be effectively policed with a generalist policing philosophy.

DEDICATION

Dedicated to those
RCMP Securities Fraud Investigators
who, against great odds, and at great personal sacrifice,
have sworn a criminal indictment
for
Stock Market Manipulation

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1.0 INTRODUCTION

1.1 The Royal Canadian Mounted Police Securities Fraud Squads

In 1967, in response to a request from the Federal Government, the Royal Canadian Mounted Police ('RCMP') established a securities fraud enforcement program. This initiative consisted of building a central repository of criminal intelligence information relating to securities fraud and establishing a number of securities fraud investigative squads across the country. The RCMP was prepared to assume responsibility for the enforcement of securities regulation, with a primary focus on the securities related offenses defined in the Criminal Code of Canada.

In the early years, these squads were considered very effective and demonstrated that they could have a definite deterrent effect on abuse in the public market place. However, this effectiveness appears to have waned in that there have been very few securities related Criminal Code convictions in the past 15 years. RCMP investigators attached to these squads have also been known to express frustration at their seeming inability to have any affect on protecting the integrity of the public stock markets.[1] This frustration has been intensified in the past few years with the extensive coverage by the media of incidences of abuse and corruption by stock brokers and promoters in Canada's Junior Stock Markets ('Junior Markets').

1.2 Objective of Paper

The objective of this paper is to explore why the fraudulent abuse of Canada's junior markets has not been deterred by the current federal government securities fraud enforcement policy. This exploration will include a detailed review of the original organization and subsequent performance of the RCMP Securities Fraud Squads. This paper is also intended to foster discussion of the jurisdictional issue with respect to federal

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[1] The author is a sixteen year veteran of the RCMP of which includes eight years with the Vancouver Commercial Crime Section Stock Market Group. The experience and knowledge from this association forms the basis of general references to RCMP procedures and policy.

and provincial responsibility for enforcement of securities regulation. An additional objective lies in the examination of some of the key driving forces within the securities industry itself, with the intention of suggesting new, more optimal enforcement strategies patterned after these forces.

1.3 Procedure/Methodology

Information has been collected from each of the current RCMP securities fraud investigative units in Canada. This information includes statistical estimates with respect to the proportion of criminal investigations within each respective market, and common characteristics of the offenders.

A questionnaire was also sent to each individual market investigator known to have been attached to one of the Securities Fraud Squads at some point over the past 27 years. (See Appendix A.) Information was sought with respect to their individual entry level education, their training, their respective investigations, and their impression of the overall effectiveness of the squad.

Interviews were then conducted with select investigators who were attached to a securities squad for an extended period and were known to have developed a strong understanding of the work.

Research also included review of the historical files of the Royal Canadian Mounted Police with respect to the formation of the Securities Fraud Squads and the ongoing government policy.

1.4 Policy Analysis/Project Structure

This paper is focused on the enforcement aspect of securities regulation with particular emphasis on the role of the RCMP. The analysis begins with a review of the overall securities industry, with particular attention paid to the current driving forces. There is then an analysis of the fraudulent abuse occurring within the industry in an effort to narrow the focus of the problem. This is followed by an examination of the conditions that produce a general market failure and warrant government intervention. The extent of this intervention, in terms of existing securities regulation, is then outlined. The

history of the RCMP Securities Fraud Squads is then reviewed in order to determine the original Government objectives with respect to this early policy. This is followed by a review of the performance of these squads over the past 27 years to determine what went wrong. A number of obstacles facing the current securities fraud enforcement program are identified. These obstacles are defined as either being internal or external impediments to the RCMP. They are then used as a basis from which to prepare a series of recommendations for an enhanced securities fraud enforcement program. The recommendations are specifically directed towards the senior management of the RCMP but have obvious implication to various other inter-governmental departments having overlapping responsibility for anti-fraud measures found within Canada's securities regulation.

2.0 THE CANADIAN SECURITIES INDUSTRY

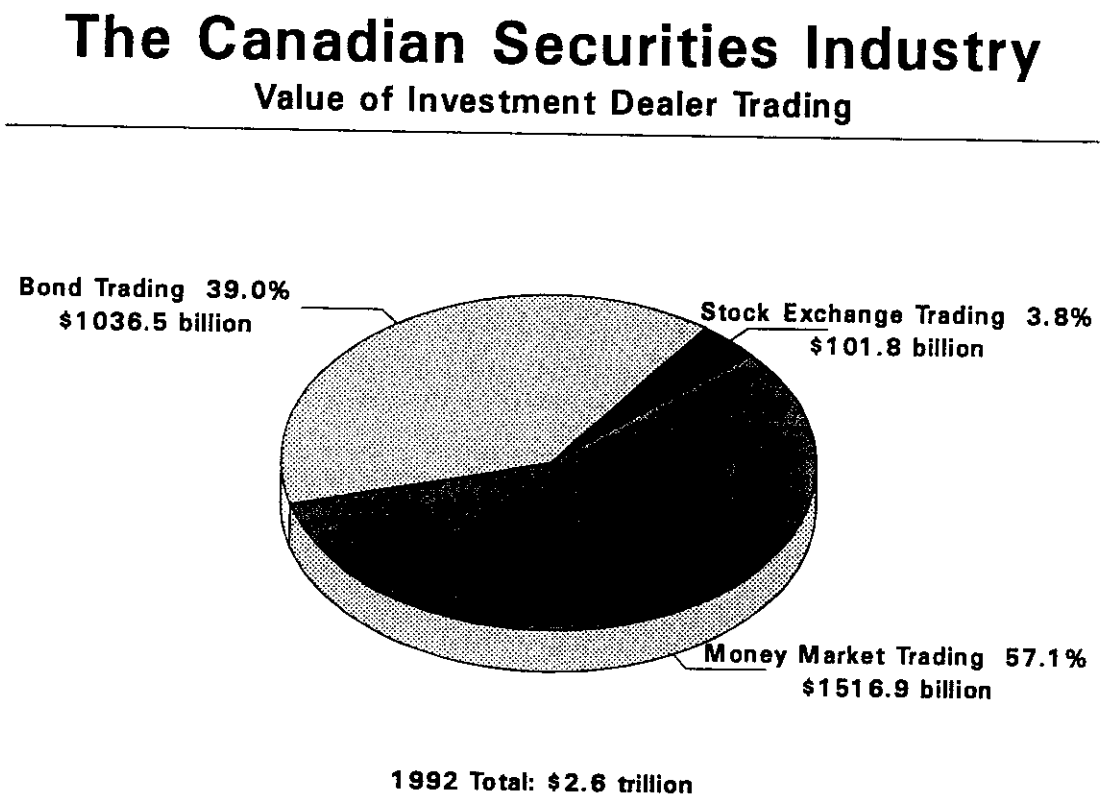
This chapter contains a review of the overall Canadian Securities Industry and the key players involved. The intention is to provide a framework with which to build enforcement policy that is relevant to key driving forces within the industry.

2.1 Economic Characteristics

Securities markets play an important role in the Canadian economy as a means of allocating savings to investment opportunities, spreading risk, and permitting redeployment of assets.

Securities valued at over $2.6 trillion dollars traded in Canada in 1992. Figure 2-1 outlines the proportion of this trading as shared between bonds, money market and stock market trades. Stock Exchange trading went on to reach an all-time high of $186 billion in 1993 (IDA Year-end Review, p. 1).

Figure 2-1



There are essentially two types of markets where buyers and sellers of securities interact for business purposes; Organized Stock Exchanges and Over-the-Counter markets.

2.2 Organized Stock Exchanges

A stock exchange has its own physical trading facilities where members can meet to trade in listed corporate stocks (preferred and common shares). This trading facility used to consist of a physical 'trading floor', however, this is gradually being replaced with the implementation of computerized trading operations. Qualified individuals representing investment dealer firms or 'brokerage' firms hold 'seats' on the stock exchange and thus have the right to trade there. A seat, the traditional term for stock exchange membership, represents one unit of ownership and entitles the holder to certain rights and privileges, including a vote and voice in the affairs of the respective exchange. These seats or rights to trade are traded back and forth among investment dealers. For example, as of December 31, 1993 there were 70 seats held on the Vancouver Stock Exchange with the last seat having been sold for $15,000 (VSE 1993 Statistics, p. 64).

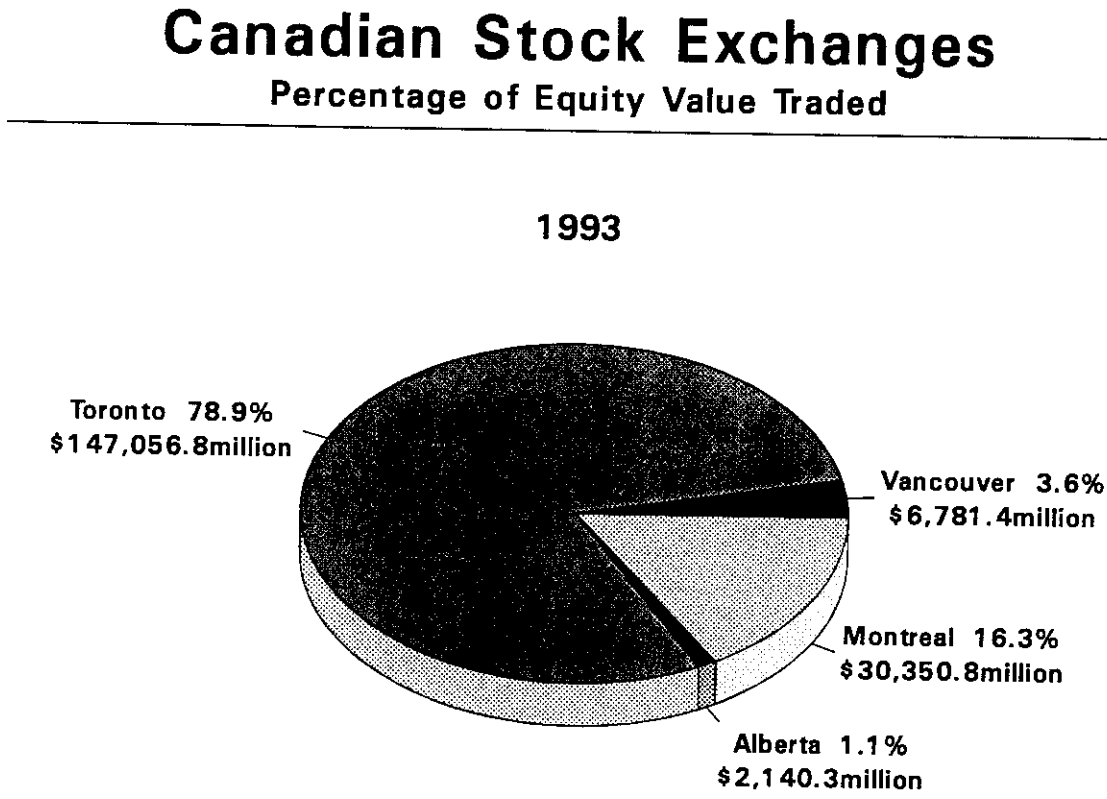
A stock exchange can basically be considered an auction market where the sellers "ask" a price for the security and potential buyers return with "bid" prices. Negotiations continue until a sale is made.

Companies that want a viable secondary market for their securities "list" such securities on a stock exchange. Permission to list is granted only if the firm meets the listing requirements specified by that stock exchange. These list requirements relate to minimum assets, earnings capacity and corporate standing in general. Once listed, firms have prescribed reporting functions and the conduct of management is subject to specific regulations. For example, it is a general rule of all Canadian stock exchanges that members of each exchange should trade listed securities on the "floor" of the respective exchange. Special permission is necessary to sell listed securities outside of the exchange or "off the floor".

In Canada there are five organized stock exchanges - The Toronto Stock Exchange ('TSE'), the Montreal Stock Exchange ('MSE'), the Vancouver Stock Exchange ('VSE'), the Alberta Stock Exchange ('ASE') and the Winnipeg Stock Exchange. The Winnipeg

Exchange has almost no trading in equity stocks. Figure 2-2 depicts the equity value of each exchange as well as their respective proportion of the total Canadian market.

Figure 2-2



Source: Vancouver Stock Exchange
1993 Statistics Book

2.3 The Over-the-Counter Market ('OTC')

The second potential meeting place of buyers and sellers of securities is the OTC market. This market facilitates the trading of unlisted corporate stocks and bonds. Investment dealers hold inventories of unlisted securities and stand ready to trade in these

securities. Buyers and sellers 'meet' by telephone and initiate trade transactions. A prominent example of this market exists in Ontario called the Canadian Dealer Network ('CDN'). The CDN market was formed a few years ago when the TSE took over operation of the unlisted securities market. Trade transactions valued at approximately $10 billion took place on the CDN market in 1993 (Boyce, March 10, 1994).

2.4 The Industry Driving Forces

2.4.1 - Venture Capital

In the mid 1980's we witnessed an era of venture capital, high yield bonds and global capital flows. Access to needed capital was suddenly no longer restricted to large, established companies. The volume of newly issued high-yield bonds in the USA, for example, leaped from $2.1 billion in 1980 to $27.8 billion in 1988 (Copeland et al, p. 6). While widely recognized as a source of financing for leveraged buyouts and raids by takeover entrepreneurs, many of these funds went to smaller entities that formerly would not have had access to debt capital other than through banks.

In the 1990's, market participants continue to talk of a glut of venture capital funds, and the large supply seemed to drive down returns. The volumes may not be growing as rapidly, but the blue-chip companies clearly no longer enjoy exclusive access to large amounts of capital.

2.4.2 - Information

Information is more widely available today than ever before. Large firms used to have a substantial advantage over smaller competitors in gathering market and competitive information. This is no longer so. The information services industry has grown rapidly and information is now available to any subscriber, regardless of size. The number of on-line data bases available in the market increased more than eight times in the 1980's. This can mainly be attributed to the declining cost of computers and magnetic storage devices. Competitive advantage now lies not in the assembly of information, but rather in making it available to clients and using it for decisions.

2.4.3 - Technology/Innovation

Heavy investments have been made in systems technology by brokerage firms attempting to become low-cost providers of financial services. The cost of such investments is reflected in the growth of communications expenses and depreciation, both of which have steadily increased in real terms since 1980 (Andrews, p. 14). Increasing investment in electronic equipment and links to markets and dealers are required in order to participate in an increasingly fast paced and global system.

Current technology allows market participants to scan the world for economic and business information searching for the best available prices. Electronic trade transactions spanning continents are performed instantly. Trade settlements are very simple and instant via electronic transfers of funds.

The conduits of the trading, i.e. the stock exchanges themselves, are also advancing technologically at a rapid pace. In 1990, the Vancouver Stock Exchange became the first exchange in North America to convert from a traditional open-outcry method of trading to a fully automated trade system by introducing their Vancouver Computerized Trading system ('VCT'). The VSE reports that the VCT system offers numerous benefits including streamlining the trading process and increasing the speed of execution and accuracy (VSE, 1993 Statistics, p. 2). Mr. Don Hudson, President of the VSE recently noted the following when referring to the affect of technology on stock exchanges:

> ***...One of the major influences on exchanges is the use of computers and modern telecommunications. Virtually every exchange in the world feels that impact of these new ways of doing business. Exchange operations lend themselves perfectly to these new technologies...***
> ***...Computerized systems have proliferated in the last five years throughout the world.***
> (Hudson, Oct 26, 1993).

2.4.4 - Globalization

The affect of global competition has had a dramatic affect on all Canadian industries. This trend is expected to continue in the decade ahead and result in more restructurings, acquisitions, and alliances around the globe. The removal of customs and

other regulatory trade barriers within both the European community and North America is causing a substantial reshuffling of corporate relationships.

Foreign banks are eager to enter the Canadian and US markets. Although they are lacking the deep expertise and contacts in Canada at this stage, they can use enormous capital resources to finance acquisitions in the hope of building credibility, skills, and banking relationships. Canada currently ranks fourth in the world in terms of stock market capitalization (The Canadian Securities Institute, p. 46).

Historically, foreign firms have not had much success in Canada. This was exemplified by the 1991 withdrawal from the Canadian retail market by Merrill Lynch Canada and Prudential Bache. For Canadian firms looking outwards towards the United States, the continuation of the Glass-Steagall restrictions places constraints on the largest Canadian brokerage firms because they are owned by banks and thus, are unable to freely compete in U.S. markets.

Canadian firms are looking to other countries, however. For example, the Canadian brokerage firms are looking to opening offices in Hong Kong to take advantage of the growing number of opportunities in China and Southeast Asia. ScotiaMcLeod announced recently that they intended to lead the way and be the first Canadian investment firm to open an office in Hong Kong (Evans, Dec 29, 1993, p. 12).

This trend is expected to continue and the borders between various types of financial institutions will gradually disappear. The most efficient institutions are expected to become global players and increasingly participate in international transactions with a strong presence in other financial centres (The Canadian Securities Institute, p. 56).

The Stock Exchanges are also beginning to think on a global basis. The number of U.S., Canadian, Japanese, French, British, German and Australian stocks that are now listed and traded on at least one stock exchange outside their national boundaries has multiplied (The Canadian Securities Institute, p. 55). Trading volumes have flowed to those markets offering the best prices and liquidity. In January of 1994 PIC Pacrim International Corp. became the first Hong Kong based company to be granted a direct listing on the Vancouver Stock Exchange (Evans, March 8, 1994, p. 5).

Mr. Don Hudson, President of the Vancouver Stock Exchange made the following comments at a recent Vancouver Board of Trade luncheon:

> ***In the last five to ten years, we have also seen an increase in the number of active exchanges in the world as a result of virtually every developing country wishing to have an exchange as a symbol of an effective market economy and as a spur to the development of domestic business. Many of these exchanges are becoming strong and important operations. Today we see serious and active exchanges in cities like Bangkok, Kuala Lumpur, Taipei, Seoul, Rio de Janerio, Buenos Aires, Santiago, Instanbul, Theran, and Tel Aviv to identify just a few. We are also seeing exchanges endeavouring to become important in cities like Warsaw, Djakarta, Shanghai, and some of the Russian cities. All of these new or newly developing exchanges are playing an important part in international trading and there is no indication that this is only a temporary phenomenon.***
>
> ***...We believe Asia represents a major opportunity for us and for example, we will be appointing a representative for the VSE in Hong Kong in the next few weeks.***
> (Hudson, Oct 26, 1993).

The VSE went on to appoint an advisory committee for their new Asia board and have stated that they would like to see 12 to 25 Asian companies listed by September, 1995 (Canadian Press, p. D4).

The VSE also introduced the concept of Associate Memberships in 1993 to facilitate access to the Vancouver market by brokers outside of Canada. Associate Membership allows offshore brokers to take advantage of many of the benefits of full membership in the VSE (VSE, 1993 Statistics, p. 63).

All of the Canadian securities markets are extending their reach. The VSE noted that a number of their listings, while registered in the province, are headquartered in other parts of Canada and the United States. In fact, during 1993, almost 40 percent of proceeds from private placement financings by VSE listed companies was raised outside of Canada (VSE, 1993 Statistics, p. 1).

2.4.5 - Disintermediation

Another area of some concern to the securities industry is disintermediation. Although "off-floor trading" has long been a sore point with brokers, the rise of electronic trading, and improving information links in general, raises the question of whether brokers will continue to be necessary as intermediators for all types of securities transactions. There is no suggestion that the broker expertise is not required for some complex transactions, but it is being suggested that there are some capital market activities traditionally conducted by brokers that can function without this intermediation. One good example is the development of the 'Capitalink' system in the United States. This electronic network allows the issuance of straight forward debt instruments directly to institutional investors, without the direct participation of an investment dealer.

In fact, the efficiency of computer trading has led many observers to question the continuing need for centralized stock exchanges in world markets and to promote the elimination of trading floors as has already been done in London and Copenhagen.

2.4.6 - Deregulation

In 1987, new regulations in Ontario removed most of the previous restrictions on the ownership of investment dealer firms. Simultaneous amendments were also made to federal legislation to allow banks, federally chartered trust companies and life insurance companies to own investment dealer firms. Freed from the limitation of a maximum of 10% ownership by an individual or company, and a maximum of 25% foreign ownership, foreign firms were able to establish Canadian subsidiaries or buy Canadian investment dealer firms. Also, Canadian financial institutions were permitted to purchase or form investment dealer firms.

2.4.7 - Institutional Investors

There has been a long-term trend away from personal direct holdings of securities in favour of intermediated savings. This is illustrated by the decline in the percentage of household assets held in corporate bonds from 16.8% in 1967 to 11.9% in 1989 (Andrews, p. 8). However, household holdings of stocks and bonds through the vehicles

of pension plans and mutual funds have increased substantially. The Financial Post reported that the annual RRSP rush of February, 1994 pushed the mutual fund industry's assets to a record $129.8 billion. It was also reported that approximately seven million Canadians have mutual funds (Chevreau, p. 13).

Consequently, an increasing proportion of stock market trading in Canada and the United States is accounted for by institutions. Further evidence of the increasing role played by institutional investors is the increasing size of the private placement market. This is particularly apparent in the venture capital market. Eighty-nine percent of the public financing on the VSE was done without a prospectus under the exemption for private placements in 1993 (VSE, 1993 Statistics, p. 17). This is in comparison to The Toronto Stock Exchange where private placements appear to be declining to the 15 to 20 percent range (Vancouver Stock Exchange & Securities Regulation Commission, p. 102). Some observers believe that the major reason for this wide difference is that Toronto-listed companies are more substantial and can take advantage of the short prospectus which can be prepared in several days. Most VSE-listed companies are not permitted to use the short form prospectus (Vancouver Stock Exchange & Securities Regulation Commission, p. 102).

2.4.8 - Decline of Retail Brokerage Business

Related to the increased proportion of institutional trading is the decline of the retail brokerage business. The growth rate of personal holdings of securities has lagged far behind the growth rates of other household financial assets such as pension plans, mutual funds and deposits with institutions and, therefore, the relative size of the retail brokerage market has declined. This trend is expected to continue.

2.5 The Securities Firm or Investment Dealer

Institutional services for the securities industry are provided by a group of securities firms with specialists performing dealer, broker, and counselling functions. Securities firms, also known as brokerage firms or investment dealers, are best known for two functions; they act as underwriters for new primary issues and they provide support for the secondary trading of outstanding issues.

When a company decides to raise funds, an investment dealer often buys the issue and sells it to investors. Because the investment dealer is continually in the business of matching users of funds with suppliers, he or she can sell the issue more efficiently than the issuing company can. For this service, the investment dealer receives a fee in the form of the difference between the amount received from the sale of the securities to the public and the amount paid to the company.

Investment dealers also have the organizational structure (administration, research, management, marketing, etc.) to provide a continuous brokerage and counselling service to investors as well as to their corporate clientele.

The traditional role for investment dealers then, has included the maintenance inventories of corporate securities, acting as buy and sell agents for investors, providing investment advice, acting as fiscal agents to companies, and providing associated services on a year-round basis. This traditional service has now been split into two distinct levels of service. A customer can choose between a full-service broker and a discount broker. Unlike full-service brokerage firms, discount brokers generally don't include investment advice in their basic services, and instead, charge lower fees for simply executing orders. Green Line, for example, has round-the-clock automated brokerage services which link clients with traders via personal computer or telephone.

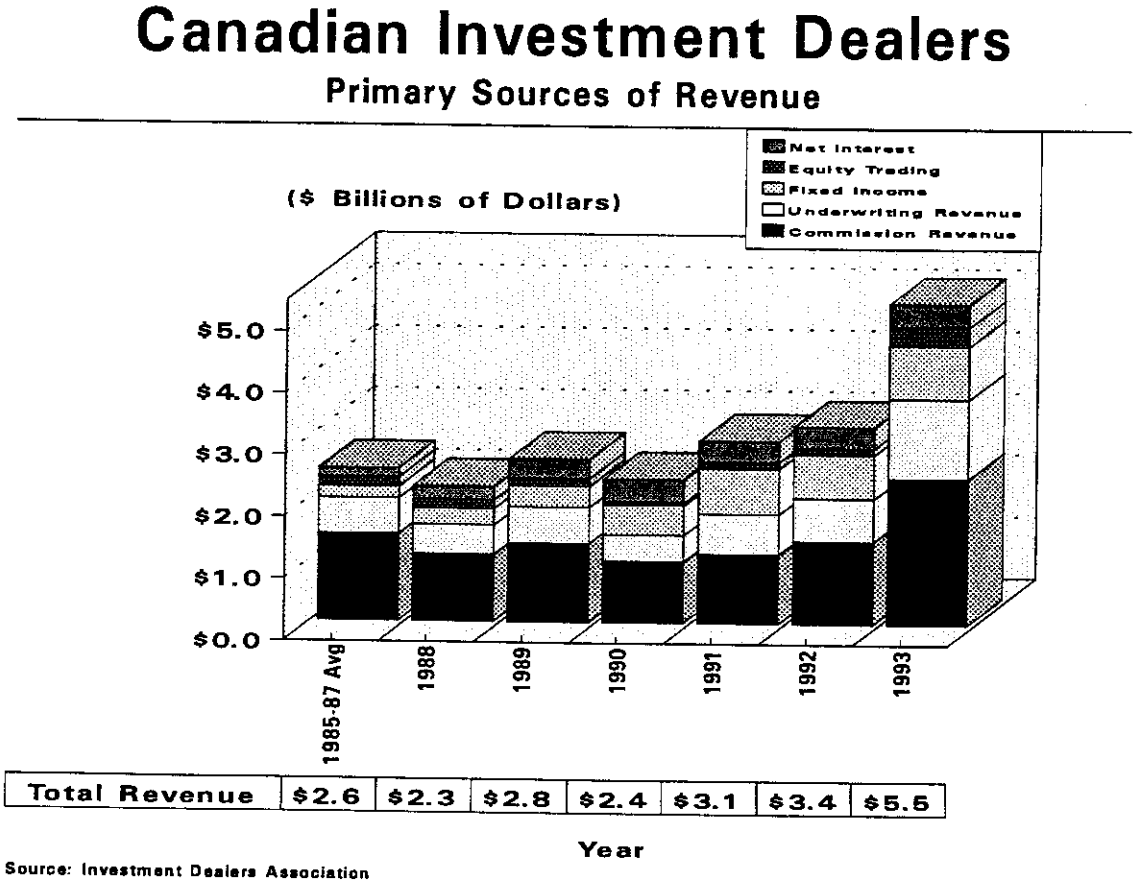
Another development on the full-service side of things has been the brokers' attempts to be seen more as providers of financial services, rather than sellers of stocks. First, they began to offer quasi-deposit products in the form of T-bills in small denominations. While not overly profitable, such a product was used to attract investors who might not otherwise use a broker, providing an opportunity to cross sell equities, mutual funds and financial planning. Then the brokerages began to promote self-directed

RRSPs to compete for the ever-growing pool of RRSP dollars. Canadian investment dealers now offer a full range of financial service products to their clients, competing directly with other financial institutions.

2.5.1 - Primary Sources of Revenue

The aggregate revenue of investment dealers in Canada was approximately $3.4 billion in 1992 and was over $5.5 billion in 1993. Figure 2-3 contains a graphical representation of the growth and breakdown of the main sources of that revenue.

Figure 2-3



2.5.2 - Number and Size of Brokerage Firms

There are approximately 144 investment dealer firms in Canada. Table 2-1 reflects the growth in the amount of capital and the number of firms and employees since 1976.

Table 2-1

CANADIAN INVESTMENT DEALERS

	Regulatory Capital ($ Millions)	Number of Employees	Number of Firms
1976	$217	12,153	120
1977	$221	11,779	124
1978	$257	12,386	104
1979	$346	14,247	100
1980	$531	17,980	102
1981	$569	18,659	100
1982	$577	16,950	98
1983	$721	19,460	98
1984	$769	18,884	95
1985	$1,027	20,292	100
1986	$1,535	23,106	96
1987	$2,504	26,954	108
1988	$2,640	24,583	124
1989	$3,048	23,463	119
1990	$3,034	21,602	119
1991	$2,938	19,324	118
1992	$3,204	19,968	131
1993	$4,208	22,553	144

Source: Investment Dealers Association

The industry as a whole consists of several different types of firms. These include the large full-service investment dealers that provide a range of corporate finance-related services and products to companies, research and trading for institutional clients, and research and trading for individual investors. There are also firms that provide a full range of services, but concentrate on a particular segment, such as the retail brokerage business, or in a particular geographic area. After the elimination of fixed commissions in 1984, a number of discount brokers emerged to compete on price in the retail market. These discount brokers now account for as much as 20% of the retail trades (Toole, Oct 10, 1993, p. B3).

Firms concentrating on the discount broker side of the business may find it exceedingly difficult to compete solely on costs with the bank-owned firms which enjoy huge economies of scale. John Bart, president of the Canadian Shareholders Association made the following comment on the banks' takeover of the discount brokers:

> ***Deep discounters may find the going much tougher now. They will only be able to compete on price. To increase their services requires a big build-up of technology and that is very expensive.***
> (Waldie, p. 16).

Institutional firms have expanded their share of profits this past year. The IDA reports that this group has prospered from the rash of initial public offerings ('IPO's) as well as from the many junior resource companies tapping the market for funds. The institutional firms' share of net profits rose to 30% in 1993, almost triple the 1992 share (IDA, "Securities Statistics").

The eight integrated firms were responsible for 90% of the 1992 industry profits. This share dropped dramatically to 62% in 1993, but these firms maintain a great deal of control over the market and this could make entry into the industry extremely difficult, at least at the corporate finance end. This is illustrated in the significant presence in the securities industry built up by The Toronto-Dominion Bank, a presence that was cemented with the purchase of Marathon Brokerage in October, 1993. Although most of the banks have a discount brokerage arm, Green Line and Marathon were the largest, accounting for an estimated 90% of the discount market between them (Hemeon, p. B1). The two firms now operate under the Green Line name and have up to 15% of the entire Canadian brokerage market. David Toole of the Toronto Star had the following comment on the Green Line takeover of Marathon Brokerage:

> ***The $59 million buyout of Marathon Brokerage will soon leave this country with one major discount broker and a handful of others who have barely made a dent in the market. For all intents and purposes, Green Line is about to become the only game in town for serious players.***
> (Toole, p. B3).

Many other firms do not compete in the retail market. For example, most of the foreign owned firms in Canada do not serve the retail market, focusing instead on large corporate finance transactions. Other firms provide specialized research or management services for institutional investors. The relative size of these firms as of 1990 is outlined in Table 2-2.

Table 2-2

Largest Canadian Investment Dealers

1980	1990
Over $25 Million Capital	**Over $200 Million Capital**
Wood Gundy	RBC Dominion Securities
Merrill Lynch Royal Sec	Burns Fry
Midland Doherty	Gordon Capital
Burns Fry	ScotiaMcLeod
McLeod Young Weir	Wood Gundy
Richardson Securities	
Pitfield Mackay Ross	
Dominion Securities	
Over $10 Million Capital	**Over $100 Million Capital**
A.E. Ames & Co.	Nesbitt Thomson
Nesbitt Thomson	First Marathon Securities
Walwyn Stodgell	Midland Walwyn
Greenshields Inc.	Richardson Greenshields

(Source: Andrews, p.6)

2.5.3 - Degree of Integration

The degree of integration has increased dramatically and this can be directly attributed to the swing towards deregulation. This was discussed earlier in the review of deregulation as one of the driving forces within the industry. Figure 2-4 will provide an idea of the percentage of the market captured by the integrated firms. Table 2-3 outlines the number of takeovers by the banks since deregulation came into effect.

Table 2-3

Brokerage Takeovers by Banks

Sep,1987	Nesbitt Thomson Inc.(75% by Bank of Montreal) BOM buys balance in April,1992.
Jan,1988	ScotiaMcLeod Inc.(100%) by Bank of Nova Scotia.
Mar,1988	RBC Dominion Securities Inc.(74.3% by Royal Bank of Canada.
Apr,1988	Burns Fry Ltd.(30%)by U.S. based Pacific Security Corp.
Jun,1988	Wood Gundy Inc.(66.6%) by CIBC.
Jul,1988	Levesque Beaubien Geoffrion Inc.(60%) by National Bank of Canada.
Oct,1991	McNeil Mantha Inc.(100%) by RBC Dominion Securities Inc.
Jan,1992	Select Securities Inc.(51%) by Laurentian Bank of Canada.
Oct,1993	Marathon Brokerage(100%) by Toronto Dominion Bank.

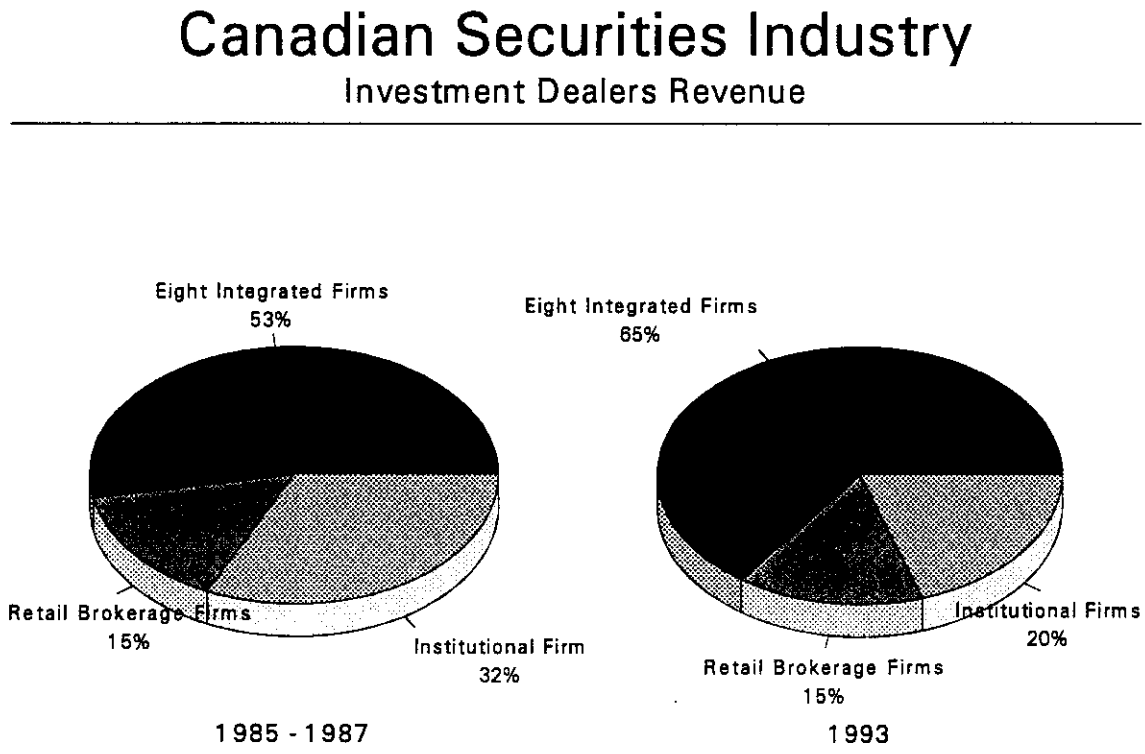
Source: Financial Post, Oct 9,1993

The bank-owned firms now provide a full range of corporate finance and retail services on a national basis.

2.5.4 - Revenue Share

The Canadian Investment Dealer industry currently consists of eight large full-service integrated investment dealers, a number of large institutional firms targeting specific markets, and approximately 100 niche retail players. Figure 2-4 provides an idea of the proportionate share of the market among these firms. The large integrated firms' share of the industry revenue had grown to a high of 70% in 1992 and has now levelled out to approximately 65%.

Figure 2-4

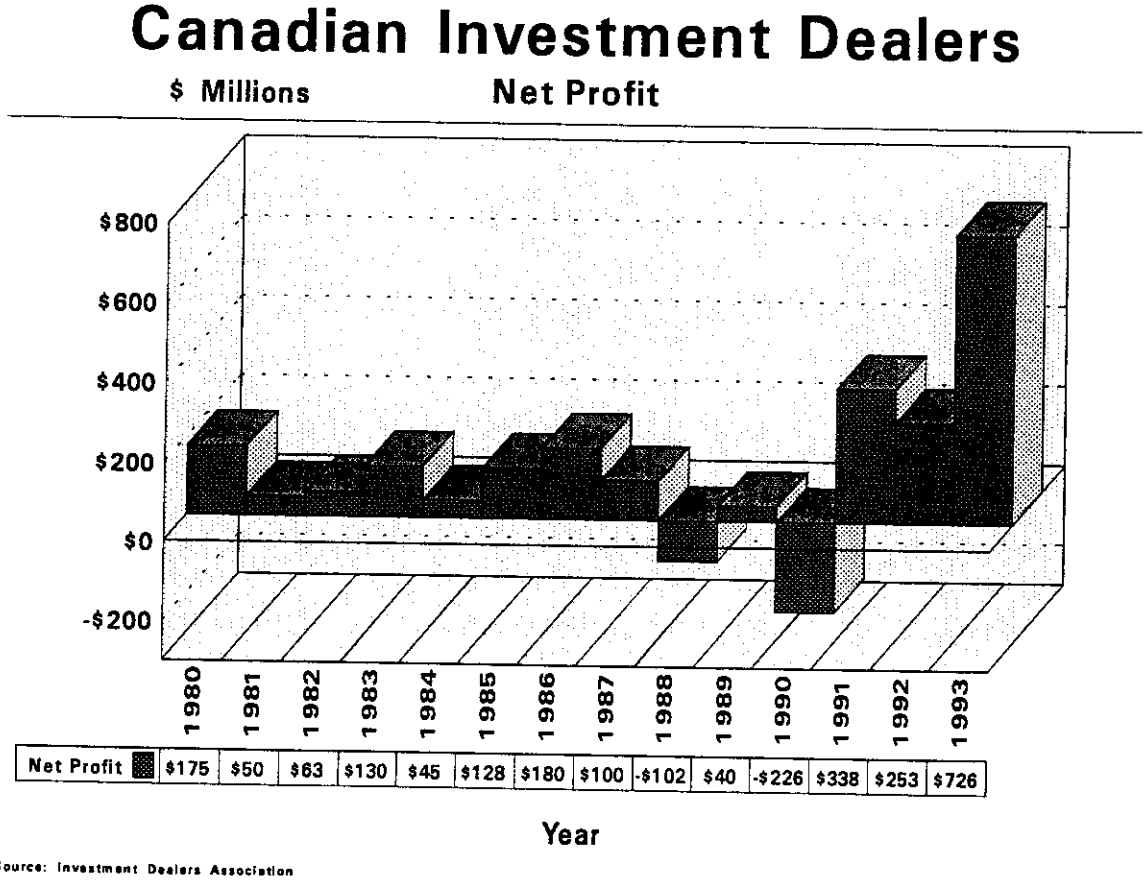


Source: (Investment Dealers Association)

2.5.5 - Profitability of Investment Dealers

The Canadian brokerage industry entered the 1980s with a year of record profitability. In 1981, however, the vulnerability of the industry to sharp cyclical swings became evident. Following an unprofitable 1981, the industry began a recovery in the second half of 1982 that continued until October, 1987, with only a minor setback in 1984. The market crash of October, 1987 resulted in reduced profits for the next several years.

Figure 2-5



Source: Investment Dealers Association

As the industry entered the 1990s, there has been a strong recovery as indicated in figure 2-5. The Investment Dealers Association also reported that 1993 was the most rewarding year on record for the Canadian securities industry (IDA Year-end Review 1993, p. 1). This performance is attributed to strong revenue growth on one hand and good cost control on the other. Underwriting revenues accounted for 24% of overall revenue in 1993, the highest share since 1985-87. Fixed income trading revenues made up another 16% of overall revenue which is on par with the average share in the past three years. The other key source of strength is coming from the retail side. In 1993, commission revenue increased to $2.4 billion, comprising 43% of total revenue. This is far below the average share of 54% contributed by commissions in 1985-87, but it still marks a healthy comeback from 1991.

2.5.6 - Key Success Factors

Key factors for success in the securities industry have changed somewhat as the full integration into the financial services industry reaches completion. Efficiency and information are the two key factors. Investment dealers have moved into a new arena and now are forced to join in the financial institutions' race towards the most efficient low-cost service. This service must include quick access to good reliable investment information and the state of the art technology to access it. Specialization is also a key factor for the niche market players, as noted by First Marathon president and chief executive Lawrence Bloomberg:

> ***Successful businesses must learn that they can't do all things for all people. If you try to do everything, you simply dissipate your energy and resources. So instead, you have to make choices and decide what you do best.***
> (Waldie, p. 16).

2.5.7 - Industry Prospects and Overall Attractiveness

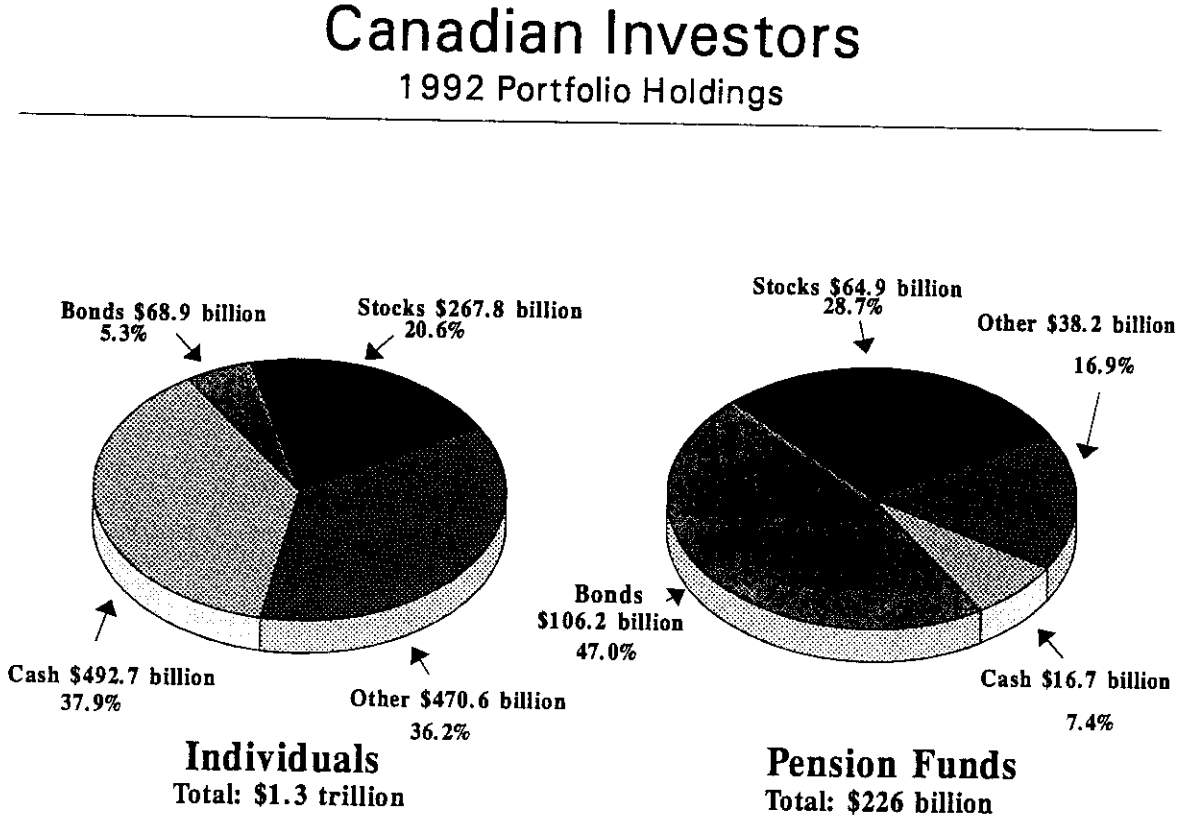
The mid-term survival prospects for the existing players are unknown. Some observers believe that most remaining players have successfully ridden out the cyclical downturn. There is concern over the mid-term prospects for the industry and this relates, in part, to the increased trend toward indirect investment through pensions, mutual funds and life insurance, leading to further shrinkage of the retail brokerage sector. Although it would appear that the downturn in the retail market has ended, there was concern in many quarters that this new boom would not be strong enough to support the existing number of firms in the retail sector. These fears would appear to have been unfounded as the extent of the boom became apparent.

There is also some real concern over the trend towards further disintermediation. It is not clear where the Canadian securities firms will fit within the broader context of the Canadian and international financial services industry. The securities industry has become an integrated component of the financial services industry. Having said that, the effects of an increasingly global market for financial services have been evident in the role played by foreign securities firms in advising Canadian business and the role of the offshore markets, particularly for Canadian debt.

2.6 The Investor

The Investor can be classified into two types of buyers of a brokerage service: individual or retail investors, and institutional investors. In 1992, Canadian households held approximately $1.3 trillion in financial assets. Figure 2-6 contains a chart that uses pension fund portfolios as a representation of the institutional investor to compare the proportion of each type of financial assets held by both the individual and the institution investors.

Figure 2-6



Source: (Investment Dealers Association)

2.7 The Stock Promoter

Another player in the Canadian securities market is the stock promoter. Promoters can play a valuable role in founding new ventures and providing a steady flow of information to the public. In fact, promoters are a key participant in any junior company marketplace. The VSE has recently undertaken to define the functions of a promoter in a listings policy statement as follows:

> 1. communicating with investment dealers, advisors and shareholders - both current and prospective - to increase awareness of and interest in the issuer (this will be referred to as the "promotional role"); and
>
> 2. maintenance of an orderly market in the issuer's securities (the "market-place role").
>
> (VSE Special Committee Report, p. 1).

The VSE goes on to note that "while neither of these roles is objectionable in and of itself, the concurrent performance of both roles can create serious conflicts of interest that results in both roles being improperly performed. Furthermore, when inappropriate activities are conducted under the guise of diligent performance of those roles, the fairness and integrity of the marketplace suffer." (VSE Special Committee Report, p. 1).

Thus, the role of the promoter is of great significance in consideration of effective regulation enforcement policy.

2.8 The Future of the Canadian Securities Industry

The future of the Canadian securities industry may be somewhat uncertain but the profitability would definitely appear to be on a strong upswing. This can be attributed to the large infusion of capital from the banks resulting in heavy investments in systems technology by firms attempting to become efficient and low-cost providers of financial services. They have been successful.

The future will see an industry heavily dependent on technology and with an international focus. Johanna Powell of Investment Executive magazine had the following to say about Keith Gray, the chief executive officer of Green Line with regards to the future of the securities industry:

> ***Gray holds his cards close, but he talks about the refinement of phone, computer and home trading links as directions for the future. Stock quotations are already available from Green Line by touchtone phone and computer, and equity trading by phone and computer is scheduled to be added in November, with an inviting 10% discount on fees. Mutual funds will be added to this system "likely within the next year", Gray says. Mutual funds may even be available in the next few years through automated bank machine terminals, although there are regulatory issues which have to be resolved first.***
> (Powell, p. 18).

It is important to recognize that the re-shaping of the Canadian securities industry is still in progress. J. Pearce Bunting, President of The Toronto Stock Exchange, has said:

> ***I am unaware of an industry where the rules of the game are changing faster than in the securities business. The combination of deregulation and globalization has made the successful management of change a necessity ... While traumatic for those affected, these changes were not unanticipated by those who decided on Canadian deregulation. Their view was that the survivors of deregulation would be battle-hardened to compete internationally.***
> (The Canadian Securities Institute, p. 58).

2.9 The Driving Forces Affect on Effective Securities Fraud Enforcement Strategy

Each of the industry driving forces warrant careful consideration for regulation enforcement policy. Of particular importance is the fact that the industry is making huge investments in systems technology and electronic equipment in order to participate in an increasingly fast paced and global system. In addition, Canadian investment firms have been taken over by the banks and have become global players. An effective enforcement strategy will have to invest equally in technology and be prepared to undertake investigations of increased international dimension.

These two key forces of advanced technology and globalization will without a doubt have the greatest effect on enforcement. The high-tech globalization of the securities industry has presented new opportunities for investors and securities professionals to legitimately utilize capital, and in innovative ways. However, the ability to effect immediate trade transactions in and across different countries has also afforded new opportunities to the unscrupulous to commit securities fraud offenses. In particular, those who seek to engage in illegal or manipulative trading practises now commonly attempt to conceal their activities by conducting their trading through foreign firms. It is now possible to purchase RRSPs through the use of touch-tone telephones and it is expected that we will soon be able to purchase stocks in the same manner. In the following chapters it will be seen that a significant part of major criminal securities investigations involves matching responsibility for a given trade transaction to a person, a suspect. This task has become exceedingly difficult and undoubtedly will become much more so, caused in part by the driving force of high tech globalization.

3.0 NARROWING THE FOCUS

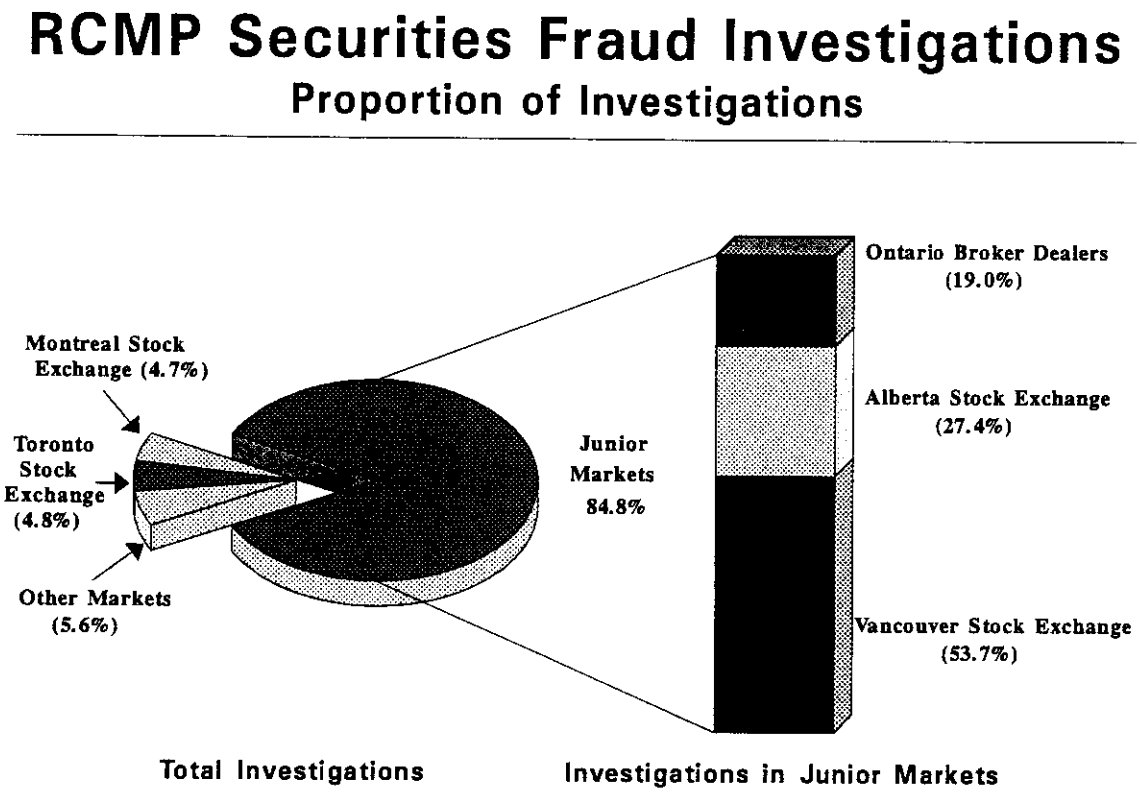
As a preliminary step to effective policy analysis, it can be of significant benefit to narrow the focus of the identified problem as much as possible. Therefore, it became a primary consideration to determine whether fraud and corruption are problems within the whole of the securities industry or alternatively, are concentrated in one particular segment. Similar reasoning dictated that it be determined whether the securities fraud perpetrators are widely dispersed throughout society, or are concentrated in one particular profession. In order to try to narrow the focus of fraud in the Securities Industry, each existing RCMP Securities Fraud Group was asked to provide an estimate of that proportion of their respective 'market manipulation' investigations that involve securities listed on each respective stock exchange or over the counter market. The rationale behind restricting the estimates to market manipulation and the legal characteristics of these investigations are outlined in chapters 5, 6 and 7. Appendix C contains a summation of the raw data as received by each securities fraud investigation group. Figure 3-1 contains a graphical representation of these estimates.

3.1 The Junior Markets

A majority (85%) of the market manipulation investigations are centred on the junior stock exchanges and the Ontario Broker Dealers as indicated in Figure 3-1. The Ontario Broker Dealers constitute just a small segment of the Canadian Dealer Network, a segment that is very much like that of the penny stock dealers in the United States. They sell only their in-house stock as principal, most of which is acquired from promoters or vendors of assets into the underlying companies.

The designation 'Junior Markets' will be used to refer to these specific Canadian junior markets that are the primary focus of the RCMP Securities Fraud Squads. This definition then, will encompass all of those securities traded on the Vancouver Stock Exchange, the Alberta Stock Exchange, and through the Ontario Broker Dealers.

Figure 3-1



It is acknowledged that there is the possibility that the investigators are simply acting in a reactive capacity to the magnitude of the problem in the junior markets and are too busy to become aware of any existing criminal activity on the senior exchanges. In fact, in support of this possibility, one retired senior investigator commented that he thought the problem was not limited to the junior markets and that the frauds on the senior exchanges were naturally of much larger value. However, he suspected that they simply go undetected or are dropped (Bullock, Jan 25, 1994). This is supported by the recent announcement that the Ontario Securities Commission was accepting a $2.7 million payment from Sergio Cragnotti and Roberto Marziale to settle allegations of insider trading and stock manipulation (Haggett, p. 18). The Ontario Securities Commission also recently concluded a settlement with a brokerage firm and other individuals concerning

the allegations of short-selling on insider information in shares of Laidlaw Inc. That settlement included the formation of a $26 million fund to compensate those who may have suffered losses as a result of the defendants' conduct (Vancouver Stock Exchange and Securities Regulation Commission, p. 93).

However, it is generally believed by investigators and other industry regulators that the problem is of significantly less concern on the senior stock exchanges.

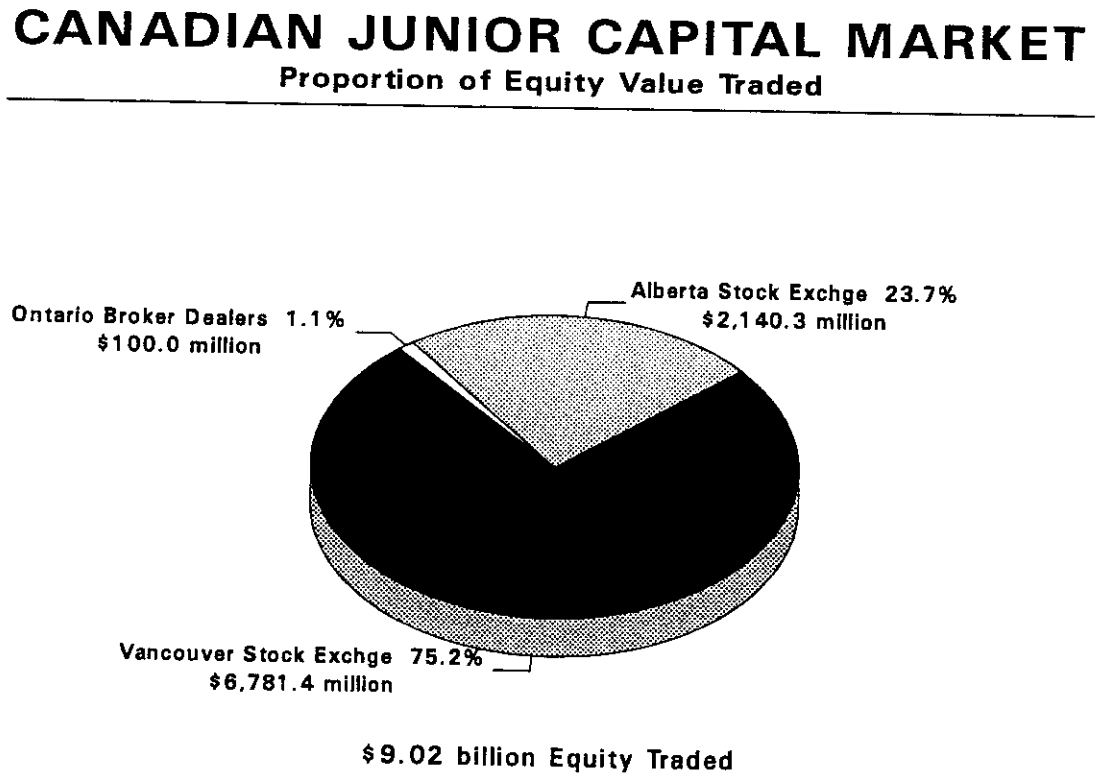
> ***There is no doubt that fewer (and different) problems exist in other more senior markets and that similar problems exist in all junior markets.***
> (Vancouver Stock Exchange and Securities Regulation Commission, p. 9).

Junior markets provide public financing to early-stage ventures. This financing is often commonly referred to as 'venture capital'. Venture capital can have many slightly different definitions, but the main overlying characteristic is that it is start-up capital exposed to higher-than-normal risk. It is thought to fill an economic niche in Canada by financing the smaller, developmental-stage companies. Such investments are exposed to a greater-than-normal risk of losses, and consequently, venture capitalists require the potential for higher-than-normal returns. In fact, it is this prospect of high returns on speculative ventures that attracts investors to the junior markets.

3.1.1 Size of Canada's Junior Capital Markets

The value of the securities traded on each of the VSE, the ASE, and the CDN was outlined in chapter 2. Figure 3-2 contains a graphical representation of the segregated junior capital market. The overall market value of the securities traded on the Canadian Junior markets, as we have defined them, was approximately $9.02 billion in 1993. This is the monetary stake when considering the effectiveness of a securities fraud enforcement strategy.

Figure 3-2



Source: Vancouver Stock Exchange
1993 Statistics Book
& (Financial Post Sep 25,1992)

3.1.2 Reputation of Canada's Junior Markets

All Junior markets have a reputation that stems from an inherent part of their definition - 'start-up' or 'venture' capital for high-risk ventures. The overall image begins with a reputation for high risk, and it is important to note that this reputation would be quite acceptable to investment dealers, the public, and regulatory authorities if it ended there.

It is only when evidence of fraud and corruption appears, that a market will develop an added reputation for being unfair, or having an 'uneven playing field'. Although venture capital markets have a legitimate and economic function, the acceptance of high risk by investors is sometimes compared to that of common gambling. However, even those particular investors that may be quite willing to accept high risk must be assured that this risk is equally shared by everyone. They will participate in the market only when they are certain that there is no manipulation or insider trading. A securities market having a reputation for fraud and corruption will cause investors to search for alternative markets with a more level playing field. Therefore, the reputation of Canada's venture capital market is of paramount economic importance.

All of the VSE, the ASE and the Ontario Broker Dealers have been subjected to exceptionally negative press coverage during the past several years. In fact, there is evidence that the VSE has suffered a poor reputation for many years. As far back as 1977, Philip Manthias of the Financial Post was writing of problems on the VSE.

> ***VSE President Robert Scott is tilting at the exchange to clean up a long-standing mess that has gained it an unwanted reputation as the bad boy of Canadian stock exchanges. Appointed last year, he is the third "clean-up" president to head the exchange since 1971. But even though the stock scams (ripoffs) in Vancouver are milder now than those in the wild and wooly days of 1969-1972, they are still tough to control.***
> (Manthias, Apr 16, 1977, pp. 43-44).

VSE President Scott was obviously not successful as things had not improved by the 1980s. In 1987, Forbes magazine published a scathing article which harshly criticised VSE promotions and the typical products offered by VSE ventures (Forbes Magazine, pp. 132-136). In 1990, Prime Time televised an expose of the VSE, involving some undercover video footage of a Prime Time producer posing as an investor interviewing

several Vancouver brokers (ABC-TV - 'PrimeTime Live', Oct 10, 1990). The reputation worsened to the point where critics frequently call the VSE the "scam capital of the world" (Vancouver Stock Exchange & Securities Regulation Commission Report, p. 13).

In May, 1993 the Province of British Columbia appointed a Commission to conduct an independent policy review of the regulatory framework of the British Columbia securities market. This Commission, entitled the Vancouver Stock Exchange & Securities Regulation Commission ('Matkin Commission'), conducted questionnaire surveys of investors and learned that VSE listed company shareholders typically hold their shares for less than one year and the majority do not view purchasing shares on the VSE as an investment, but rather as "speculation", "an outright gamble" or "a reasonable risk". The most popular reasons cited for not investing on the VSE were:

- the bad reputation;
- it is too risky;
- lack of confidence in the VSE; and
- bad investment experiences on the VSE in the past.

The Commission of Enquiry went on to note that this lack of confidence may be eroding the competitiveness of the VSE and that the VSE's market share had declined from 12 percent of the Canadian total in 1980 to 3.5 percent in 1992 (Vancouver Stock Exchange & Securities Regulation Commission, Interim Report. p. 6).

The ASE has suffered a similar loss of confidence. In 1988, Diane Francis wrote about the ASE in her book, 'Contrepreneurs':

> ***The Alberta Stock Exchange is a disaster waiting to happen...***
> ***..What the brokerage community and other exchanges and the federal government must realize is that a financial system is only as strong as its weakest link. And Alberta is Canada's weakest link.***
> (Francis, 'Contrepreneurs', p. 207).

Ms. Francis went on to quote lawyer Len DOUST, a Vancouver ad hoc Crown prosecutor and prominent defence counsel as follows:

> ***The way the Vancouver and Alberta markets are run is nothing short of criminal as far as I'm concerned, and don't let anyone tell you differently.***
> (Francis, 'Contrepreneurs', p. 207).

The Ontario Broker Dealers have also become subject to similar negative publicity. Although this market may only be a few years old, it has already developed a reputation as an unregulated market in that the Ontario Securities Commission is forced to allocate 15% to 20% of its total enforcement budget (of $3 million) on enforcement efforts directed at the Broker Dealers. The cost of this enforcement effort is out of proportion to the Broker Dealer's $100 million contribution to the overall 'tens of billions' in security trading in Ontario (Financial Post, Editorial, Sept 25, 1992 p. 8). In fact, the problem became so serious that in October, 1993 the Ontario Provincial Government launched a task force to determine a better method of regulating these penny stock dealers (Kelly, Doug., p. 17).

In summary, there is substantial evidence that Canada's Junior markets suffer from a very poor reputation of fraud and corruption. This is believed to cause prudent investors to search for alternative markets that offer a more level playing field. There are also other consequences to this poor reputation. Legitimate companies are undoubtedly hampered by this publicity in their efforts to secure financing for genuine ventures. For example, in 1991 Charles Mayer, the minister responsible for the federal office of Western Economic Diversification Canada, announced that they were reassessing their loan policy with regard to VSE companies (Smith, David, p. C1).

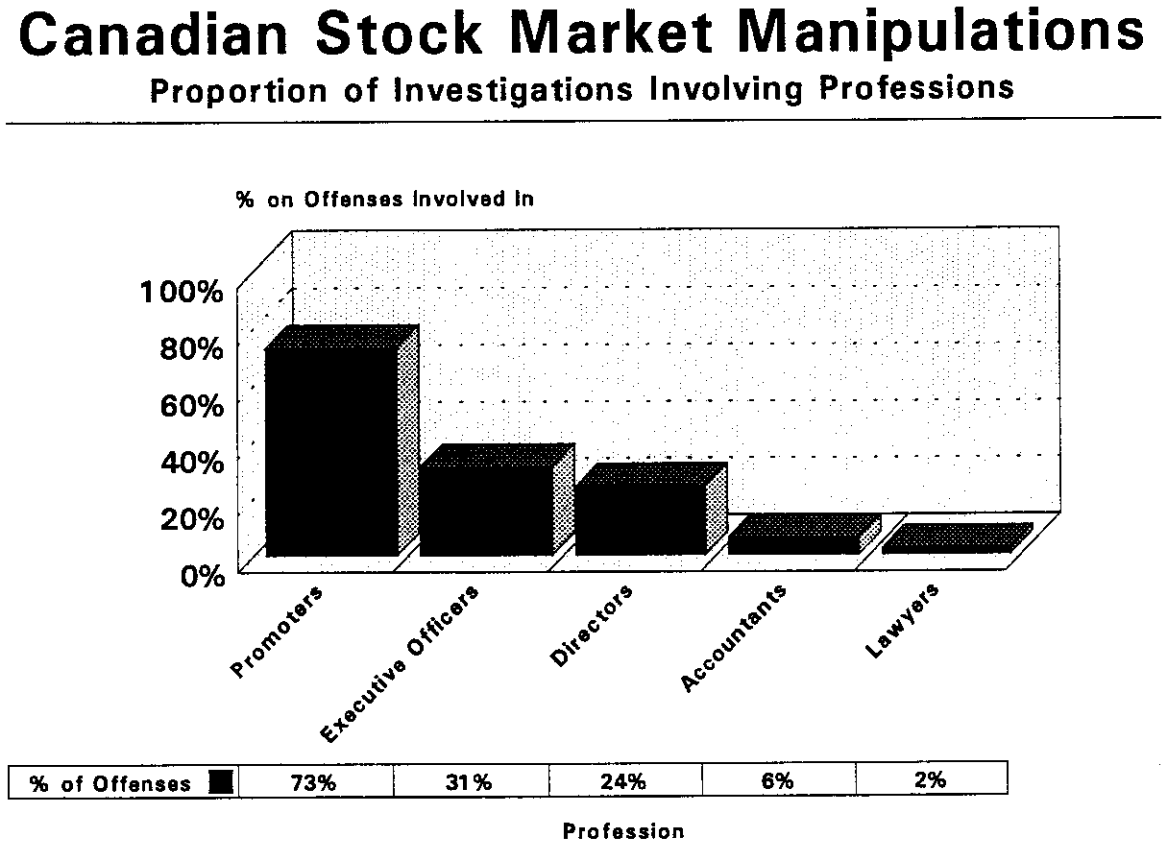
3.2 The Offender

There have been Royal Commissions and Senate Committees involved in the development of securities regulation. Unfortunately, these studies said very little about the people involved, their professions, their lifestyles, or other personal characteristics.

3.2.1 Profession

It is demonstrated in chapters 6 through 8 that 'Market Manipulation' investigations have come to symbolize the unofficial mandate of the RCMP Securities Fraud Squads. The legal characteristics of these offenses are outlined in chapter 5 (Section 380(2) and section 382 of Criminal Code of Canada). Each of the existing RCMP securities fraud squads were asked to provide an estimate of the percentage of market manipulation investigations that included suspects of which were company insiders. Figure 3-3 reflects the weighted average of these estimates.

Figure 3-3



Appendix C contains reference to the specific estimates as received from each RCMP Securities Fraud Squad. The company 'stock promoter' is estimated to be involved in 73% of the total market manipulation investigations.

3.2.2 The Offender - Personal Characteristics

> ***Those who become white collar criminals generally start their careers in good neighbourhoods and good homes, graduate from colleges, have some idealism, and with little selection on their part, get into particular business situations in which criminality is practically a folkway and are induced into that system of behaviour just as into any other folkway.*** (Sutherland, p. 11).

A review of the Vancouver RCMP market investigations also revealed several general characteristics of suspected market offenders involved with public companies trading on the VSE and/or the ASE. Table 3-1 contains a summation of these characteristics.

Table 3-1

Characteristics of Securities Fraud Offender

- **The primary suspects are generally involved in an intimate and undisclosed relationship with the underlying public company.**
- **Securities fraud suspects are often involved with more than one public company at one time. It is estimated that there are less than 100 active promoters involved in illegal market activities relating to the VSE.**
- **The provincial regulatory commissions and stock exchange investigative services sections are generally not aware of the true nature or extent of the suspects relationship with the underlying public company.**
- **Securities fraud suspects are generally long term market 'players' or loosely defined 'promoters' who are also known repeat offenders.**
- **Suspects orchestrate their schemes through the use of nominee trading accounts in a manner that requires the acquiescence of several individual registered representatives or stock brokers.**

Source: Dec 31, 1993 Vancouver RCMP 'Market' file review.

3.3 Characteristics of a Junior Company

There are two primary characteristics of 'Junior' or 'venture capital' companies that make them a prime target for securities fraud:

3.3.1 Thinly Capitalized

Junior public companies are generally known to be more thinly capitalized. In fact, it is not uncommon to find newspaper advertisements relating to public companies for sale claiming 'tight' floats. The desirability of a tight float stems from a need for some degree of control over the outstanding shares of a particular company. Innovators of new products or projects are generally reluctant to vend their assets into a loosely held company, in that the shareholders are more apt to sell immediately upon the insiders getting the project off the ground. In essence, the shareholders will not give it time to develop. In tightly held floats, insiders can make personal contact with majority shareholders and ensure that they have longer term support for their project before they attempt to get it off the ground.

Therefore, it is the inherent developmental nature of junior companies that creates a natural instinct for insiders to maintain a tight or close capitalization.

3.3.2 Information Exemptions

There are several unique legislation exemptions that are intended to provide the opportunity for small companies to raise capital quickly and cheaply. It is the nature of small issuers that they often need to raise money quickly and in amounts that do not justify the costs of a full public offering (British Columbia Securities Commission, p. 8). Basically, in the interests of efficiency junior companies are often permitted to raise funds whilst providing less information than might be demanded of a senior company.

3.4 Summary

There exists a problem of a reputation for fraud and corruption in Canada's securities industry with particular concentration in the Junior Markets. This problem has been identified as encompassing all of the VSE, the ASE, and the Ontario Broker Dealers. The equity value of this market segment is approximately $9.02 billion, which accounts for approximately 5% of the total equity value traded in Canada. The offenders themselves are thought to be closely associated with the company although they are not likely to be in an official and/or regulated capacity. More often than not the primary offender will be the company promoter, of which there are a small core of long term repeat offenders.

There are two primary characteristics of the companies involved in this junior market that are considered to make them more susceptible to fraudulent abuse. These characteristics relate to economic efficiency as they stem from a requirement that the companies be able to raise financing cheaply and quickly. Firstly, junior companies are generally known to be more thinly capitalized and secondly, less information is made available to prospective investors (and regulators).

4.0 THE MARKET FAILURE - THE NEED FOR SECURITIES REGULATION

Economists recognize several commonly occurring situations, referred to as "market failures", that violate the basic assumptions of the idealized competitive economy and therefore, interfere with efficiency in production or consumption. "Perfect competition" is a term used by economists to describe a conceptual market place that can be used as a model for optimal efficiency. In a perfectly competitive industry, market prices are determined solely by the forces of the market supply and demand.

In the early days of economics, followers of Adam Smith believed that competition, if unregulated, would allocate resources efficiently in the sense that returns would tend to be equalized in all alternative uses. An important change in emphasis later took place that shifted the economic focus from competition as a mode of behaviour to competition as a characteristic of the state of the market after rivalry had run its course (Demsetz p. 2).

Among the conditions that economists agree are necessary to ensure that rivalry or competition will result in an efficient long-run market equilibrium, two are important for this study.

4.1 Absence of Monopoly Power

No market participant (or group of successfully conspiring participants) should be so large, relative to the market, that its production or purchase decisions affect the market price. This concept can be extended to the public market for an individual security. As demonstrated in chapter 5, a common element of an illegal market scheme involves the 'cornering of the market' or restricting the supply of a given security.

4.2 Perfect Information

The model for an efficient securities market calls for all buyers and sellers having the same or 'perfect' information about a particular security, that is there must be no information asymmetry. The transaction occurs because someone wants to sell and

someone wants to buy, and not because someone has secret or privileged information about the value of a security.

> ***To put a man out of business by stealing his stock in trade or by defrauding him is defined as criminal behaviour; however to put him out of business by outcompeting him in the market is considered not only fair but also socially desirable.***
> (Dales, p. 490).

It is important to recognize that the buyer and seller in a public market transaction may have different legitimate information about the quality of the underlying security being traded. It is, therefore, vital that we distinguish between two types of information - legitimate information and privileged information. It is only this privileged information that is of concern to an efficient market as the possession of such information places someone in a far more advantageous position than others in the market to evaluate the investment risks involved. In fact, in some extreme instances, insiders have the advantage of trading with virtual certainty, whereas, the rest of the market can at best informatively speculate.

4.3 Why Efficiency is Vital in the Securities Market

Consider the model for an efficient public market place, where there exists a state of perfect competition. Perfect information would allow purchasers of newly issued securities to improve their estimates of future earnings for the company and thus determine the price they are willing to pay for the shares. This reduction in uncertainty would result in an improved allocation of resources. Allocative efficiency relates to the ability of the securities market to maintain equivalent rates of return or costs of financing on comparable investments. This quality of the markets helps ensure that funds are channelled from savers to those users who will apply them most profitably and that portfolio shifts can be made to the mutual advantage of different investors. This allocative efficiency has been regarded as the most important economic function performed by the securities markets (Friend, p. 190).

4.4 The Market Failure

Violation of either of the two conditions referred to above will result in a general market failure. The market failure stems from those conditions that allow and encourage offenders to attempt to secure monopolistic control over a given security and/or to withhold privileged information about that security to the detriment of the overall efficiency of the public market.

The rewards involved in a successful illegal market scheme can often run into the millions of dollars, and in recent years, into the hundreds of millions. For example, the press recently reported that Prudential Securities in the United States paid a record $486 million Cdn to settle charges it committed fraud and steered thousands of unwitting investors into high-risk deals (Reuter, p. A46).

4.5 Correcting the Market Failure

> ***There simply is no such thing as the unregulated economy. All economies are sets of rules and regulations. Civilization is, in fact, an agreed upon set of rules and behaviour. An economy without rules would be an economy in a state of anarchy where voluntary exchange was impossible. Superior force would be the sole means for conducting economic transactions. Everyone would be clubbing everyone else.***
> (Thurow, p. 129).

Securities regulation is the government's attempt to correct the market failure and to bring about optimal market efficiency. Given the importance of the securities industry in the Canadian economy, it would seem reasonable that underlying securities regulation be of equal importance.

The obvious solution to that portion of the failure relating to information asymmetry can be made to sound quite simple: use regulation to force those persons with more information to provide it to those who have less. An example of this lies in the provincial securities regulation that requires the filing of insider trading reports. The objective of the regulation is to force insiders to disclose the extent of their personal trading to those persons who are not insiders. Similar regulation exists relating to the public distribution of shares that is intended to curtail persons from achieving

monopolistic control over a given market. A full review of existing securities regulation in Canada is contained in chapter five.

4.6 The Cost of Regulation

Economists can also be practical, in the sense that they have acknowledged there can be a huge cost to eliminating monopolistic elements and disseminating knowledge. The removal of these market imperfections would only be efficient if the benefits from the efficient market would exceed the cost of accomplishing this. It is also recognized that "efficiency requires that some positive amounts of ignorance and monopoly be tolerated because it is too costly to remove all traces of both." (Demsetz, p. 3). Therefore, the cost of regulation must be carefully weighed against its benefits. The rate of return to investing in regulation is the present value of the stream of future benefits less future costs, all divided by the required initial investment. It is also prudent to consider the opportunity cost, or potential benefit if the required resources for regulation were to be employed elsewhere.

4.7 Summary

In summary, there are good economic reasons to justify government interference in the public securities market. The specific intent of this interference is focused on restricting monopolistic control and ensuring that information is not asymmetrical. The cost of the interference should be monitored closely to ensure that it does not exceed the benefit resulting from the expected gains in efficiency.

5.0 THE GOVERNMENT FAILURE

This chapter consists of an overall review of the Government response to the market failure identified in the preceding chapter. The focus here is on government policy issues that are external to the RCMP. Both the Federal and Provincial Governments utilize various regulatory methods to police the securities market. Effective regulation of the securities market requires a precise blend of available regulatory techniques. It is respectfully submitted that the provincial emphasis on the prosecution of regulatory violations to combat criminal fraud has been ineffective and a primary cause of the failure to effectively deter this criminal activity.

5.1 Government Securities Regulation

> ***The purpose of regulation in a securities market is to ensure the fair and efficient operation of the market while promoting the development of a dynamic and competitive securities industry.***
> (British Columbia Securities Commission, Oct, 1993).

The British Columbia Securities Commission has outlined four broad objectives of British Columbia's securities regulation: ensuring access to information; providing rules of fair play; establishing qualifications and standards of conduct for persons in fiduciary positions; and protecting the integrity of the market and the confidence of investors (British Columbia Securities Commission, Oct 3, 1993).

Securities regulation, like any form of government regulation, is used to "command and control". Directives are given, compliance is monitored, and noncompliance is punished. There are three basic regulatory techniques in Canadian securities law that are used to achieve this control. These include the registration of securities, the registration or licensure of persons and institution, and anti-fraud or enforcement measures. It is these anti-fraud measures that fall within the focus of this paper. However, it is important to include a review of the other techniques as they should each be considered an integral part of the overall regulation package. It is the combination of these three regulatory techniques that determines the overall effectiveness of government control.

5.1.1 Registration of Securities

In Canada, regulation relating to registration of securities generally relies on the practise referred to as "full disclosure". This refers to an obligation on the part of the issuer of securities to prove to a regulatory agency, before the time of issue, that its disclosure of information meets some legislative standard. This direct information provision is a government response to the market failure problem identified in the preceding chapter.

5.1.2 Registration or Licensing of Persons & Institutions

The registration or licensing of persons and of firms or institutions participating in the securities industry is designed to ensure that active participants in the industry have achieved a minimum standard of honesty, good reputation and competence and maintain the competence together with observing minimum standards of fair dealing. Competence was increasingly emphasised in the past decade as the industry achieved a professional identity. This method of licensure is used as a means of providing indirect information to the investor.

5.1.3 Anti-Fraud or Enforcement Measures

It is the anti-fraud measures that define fraudulent or otherwise improper conduct, provide civil or criminal penalties for engaging in such conduct, and create investigatory and enforcement bodies to identify and suppress it. It is this enforcement incentive that provides the mandate for the RCMP Securities Fraud Squads. These enforcement measures are also a response to the identified market failures as they allow the Government to coerce, rather than induce (through incentives), certain behaviour.

5.1.4 The Blend of Regulatory Techniques

As noted in chapter 3, there are two central characteristics of junior companies that make them tempting vehicles for fraud and manipulation. It is the underlying principle of economics behind these two characteristics that is at constant odds to effective regulation. Small start-up companies cannot afford the cost of extensive regulation. They

cannot afford the cost of providing complete information to potential investors, nor afford to be widely capitalized, at least until they have developed their reputation to a point where an effective public market exists for their securities; a market that can accommodate truly 'economic' driven buying and selling. Excessive regulation that attempts to force junior companies to provide complete information and to be widely capitalized will cause them economic hardship and, possibly, to fail. Therefore, it is argued that the blend of regulatory techniques used to control fraud in the junior capital markets should consist of moderate emphasis on registration and licensing coupled with stringent enforcement of anti-fraud measures.

5.2 Sources of Canadian Securities Regulation

Securities markets in Canada are regulated by provincial securities administrators and industry self-regulatory organizations. Regulatory requirements and standards are set out in provincial securities legislation, policy statements, decisions and notices of securities administrators, and in by-laws, rules and policies of self-regulatory organizations. Canada has multiple sources of securities regulation such as:

- Policy Statements
- Provincial Company Acts
- Canada Business Corporation Act
- Common Law
- Provincial Securities Legislation
- Self-Regulation
- Criminal Code of Canada

The anti-fraud or enforcement measures are primarily found in the last three sources of regulation listed, and therefore, are the focus in the identification of specific problem areas. The remaining sources are limited to a brief summary of their overall contribution to Canadian securities regulation.

5.3 Policy Statements

Policy statements are issued by each of the provincial jurisdictions and are used to advise market participants how the administrators or tribunals intend to interpret and execute the discretionary authority given to them under provincial legislation. There are three general types of policy statements:

A. National Policy Statements

- These are policy statements agreed to and issued by all Provincial Securities Administrators in order to establish a set of uniform rules with which to govern the national securities market.

- National policy statements deal with matters such as national prospectus filing and clearance, mutual funds (investment rules, sales and redemption procedures, etc.), timely disclosure by issuers, and shareholder communications.

B. Uniform Act Policy Statements

- These are similar to national policies but apply only in five provinces (Ontario, Manitoba, Saskatchewan, Alberta and British Columbia). They are gradually being replaced by national policies.

C. Local Policy Statements

- These are issued by each respective jurisdiction to provide guidance to the securities market within the given province. They establish a variety of rules for the local market.

- Local policy statements deal with matters such as local prospectus filings, technical reports, offering memoranda for private placements, and capitalization rules for issuers planning initial public offerings.

5.4 Provincial Company Acts

This is the basic law governing business corporations within each province. It establishes the framework of corporate law and prescribes the duties of directors and officers.

5.5 Canada Business Corporation Act

This federal legislation sets out the corporate law framework and some securities requirements for federally incorporated companies.

5.6 Common Law

Under the common law, securities market participants may obtain civil remedies for fraud, breach of trust, breach of fiduciary duty, etc., which are in addition to the civil remedies provided under provincial securities acts.

5.7 Provincial Securities Legislation

Each of the ten Canadian provinces as well as the two territories have a securities statute or ordinance. These statutes create a basic regulatory framework within each province. The acts are fairly uniform in nature and contain the necessary authority to enforce compliance. For example, the British Columbia Securities Act furnishes enforcement authority as follows:

- provides power to the British Columbia Securities Commission to investigate and impose administrative orders where required in the public interest;

- provides authority for prosecution by the Attorney General's office for offenses under the act, including misrepresentation, trading without registration, distributing without prospectus, improper insider trading and manipulation.
  (B.C. Securities Act, 1993).

5.7.1 Issues Concerning Provincial Administrative Proceedings

Each provincial jurisdiction is empowered to hold administrative hearings or tribunals at which a panel of commissioners may invoke penalties such as trading suspensions or prohibition from becoming an officer or director of a public company.

There is no question that administrative proceedings require a great deal less investigative time and expense. The question is whether administrative penalties are enough of a deterrent to persons considering committing a securities fraud. As discussed in chapter 3, it was determined that the majority of offenders were promoters and other company insiders, but most importantly, that they were generally repeat offenders using nominee brokerage accounts. Administrative penalties can only be levied against those persons or firms operating in a registered fashion within the industry. Therefore, it is argued that administrative penalties do nothing more than drive the serious market fraud offender underground. These penalties are effective only in dealing with first time offenders or those wishing to remain lawfully within the industry. Those persons willing to accept the risk of possible criminal prosecution are not seriously concerned with remaining lawfully within the industry. They are simply forced underground and continue to abuse the market through the use of nominee accounts which are not the subject of cease-trade orders.

Consider the case of Philip Lieberman. In 1988, he was suspended from trading for 10 years by the British Columbia Superintendent of Brokers. In March of 1994 an administrative tribunal of the British Columbia Securities Commission heard new allegations that Lieberman had violated his cease-trade order and had, in fact, traded about 60,000 shares of a VSE company. The Commission counsel recommended that Lieberman be fined $25,000 and that another 10 years be added to his cease trade order. Lieberman openly responded to the Commission by stating "Try and collect. Try and collect". He also hinted that he intends to beat the suspension as well (Hogben, p. D1).

Other regulatory agencies in other nations have also observed the inadequacy of administrative penalties as an effective deterrent to securities fraud. The topic was

referred to by Dr. Michael Levi in an 1988 Economic Crime Workshop sponsored by the Commonwealth Secretariat Commercial Crime Unit.

> ***The administrative penalties may be financially expensive, but they involve less publicity, less (if any) stigma, and no chances of imprisonment.***
> (Levi, p. 69).

The Matkin Commission report outlined a number of provincial regulatory issues of concern to the province of British Columbia. Subsequently, the report also recommended a number of changes to the British Columbia Securities Act, which included requiring promoters to become registered. This attempt to bring more of the securities fraud offenders within the regulatory jurisdiction of the British Columbia Securities Commission would at first glance, seem like a positive move. However, as was noted in chapter 3, most of the offenders prefer to remain anonymous and will go to great lengths to work outside of the regulatory structure. Therefore, it is argued that this attempt to bring promoters within the regulatory system will simply drive the securities fraud offenders further underground. In fact, in referring to specific evidence of the need for reform, the Matkin report did note that "the real promoters of the company were often invisible to regulators" (Vancouver Stock Exchange & Securities Regulation Commission, p. 8).

5.7.2 Issues Concerning Provincial Prosecutions

Provincial administrators sometimes request the provincial Attorney General's office to prosecute the offenders in a provincial court. The provincial securities acts outline several market offenses that are considered 'quasi' criminal. Examples include failure to file insider reports, unregistered selling or advising, and unlawful distribution from not filing a prospectus. The securities commissions conduct the majority of investigations under these acts, however, on occasion the RCMP have exercised their jurisdiction to enforce provincial statutes and conducted similar investigations.

In chapter 3 it was noted that Canada's Junior Markets have a reputation for criminal fraud and corruption. This distinction of criminal behaviour is extremely important. Securities frauds often involve one or more provincial securities act violations

that form portions of an overall scheme to defraud. There are two types of regulatory infractions: those that stem from innocent negligence, and those that stem from intentional acts that are part of an overall fraudulent scheme.

There are serious criminal frauds occurring within the securities industry, and because the industry itself falls under provincial jurisdiction, there has been pressure put on the provincial regulatory authorities to assume jurisdiction and responsibility for these market abuses. In reality, the problem is one of serious criminal behaviour and one for which responsibility should lie with the criminal justice system. A good portion of the time, securities regulation infractions are simply part of larger criminal schemes; criminal schemes that are not being effectively deterred because they are being dealt with as regulatory infractions. This trend of provincial regulatory authorities being forced to assume jurisdiction and responsibility for those infractions that are actually part of a larger fraudulent scheme, has resulted in the offender successfully avoiding being prosecuted for criminal fraud.

The prosecution of regulatory violations as a method of trying to prevent serious frauds from occurring, or 'nipping them in the bud', does not work. The perpetrators are known to be repeat offenders who are long time market players. They may have faced regulatory action at some point. They are still active because they have never been effectively deterred. They find no, or very little, harm in trying. If one method does not work, they simply try something else.

Sometimes the situation is mitigated even further, and the offenders are dealt with by way of administrative tribunal. Unfortunately, many criminal prosecutions do fall victim to what Dr. Michael Levi of the Commonwealth Secretariat describes as 'litigotiation':

> ***....Mann's (1985) study of the preparation of defence cases against white-collar crime allegations reveals the lengthy processes of what Galanter (1985) has termed 'litigotiation' between defence and regulatory personnel at a variety of stages, from front-line investigators, through those who take the decision to refer an investigation to agency prosecutors, to those who actually make the decision to prosecute.***

> ***At each stage, depending on the evidence they believe the agency possesses - which in turn reflects defence actions in seeking to limit prosecution access to damaging documentation or witnesses - the defence counsel and their batteries of accountants and subsidiary personnel will seek to get the investigators/prosecutors to define the case either as 'no crime' or as a relatively minor violation that, without damage to the effectiveness of the regulatory agency or to public morality, could be disposed of by means other than prosecution. Sometimes, defence arguments rely upon implicit notions of resource prioritization within the regulatory agency: as I observed in the last chapter, it is more expensive in resource terms to take a case to prosecution than to deal with it informally by administrative penalties. If they cannot deny culpability altogether, counsel therefore argue that this case is not a particularly grave example of its general class of violations. Thus, many against whom there is a strong prima facie case of fraud negotiate their way out of the criminal justice process.***
> (Levi, p. 69).

5.8 Self-Regulation

5.8.1 Stock Exchange By-laws, Rules and Policies

Stock Exchanges such as The Toronto Stock Exchange or the Alberta Stock Exchange are formally recognized under each provincial securities act to operate as an exchange and a self-regulatory organization. They fall under the general supervision of each respective securities commission. Each securities commission also relies on the respective exchanges to perform a regulatory function with respect to both their member firms and their listed companies.

By-laws and rules have been issued by each stock exchange to govern the conduct of member firms and their employees. Compliance with these by-laws and rules is a condition of membership.

Listings policy statements establish guidelines applicable to listed companies under the terms of each exchange's listing agreement with each company.

5.8.2 Investment Dealers Association ('IDA') By-laws and Rules

The Investment Dealers Association is a federal association to which most brokerage firms belong. The IDA has issued a set of rules and by-laws to govern its

members. These are largely parallel to each respective exchange's provisions for members but they also address the operation of bond and money markets. The IDA sets and maintains ethical standards, provides educational programs for employees, maintains a constant liaison with securities authorities and other relevant institutions, and in general, provides services for the goodwill of the industry. The association's principal objective is to protect investors by ensuring that its members are ethically responsible, educated, and responsive to the needs of the varied clientele.

The IDA has proposed a new system of member regulation which would involve creating a self-governing organization independent of the Canadian Stock Exchanges (Kelly, Doug, Apr 5, 1991, p. 1). Acceptance of this proposal would remove the self-regulation role from the stock exchanges. The concept has received conflicting reviews from the various regulatory agencies across Canada. For example, it is supported by the TSE, but rejected by the VSE and the British Columbia Securities Commission (Vancouver Stock Exchange & Securities Commission, p. 8).

5.8.3 Issues Concerning Self-Regulation

There is little doubt that self-regulators are motivated by a concern for society that extends beyond a narrowly conceived notion of self-interest. But there is even less doubt that their own interests and the interests of those with whom they associate most closely, their peers, will have an impact on their regulatory decisions (Demsetz p. 4). The possibilities for rationalizing self-interest into social interest are many and varied, and the probability is high that self-regulators will believe the rationalizations.

The degree of self-regulation is believed to be related to the scale and cost of the regulatory task.

> ***It should also be noted that there is a strong case for suspecting that implicit self-regulation is related to the scale of the regulatory task. If the scale of the task is great and, as generally is the case, if taxpayers are unwilling to provide enough funds to have the task performed well, then regulators increasingly will tolerate implicit self-regulation. As the gap increases between the funds required to do the regulatory task well and the funds that are available to do the task, regulators will resort more frequently to stamping an official approval on requests originating***

> ***from those who are supposed to be the regulated. Regulation gives way to self-regulation and the benefits that can be expected from regulation are reduced correspondingly.***
> (Demsetz, p. 6).

The ability of exchanges to operate the private business of an exchange and also be responsible for investigation, prosecution and adjudication of complaints concerning conduct of members and brokers is being reviewed in many jurisdictions. As referred to above, the IDA has proposed that all Canadian stock exchanges transfer member and broker regulation to regional organizations affiliated with the IDA. The British Columbia Securities Commission has opposed the Matkin Commission report recommendation in support of the IDA proposal relating to taking away the VSE's self-regulation responsibility, although the BCSC did note that it is of paramount importance that self-regulatory executives be insulated from 'potential undue member influence' (Schreiner, Jan 19, 1994 p. 3). RCMP investigators have historically enjoyed a very close and professional relationship with personnel of the individual self-regulatory organizations. There is some concern however, that self-regulatory investigators be properly insulated from influence by those they are attempting to regulate. The notion of senior officers of investment dealer firms occupying positions on disciplinarian review boards is viewed by many as a definite conflict of interest. These persons are undoubtedly considered by self-regulatory investigators as positions of authority. Therefore, it is argued that it might be difficult to recommend a substantial fine be levied against close associates of one's superior.

In 1989, the IDA held a meeting of compliance officers who were members of the Canadian Joint Industry Compliance Group. An important issue that came up at that meeting and later leaked to the Financial Post was that compliance officers sometimes face opposition from people in powerful positions who feel threatened by investigations. The group cited that the most common causes of deficiencies in brokerage accounts under their supervision were "attitudes of senior management; allocation of resources; lack of responsiveness to recommendations, and conflicts between making money and controlling behaviour" (Francis, Feb 3, 1989, p. 3).

It was noted in chapter 3 that perpetrators of securities frauds orchestrate their schemes through the use of nominee trading accounts in a manner that requires the acquiescence of several individual registered representatives or stock brokers. Stock brokers have an interest in the commissions that flow from active trading, hence it is to their own benefit to turn a blind eye to illegal activities. The inherent structure of stock exchange trading forces the securities fraud perpetrators to rely on the participation of stock brokers. Therefore it is of paramount importance that there be strong disciplinary action by Self-Regulating Organizations for misconduct. The penalties must not be seen merely as a cost of doing business. Strong and convincing disciplinary action against stock brokers found participating in securities frauds will have the effect of reducing their acquiesence. It is suggested that this is one viable method of preventing securities frauds from occurring.

5.9 Federal Securities Legislation - The Criminal Code of Canada

There is no specific federal statute relating to securities regulation in Canada. However, the Criminal Code, which is the general criminal law of Canada, includes criminal sanctions for certain securities market offenses. Investigations of securities offenses involving these sections of the Criminal Code have traditionally been the sole responsibility of the Royal Canadian Mounted Police. In fact, the following criminal offenses form the primary instruments of securities fraud enforcement used by the RCMP:

5.9.1 Spreading False News Section 181 CC

Section 181 deals with the wilful publication of a statement, tale or news known to be false and which causes, or is likely to cause, injury or mischief to a public interest. It carries a penalty of up to two years imprisonment. This section is fairly straightforward and is, therefore, sometimes used as either a complimentary or alternative charge to market manipulation when taking action against persons involved in the spreading of information intended to affect the public market price of a security (Tremeear's Criminal Code - 1994, p. 270).

5.9.2 Theft - Section 322 CC

Section 322 refers to the general section for theft. It states that everyone commits theft who, without colour of right, takes or converts something. This section is also very straightforward and used by fraud investigators to charge officers and directors of public companies found to be unlawfully removing funds from a company's treasury. It is also sometimes used to charge those registered representatives caught removing funds from their clients' trading accounts. (Tremeear's Criminal Code - 1994, p. 388).

5.9.3 False Pretences or Statements Section 362 CC

Sections 361 and 362 contain provisions for dealing with false pretences and false statements of a central characteristic involving the deception of another person in a manner which leads to his disadvantage. The penalties vary, depending on the consequences of the deception, with the maximum ranging from two to ten years imprisonment.

Section 361(1) defines a false pretence as a representation of a matter of fact, either present or past, made by words or otherwise, that is known by the person who makes it to be false and that it is made with a fraudulent intent to induce a person to whom it is made to act upon it.

Section 362 sets out the actual offense which refers to the action of obtaining by a false pretence anything in respect of which theft may be committed or causing it to be delivered to another person, or obtaining credit by a false pretence or by fraud, or making a false statement in writing relating to the financial condition of himself or any person, firm or corporation with intent that it should be relied upon for the purpose of procuring, inter alia, the delivery of personal property, the payment of money, or the extension of credit (Tremeear's Criminal Code - 1994, p. 567).

5.9.4 Fraud - Section 380 CC

Section 380(1) is a general section of wide application. It basically indicates that every one who, by deceit, falsehood or other fraudulent means, defrauds the public or any person of any property, money or valuable security is guilty of the offense. The term of

imprisonment ranges from 2 to 10 years, depending on the value of the subject-matter (Tremeear's Criminal Code - 1994, p. 583).

5.9.5 Fraudulent Manipulation of Stock Exchange Transactions Section 380(2) CC

Section 380(2) relates directly to the securities industry. It basically indicates that every one who, by deceit, falsehood or other fraudulent means, with intent to defraud, affects the public market price of stocks, shares, merchandise or anything that is offered for sale to the public, is guilty of an indictable offense and is liable to imprisonment for ten years. This section is more commonly referred to as 'Market Manipulation'. The essential elements of this offense are the intent to defraud and the affecting of the public price by deceit or fraud (Tremeear's Criminal Code - 1994, p. 583).

5.9.6 Wash Trading & Match Trading Section 382 CC

This section was introduced into the Criminal Code in 1948, and was taken from section 9(1) of the United States' Securities Exchange Act of 1934 (Williamson, p. 192). It is also closely related to the securities industry. It reads that every one who, through the facility of a stock exchange, curb market or other market, with intent to create a false or misleading appearance of active public trading in a security or with intent to create a false or misleading appearance with respect to the market price of a security,

> (a) effects a transaction in the security that involves no change in the beneficial ownership thereof,
>
> (b) enters an order for the purchase of the security, knowing that an order of substantially the same size at substantially the same time and at substantially the same price for the sale of the security has been or will be entered by or for the same or different persons, or
>
> (c) enters an order for the sale of the security, knowing that an order of substantially the same size at substantially the same time and at substantially the same price for the purchase of the security has been or will be entered by or for the same or different persons,
>
> is guilty of an indictable offense and is liable to imprisonment for five years. (Tremeear's Criminal Code - 1994, p. 589).

Sections 380(2) and 382, as a whole, are parts of the Criminal Code legislation that are directly intended to prevent fraudulent misuse of stock exchange facilities and to maintain the integrity of trading.

5.9.7 False Prospectus Section 400 CC

Section 400 relates specifically to false prospectuses. It is also straightforward and reads as follows:

> (1) Everyone who makes, circulates or publishes a prospectus, a statement or an account, whether written or oral, that he knows is false in a material particular, with intent
>
> (a) to induce persons, whether ascertained or not, to become shareholders or partners in a company,
>
> (b) to deceive or defraud the members, shareholders or creditors, whether ascertained or not, of a company,
>
> (c) to induce any person to entrust or advance anything to a company, or
>
> (d) to enter into any security for the benefit of a company,
>
> is guilty of an indictable offense and is liable to imprisonment for ten years. (Tremeear's Criminal Code - 1994, p. 604).

5.9.8 Secret Commissions - Section 426(1) CC

This section describes the offense of secret commissions or 'bribes' for which there is a maximum sentence of five years. It is a piece of legislation commonly used in reference to charges involving investment dealers receiving bribes in exchange for inducing their clients to purchase a given security. Key elements of the offense would then include that something of value be given or offered to the broker, the gift be tied to specific performance expected of the broker, and that the performance is corrupt, in the sense that the broker's client is deceived and it is to his detriment (Tremeear's Criminal Code - 1994, p. 621).

5.9.9 Conspiracy - Section 465(1)(c) CC

Section 465(1)(c) deals with the indictable offense of conspiracy to commit an indictable offense carrying with it the same penalty as the substantive offense. The gist of the offense lies in the unlawful agreement; no overt act in performance of the agreement need be established - the offense is complete when the agreement is made (Tremeear's Criminal Code - 1994, p. 687).

5.10 Issues Concerning Criminal Law

Securities fraud investigators and prosecutors commonly use the term 'Market Manipulation' to refer to any criminal scheme to which sections 380(2) and 382 of the Criminal Code apply. As demonstrated in chapter 7, Market Manipulations have come to symbolize the mandate for RCMP securities fraud investigators.

The sections of the Criminal Code that relate to market manipulation have a long history of ineffectiveness. In 1964, the Porter Commission Report commented on the ineffectiveness of section 382 (then section 340), in that only one successful prosecution had been brought under that section (where the accused pleaded guilty) (Johnston, p. 16).

The essential elements of section 380(2) are the intent to defraud and affecting the public price by deceit or fraud. In one of the few cases decided under this section, the test of affecting a public market was said to be whether the activities were conducted not to stabilize the price of the securities involved, but rather, to drive up the price by fraudulent means to a level completely disproportionate to the real value, a level that could not possibly be maintained (A.G. Que. v. McNaughton (1976)). This stabilization of the market price is commonly referred to as 'market making'. Section 382 deals with manipulative techniques commonly referred to as 'wash trading' and 'match trading'. The crucial element behind these techniques lies once again in the intention of the initiator of the trades.

There are numerous techniques employed to manipulate the public market price of a security, some of which are not illegal in themselves.[2] Some techniques may or may not also represent regulatory violations. One single example is that of 'high closing'. This strategy is designed to create the illusion of a price rise. Newspapers publish stock prices that represent the last price paid by the last buyer each day. Manipulators 'high close' or 'paint the tape' by getting a friendly floor trader to watch the trading at the end of the day. Just before the bell tolls ending the day's trading, the floor trader puts through a trade with another floor trader, thus nudging the price upward at whatever price the manipulator stipulates. By doing this gradually over several weeks, manipulators create interest among members of the public who then buy the stock and push prices up even higher. This technique is unlawful as specified under provincial securities regulations, but it is not illegal as specifically referred to in the Criminal Code of Canada. However, if it could be proven that this technique was used as part of an overall scheme to affect the public market price of the underlying security, section 380(2) could be utilized to charge the perpetrator with fraud.

One of the earliest, and perhaps the most quoted, definitions of stock manipulation stems from a 1933 American judgement by Judge Woolsey entitled United States v. Brown. This decision has been instrumental in developing criminal law both in the United States and Canada. In his judgement, Judge Woolsey found evidence of stock manipulation and saw it as fraudulent.

> ***When an outsider, a member of the public, reads the price quotations of a stock listed on an exchange, he is justified in supposing that the quoted price is an appraisal of the value of that stock due to a series of actual sales between various persons dealing at arm's length, and so represents a true chancering of the market value of that stock thereon under the process of attrition due to supply operating against demand.***
> (Loss, p. 1536).

These sections of the Criminal Code that apply to market manipulation are similar in their attempt to deter persons from interfering with the natural economic supply and

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[2] For a complete review of market manipulation techniques see the summary of Diane Francis' book Contrepreneurs as reprinted in "The ABCs of Stock Manipulation", B.C. Business Magazine, Jan, 1989. pp. 53-58.

demand for a publicly trading security. However, there are several alternative (non-criminal) reasons for interfering in the public market. Firstly, as described above, current case law dictates that it is considered quite legitimate to interfere in the public market for the purpose of supporting a market ('market making'). This involves buying when there is an excessive amount of selling, and selling when there is an excessive amount of buying. The difference in these two types of economic interference lies with the intention. One has the criminal intention of defrauding the public, while the other is intended to support a given security and remove the peaks and valleys from its public trading. Still, a second non-criminal alternative reason for this type of non-arms length trading is commonly referred to as 'debit kiting'. Consider an investor who has built up a large debt at a particular brokerage firm who, in turn, is demanding immediate payment. A means of alleviating this credit problem is to sell the underlying stock held in the account. If the investor wishes to retain ownership of the stock, they can simply arrange to also be on the buy side of this transaction through an account at a different brokerage firm who, in turn, is willing to supply credit. The net result is that a trade occurs involving no change in beneficial ownership, but the intention is not one of fraud. The intention is to move a debt from one financial institution unwilling to supply credit, to an alternative institution willing to supply credit.

In reality, these transactions are not as simple as they may sound. For example, the legislation also states that the public market has to have been affected. It does not say by how much, or suggest how this could possibly be measured. It can be extremely difficult to differentiate between effects caused by manipulative trading and effects caused by some alternative incident, such as a favourable news article or a major shift in the general economic climate.

In chapter 7 two recent court decisions in Ontario and British Columbia are reviewed that would suggest promoters may legitimately affect a public market, and make a substantial profit, as this is what promotion is - a benefit for all shareholders and the public at large. Should these two cases become effective case law this would mean that a successful conviction will require that the offenders be the sole beneficiaries of a given manipulation, else it will be surmised that they were acting in the best interests of all

public shareholders. The RCMP had very high expectations of both of these cases to provide some clear legal distinction between promotion and manipulation. This distinction, however, remains vague and undefined.

The problem lays with trying to incorporate some very conjectural economic principles and concepts into criminal law; definitions that were meant for use in economic models for academic discussion, not to be incorporated into the implicit definitions necessary for effective criminal legislation. In fact, some United States legal observers have avowed that no matter how it's defined, stock manipulation is just too vague a concept to form the basis for valid criminal charges (Fischel).

It warrants consideration to determine if fraud and corruption in the securities markets could effectively be deterred without the use of Criminal Code sections relating to market manipulation. This would be possible if each and every securities fraud consisted of multiple offenses and police investigators had the option of proceeding under other alternative sections of the Criminal Code. This is not always the case. It is possible, and quite common, to orchestrate a complete market manipulation that does not involve other criminal offenses as elements of the overall scheme.

5.11 Securities Regulation Jurisdictional Issues

There have been many instances of conflicts between provinces with respect to prospectuses, disclosures, registration, takeover bids, etc. (Economic Council of Canada, 1987 p. 25). In fact, according to a study prepared for the Macdonald Commission:

> ***...although the provincial legislatures and their delegates have for over half a century attempted to ensure the effectiveness of their securities laws and to enhance the efficient functioning of the securities market through legislative and administrative coordination, the overall scheme of securities regulation in Canada remains less than harmonious. Indeed, the history of Canadian securities regulation during the past two decades is marked by differential obligations on issuers, different levels and types of protection for investors and frequently ineffective or over-reaching enforcement. Even today, despite continuous efforts by the Canadian Securities Administrators to achieve a uniform or compatible national system of regulation, with the motivational assistance of potential federal "intrusion" into their domain, the provincial laws and administrative policies differ in substance and in detail and there is no***

> ***prospect of a diminution in regulatory diversity or its consequences. If anything, the present pace of securities law reform suggests the introduction of further disparities between the provincial statutes and ensuing alterations of policy and practice.***
> (Economic Council of Canada 1987, p. 25).

The Royal Commission on Banking and Finance in 1964 recommended that the Canadian securities industry be supervised by a federal body (Anisman, p. v). In 1967, Ontario proposed the creation of the Canadian Securities and Exchange Commission (CANSEC), which would have effected the delegation of administrative responsibility for the provincial acts, in connection with interprovincial issues of securities, to a national organization assembled from the existing provincial agencies (Johnston, p. 17). This was followed in the mid 1970s by the Department of Consumer and Corporate Affairs under the direction of their Director of Corporate Research, Philip Anisman, preparing a proposal for a Canadian securities market law for Canada. The proposal included a complete draft Federal Securities Act and would have no doubt eliminated most of the inter-jurisdictional problems referred to above. However, most provinces were reluctant to even consider the adoption of federal securities legislation (Bullock, Jan 25, 1994).

There is also evidence that the problem with jurisdictional overlap of provincial regulation still exists and that the interest of some market participants in seeing the federal government assume jurisdiction has never waned. In 1989, there was another attempt by the Federal Government to wrestle control of the securities markets away from the provinces (Whyte, p. 4). However, Finance Minister Michael Wilson later rejected the idea of forming a national securities commission (Welsh, June 6, 1989, p. B1).

More recently, in 1992, Robert Wright, chairman of the Ontario Securities Commission warned that "The nightmare of overlapping federal and provincial regulation of the securities industry is well on the way to becoming a reality" (Kelly, Doug., June 25, 1992 p. 18).

There is evidence that this provincial outlook remains in effect today, as is exemplified in the Matkin Report where the British Columbia Government made it quite clear that they wished to retain jurisdiction over the regulation of the securities market in

British Columbia (The Vancouver Stock Exchange & Securities Regulation Commission, p. 2). In spite of this limitation, the Matkin Report does recommend that the responsibility for self regulation be passed on to a national independent agency proposed by the Investment Dealers Association of Canada. The provincial governments are fighting to retain jurisdiction over the regulation of the securities markets while the stock exchanges themselves are continuously striving to extend their reach. This is exemplified in the following promotional reference to the VSE:

> ***VSE activities have a much broader reach than British Columbia. A number of the Exchanges's listings, while registered in the province, are headquartered in other parts of Canada and the United States. Through its support of new companies, the Exchange contributes to the economic development of the country as a whole and to the growth of both resource and non-resource-based organization. During 1993, almost 40 per cent of proceeds from private placement financings by VSE listed companies was raised outside of Canada.***
> (VSE 1993 Statistics, p. 1).

Securities regulators across Canada recently agreed in principle to establish a study group to suggest ways to reduce the costly overlap in rules between provinces. One example of overlap lies in the rule that companies file 13 different insider trading reports, one for each province or territory and Ottawa (Canadian Press, Mar 4, 1994 p. D3).

Securities fraud offenders are not restricted by political boundaries or borders. In fact, market players are now able to orchestrate fraudulent schemes in Toronto, Montreal, Calgary and other international markets from Vancouver. As stated in chapter 2, economic boundaries are being removed to facilitate international economies. Numerous RCMP securities fraud investigators are of the belief that the federal government should take steps to remove some regulatory boundaries by exercising jurisdiction over the regulation of the securities industry. (See Appendix E.) This stems from the recognition by the investigators that the regulatory boundaries have to closely match the economic boundaries. Those involved in combating securities fraud are seeing their enforcement efforts thwarted by sophisticated criminals using regulatory borders to conceal their illegal or manipulative trading practises. In fact, law enforcement officials involved in the investigation and prosecution of global frauds have long recognized the need for an

international focus in developing securities regulation enforcement strategy. Those lawyers and police officers who attended a seminar on economic crime in Singapore in 1987 called for a new worldwide police agency to fight global fraud (Reuter, Jan 15, 1987, p. B2).

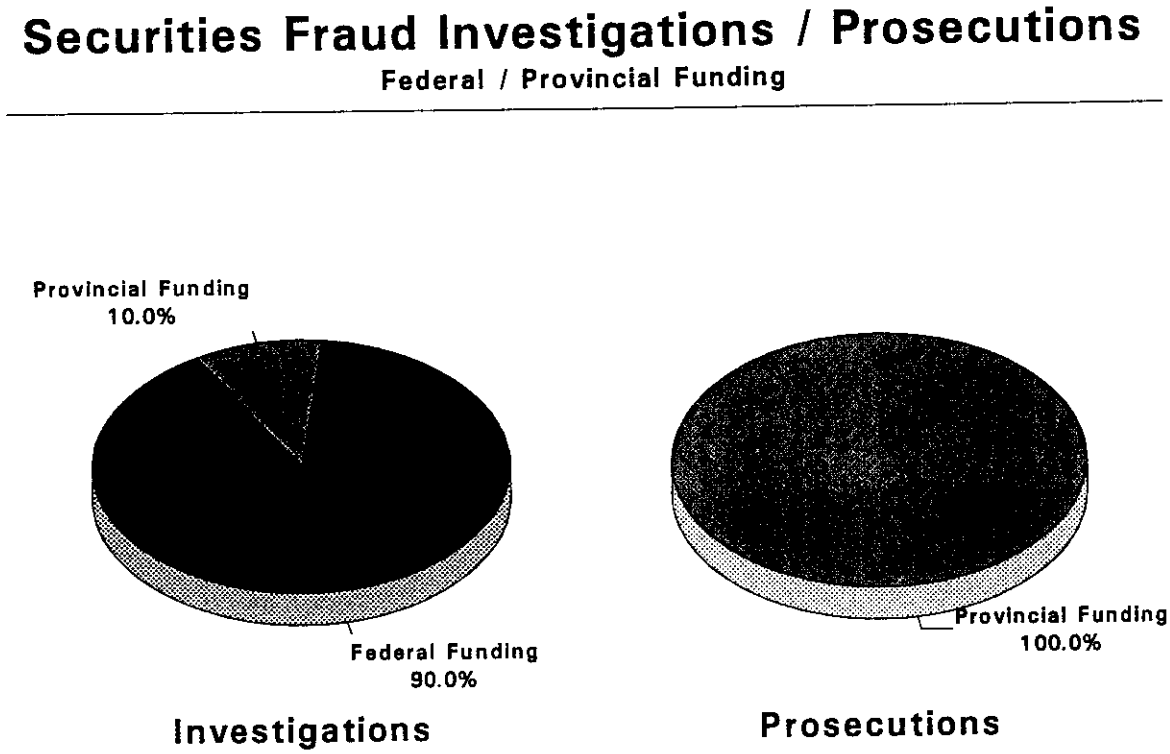
This concern was reiterated in 1991, by delegates to the International Organization of Securities Commissions conference in Washington, D.C. Australian Securities Commissioner chairman Anthony Hartnell was quoted as saying, "Clearly, it is inevitable an international enforcement confederation will be established." Britain's Serious Fraud Office director Barbara Mills went on to propose the creation of a global network to assist in multinational fraud cases, citing legal and regulatory difficulties facing authorities that chase offenders beyond their own borders (Reuter, Sep 26, 1991, p. 44).

5.12 Jurisdictional Issue of Criminal Prosecutions paid for by Provincial Government while Criminal Investigations paid for by Federal Government

The current Securities Fraud Squads are made up of RCMP members that are financed by both the Federal Government and the respective provinces. This can present a problem relating to different financial priorities of the two governments. For example, should securities fraud enforcement become a priority of the Federal Government they have the ability to induce additional investigations but do not have the direct ability to induce additional prosecutions. This system was designed on the assumption that the Attorney General's office would be willing to prosecute all those investigations referred; at least those for which there was sufficient evidence. However, the decision to prosecute is often influenced by other political priorities, particularly in a period of severe economic restraint. Prosecutors are known to be exceptionally wary about prosecuting securities fraud offenses, given the complexity and often the difficulty of obtaining necessary evidence. The RCMP has expended considerable federal resources in a particular investigation in the past only to find the respective provincial Attorney General's Office somewhat reluctant to prosecute.

This leads to a long standing issue of how the cost of RCMP securities fraud squads are allocated between the Federal and respective Provincial governments. The issue becomes particularly significant when one considers that the Federal Government pays the majority of the cost for securities fraud investigations and the provincial governments pay the entire cost of the prosecutions. Figure 5-1 contains a chart reflecting this funding allocation.

Figure 5-1



(Source: Bishop, Oct 7, 1993)

The issue is further complicated in that individual provincial governments are often asked to pay the whole of the cost of prosecution relating to securities frauds for which the underlying public company is listed in another province. In fact, this circumstance has occurred the majority of the time in recent years as evidenced by the following expensive investigations / prosecutions:

- TYE Resources Inc., a VSE listed company.
  'Carter-Ward' investigation conducted by Toronto RCMP.
  Prosecution expenses paid for by the Province of Ontario.

- Audit Resources Inc., an ASE listed company. Investigation conducted by Vancouver RCMP.
  Prosecution expenses paid for by the Province of British Columbia.

- Amswiss Scientific Inc., an ASE listed company.
  Investigation conducted by Vancouver RCMP. Prosecution expenses paid for by the Province of British Columbia.

5.13 Deficient and Unspecialized Prosecutionary Resources

The provincial Attorney General's offices have adopted special prosecution sections to handle commercial crime prosecutions. In some provinces they also contract out securities fraud prosecutions to specialized securities lawyers on an ad hoc basis. However, this is not always the case and there have been occasions where economic restraint has dictated that crown prosecutors try a 'learn as they go' approach and attempt to prosecute securities frauds from within their office. This results in the police investigator being obliged to instruct the crown prosecutor on the most elementary principles of the securities industry.

Still, other prosecutors will try to approach a securities fraud prosecution as any other criminal prosecution. This particular problem is one that is universal in all commercial crime cases; consider the following comment by Dr. Barry Rider, President of the British Institute of Securities Laws:

> ***The lack of specialization in prosecuting authorities results in cases which are pursued either being abandoned or appearing badly prepared. Many prosecutors conceive of prosecuting commercial crime in the same way as they would prepare a crime of violence.*** (Rider, p. 13).

5.14 Inability of the Court to Competently Interpret and Evaluate Evidence

Even after the specialization and expertise required of securities fraud investigators and prosecutors is considered, it is important to realize that the prosecutional arena remains that of a criminal court room. The economic principles of the securities industry now have to be matched to the basic elements of criminal law. Failure to accomplish this task will result in a judge or jury that cannot understand the underlying principles and, therefore, any subsequent decision will be totally unpredictable. Consider the following comments of Mr. Len DOUST, an ad hoc prosecutor in Vancouver, British Columbia as recorded by Diane Francis in her book 'Contrepreneurs':

> ***I had another case in Prince George (B.C.) involving a simple stock fraud case. I argued it, and the judge said, 'I cannot understand it and I can't convict this man.' In another one in Burnaby, we had a complicated two-week preliminary hearing, and the judge said afterwards, 'I don't understand it, but I will commit it to trial to let a higher court look at it.'***
> (Francis, p. 178).

5.15 Inadequate Penalties

The issue of the penalties imposed upon white collar criminals, in particular securities fraud offenders, has been a concern of investigators over the entire life of the securities fraud enforcement program. Securities Fraud Squad investigators have complained of inadequate penalties as far back as the 1970s. In 1978, Sgt. George Wool prepared a study outlining two disturbing trends relating to inadequate penalties for high value securities fraud offenses and the extended length of time it took for the justice system to deal with the matter. In his study, Wool referred to four Ontario cases of which averaged a 2.5 year time span from the date of the arrest and charge to the date the case was disposed. He also referred to an additional seven market manipulation convictions in the 1970s for which the accused received a short term of imprisonment and a small fine (Wool, April, 1978, p. 10).

These trends continue to the present day and are commonly discussed by securities regulators and police. The delay has now been extended to periods that often reach five years. It is also a common complaint that leniency by the courts is being taken as a

licence and merely considered a 'cost of doing business'.

The Vancouver RCMP Market Group investigated three securities related frauds which resulted in successful convictions in 1993. Table 5-1 contains a summary of the dispositions.

Table 5-1
'Sentence vs. Proceeds'

Offence	Proceeds	Sentence
Theft & Uttering	$300,000	4 months electronic monitoring (no fine)
Fraud	$200,000	6 months electronic monitoring (no fine)
Fraud	$300,000	4 months electronic monitoring (no fine)

Source: Vancouver RCMP, Dec 31, 1993 file review

'Electronic monitoring' relates to the convicted person being forced to remain within their residence for the specified period. They are forced to wear a electronic bracelet to facilitate the monitoring of their adherence to this confinement. Consider the probability of getting discovered and investigated for securities fraud, much less prosecuted and convicted, and one must question the overall deterrence value of forcing someone to remain in their home for a few months. Particularly when, as in these cases, the offenders earned several hundred thousand dollars in criminally generated profits.

5.16 Summary

In chapter 3 it was noted that there has been pressure on provincial regulatory authorities to assume jurisdiction and responsibility for market abuse occurring in Canada's Junior Markets. The Province of Ontario feels they have a Broker Dealer problem, the Province of Alberta feels that they have an ASE problem, and the Province of British Columbia feels that they have a VSE problem. The market abuses are acts of criminal fraud; frauds that may utilize the facilities of a specific geographic market, but the overall offence is of national and sometimes international scope. Therefore, it is argued that this is not a provincial regulatory problem, but alternatively a national criminal problem.

There are several techniques available to regulators to control the public markets. It has been demonstrated that the currently perceived lack of control pertains to fraudulent and corrupt abuse. The use of self-regulation, administrative penalties, and regulatory prosecutions are not a sufficient deterrent to serious securities fraud perpetrators. These perpetrators are known to be repeat offenders who are long term market players. They have not been deterred from committing criminal market frauds because they are not being dealt with as criminals. With a potential reward running into hundreds of millions of dollars, the only effective deterrent to these criminals is a genuine threat of discovery, prosecution, and subsequent incarceration.

There are several issues relating to criminal sanctions that hinder the ability to effectively deal with securities fraud perpetrators. Firstly, the trend of provincial regulatory authorities being forced to assume jurisdiction and responsibility for those regulatory infractions that are actually part of a larger fraudulent scheme, has resulted in the offender successfully avoiding being prosecuted for criminal fraud. Secondly, there have been problems with the interpretation and application of section 380(2) of the Criminal Code that relates to market manipulation. Finally, in those instances where criminal law is used in an attempt to sanction securities fraud offenders, there is evidence that this effort is hampered by deficient and unspecialized prosecutionary resources, an inability of the Court to competently interpret and evaluate evidence, and a perception of inadequate penalties.

6.0 THE FORMATION OF THE RCMP SECURITIES FRAUD SQUADS

This chapter provides a review of the early formation of the RCMP Securities Fraud Squads. The purpose of this is two-fold. Firstly, the review will provide the historical framework with which to analyze the overall effectiveness of the squads. Secondly, it will also be used to demonstrate that there were immediate, albeit slight, deviations from the original Government policy that went on to become a primary cause of ineffectiveness within the squads.

6.1 The Mandate

In 1966, the Prime Minister of Canada called for a federal-provincial conference to be held in June of that year to discuss securities regulations (McClellan, June 27, 1966 p. 1). The senior committee on Financial Disclosures and Securities Regulation was formed, headed by the Secretary of the Privy Council. A working group was formed under the direction of Mr. Marc Lalonde. In April and May of 1966, this group met with government officials, securities industry self-regulators and other experts across the country. The purpose of these meetings was as follows:

- to augment knowledge of provincial securities legislation and administration,
- to encourage each province to prepare for the conference, and
- to plan a mutually satisfactory agenda for the conference.

The committee reported, among others, that the following reforms were most commonly favoured across Canada:

(i) the establishment of a federal central repository for intelligence information relating to fraudulent and illegal activities in the securities field; and

(ii) the establishment of a Royal Canadian Mounted Police securities fraud squad.

The following is an excerpt from a June 27, 1966 letter from RCMP Commissioner G. McClellan to the Solicitor General of Canada, the Honourable L. Pennell.

> ***"The extent of federal participation in this sphere is uncertain at this time and is dependent on the result of discussions with the provinces at the conference. The possibility exists that federal legislation will be enacted either in the form of criminal legislation or a federal Securities Act, supplementing the existing provincial statutes. The Force's active participation in this program as an investigative agency is founded on the assumption of greater federal participation, either through formal agreements with the provinces or federally enacted legislation. Our precise responsibilities as an investigative agency are uncertain at this time and will depend greatly on what course of action is adopted at the conference. For this reason, it is difficult to state at this time the number of investigators required, the qualifications of such investigators, and the cost."***
> (McClellan, June 26, 1966 p. 2).

Commissioner McClellan also refers to a feasibility study prepared by the RCMP on 'The Participation of the Royal Canadian Mounted Police in Securities Fraud Investigations'. The report from this study details the intended role of the RCMP in securities fraud investigations. (See Appendix A.)

The Treasury Board at its meeting of May 4th, 1967 considered and approved in principle the establishment of:

(a) RCMP Security Fraud Investigation Squads

(b) A National Repository of Security Regulation Information, to be operated by the RCMP and paid for by the Federal Government.

(McClellan, Jan 13, 1967, p. 3).

The RCMP immediately began planning the implementation of the proposed Securities Fraud Squads in 1967. The proposal had been quite specific in its human resource requirements as outlined in the original feasibility study, which contains the

following reference:

> ***The Force is aware of the fact that such investigations can be a highly sophisticated and complex nature. For this reason the Force is prepared to train and maintain a staff of specialized investigators who have undergone extensive training in the securities and financial fields. While there are at present members of the Force who have university degrees in Commerce and Business Administration and who could become specialists in such an investigative body, there may not be a sufficient number of these members available, and the Force is prepared to recruit additional specialists from outside.***
>
> ***In addition to these specialists, trained investigators will also be required and will have to be oriented in this field. To enable these investigators to function efficiently, it will be necessary that they receive training within the Force, based on a syllabus of training geared to this type of offense. This aspect of their training could eventually become part of the planned Canadian Police College. Further training will also be required outside the Force and can possibly be obtained in conjunction with stock exchanges, brokers, investment dealers, etc.***
>
> ***It is intended that this investigative branch will include specialists in securities fraud, persons with accounting knowledge and legal experience, and investigators, all working in close co-operation. The function of those members of the branch possessing accounting knowledge would be to analyze and interpret financial records as an assistance to the field investigators. The legal advisers would be kept informed at all stages of the investigations of the evidence available and any legal problems that might arise.***
>
> ***For efficient and effective enforcement, this branch must be highly mobile and will be posted in a central metropolitan locale to be available on short notice to travel to any part of Canada to undertake these investigations.***
> (RCMP Feasibility Study - See Appendix D).

6.2 Four Key Characteristics for the Intended Securities Fraud Squads

There are four key characteristics of the intended Securities Fraud Squads contained in the original feasibility study that should be examined in detail. These issues became quite significant in later development of the squads and are used to compare the performance and current status of the squads.

6.2.1 - Specialization

The RCMP had formally recognized the degree of specialization required to conduct securities fraud investigations. Very specific human resource requirements were outlined - specialists in securities fraud, persons with accounting knowledge and legal experience, and investigators, all working in close co-operation.

6.2.2 - Training

The RCMP was prepared to offer extensive training to enable these investigators to function efficiently. It was deemed necessary that they receive training within the Force, based on a syllabus of training geared to this type of offense. It was also suggested that this aspect of their training could eventually become part of the planned Canadian Police College. It was also deemed necessary that further training could possibly be obtained in conjunction with stock exchanges and investment dealers.

6.2.3 - Outside Experts

The RCMP was prepared to recruit additional specialists from outside. This acknowledgment is linked to that of the degree of specialization required. The RCMP recognized that they did not have the human resources to effectively investigate securities fraud.

6.2.4 - Central Locale & Mobile

It was recognized that for efficient and effective enforcement, the branch must be highly mobile and be posted in a central metropolitan locale to be available on short notice to travel to any part of Canada to undertake these investigations.

6.3 A Shift away from Securities Fraud Specialization

This overall proposal was an ambitious venture and would likely have produced a team of highly skilled and effective securities fraud investigators. However, there were slight deviations from the original plan with respect to human resources policy that would have long term ramifications to the overall effectiveness of the squads.

Immediately after the Treasury Board approval, Assistant Commissioner H. Cooper wrote to the RCMP senior officers commanding each division across the country to inform them of the proposed organization procedure and function of the new Securities Fraud Investigative Squads. Assistant Commissioner Cooper advised that the Solicitor General approved the suggestion that the Federal Government assume responsibility for the cost of establishing and operating Securities Fraud Investigations Squads by the Force in the contract provinces and establishing and operating a National Repository of Securities Regulation Information at federal expense. He also referred to an excerpt from the original RCMP submission to Treasury Board dated March 29, 1967:

> ***The R.C.M.P. will train and maintain a staff of specialized investigators to enforce those provisions of the Criminal Code relating to securities frauds in contract provinces and, when requested, to assist in the enforcement of Provincial Securities Acts. Investigational Squads will be located at strategic points across Canada, i.e. Vancouver, Edmonton, Calgary, Regina, Winnipeg, Halifax, Toronto and Montreal. The organization and development of these squads will depend primarily on the workload at each location. Securities Fraud Investigational Squads will be integrated into the R.C.M.Police network and will have available all of our supporting investigational services including contact with all National and International Police Organizations. Squads in Toronto and Montreal will be responsible for directing enquiries, originating in contract provinces, to the Ontario and Quebec Securities Commissions respectively. Additionally, they will be responsible, when requested, for rendering assistance in these investigations and developing working relationships with the Ontario and Quebec Securities Commissions. Because of the sophisticated nature of this type of work, squads will be staffed in part by Law, Accounting and Commerce graduates. There are three sources of such personnel:***
>
> ***(1) Regular member Law and Commerce graduates from the present establishment of the Force;***
>
> ***(2) Accelerated training scheme for our members at Canadian Universities;***
>
> ***(3) Engage such experts as civilian members at salaries commensurate with their qualifications and experience.***

(Cooper, June 29, 1967, p. 2).

It is suggested that here begins the first slight shift in the direction of the Securities Fraud Squads. Assistant Commissioner Cooper does not make specific mention of Securities Fraud specialists. The new human resource requirements refer to Law, Accounting and Commerce graduates. This simple omission is symbolic of an eventual change in overall human resource policy. Securities fraud expertise was being thought of as being made up of expertise in law, accounting and commerce and not a separate field in itself. The significance of the securities aspect for the required expertise was lost.

6.4 Securities Fraud & Bankruptcy Sections Merge

Further evidence of this shift in emphasis occurred in August of 1967, when the RCMP began considering the amalgamation of Securities Fraud Sections and Bankruptcy sections throughout the Force to form more encompassing 'Commercial Fraud Sections'. RCMP Superintendent Nadon wrote to the commanding officers of each division asking for input on the proposed amalgamation.

> ***...There is considerable evidence on file to establish close ties among persons and groups of persons involved in securities fraud and fraudulent bankruptcies. In the long run, we propose to include such commercial frauds as the conspiracies under the National Housing Act, Farm Improvement Loan Act, etc.***
> (Nadon, Aug 29, 1967, pp 1-2).

Superintendent Nadon went on to report that it had become apparent that a combined section would have the following advantages:

a) Larger pool of manpower on which to draw in the event a large case breaks.

b) It will facilitate co-ordination of information and investigations in view of the frequent involvement of the same persons in both types of fraudulent schemes.

c) Less administrative work - e.g. establishment submissions, returns, estimates, etc.

d) More effective employment of personnel. Should one type of work either increase or decrease significantly in the short run, any corresponding decrease or increase in the other type could be managed better with the result that one section would not sit idle while the other remained over-burdened.

e) The same type of academic qualifications and experience is required for both sections.

f) An increase in the number of persons attached to one section will provide greater career opportunities in this specialized area in addition to a more diversified career. A member could commence as a Constable and proceed through to the rank of Inspector providing he is suitable to assume greater responsibilities.

g) The contacts made by the Securities Fraud Section are frequently the same as those professional persons encountered by the Bankruptcy Section, e.g. Lawyers and Chartered Accountants.

The majority of the above arguments appear to be logical and reasonable efforts to promote efficiency within government bureaucracy. However, it is suggested that this slight change in policy created the potential for a reduced emphasis on securities fraud.

6.4.1 The Same Persons Involved in Both Types of Fraudulent Schemes

An argument can be made that there are ties between all types of the criminal element. For example, there are ties between illicit drug barons attempting to launder their illegally gained profits through stock exchange transactions and those persons involved in attempting to artificially affect a public market. The link would be that they are both trading on a public exchange. However, it would be extremely important to differentiate between a classification of criminals and a classification of investigations. It is respectfully suggested that although there may be a small link between the bankruptcy criminal and the securities fraud criminal there are no, or very few, links between the respective investigations. One senior Stock Market Squad leader noted the following when questioned about the similarity of bankruptcy investigations to stock

market investigations:

> ***I do not see any similarity in the investigations, other than they are both corporate crimes. To the uninformed, these are simply business crimes.*** (Peters, Jan 28, 1994)

6.4.2 More Effective Employment of Personnel

There is no doubt that this was of significant benefit to a manager of each provincial commercial fraud program. However, it is also suggested that this was the beginning of the formation of a reactive approach to securities fraud. It is of significance that these 'idle' investigators would no longer be available to initiate proactive investigations. Proactive investigations are important in any effective commercial crime program, and this is particularly vital to securities fraud. Consider the following comment from S/Sgt. Monty Peters:

> ***Market investigations never come to you on a platter, you have to go out and look for them. The information in not forthcoming and unless you know where to look for it, you are not going to find it. In my ten years in Market Group, I cannot recall anyone from the brokerage community ever calling and telling me there is a market manipulation in progress.*** (Peters, Jan 28, 1994)

Secondly, as noted in chapter 7 relating to the specific performance of the squads, this managerial means of redeployment became an ongoing handicap to securities fraud investigations.

6.4.3 Similar Academic Qualifications and Experience

The suggestion that a bankruptcy investigator had need of the same expertise as a securities fraud investigator is further evidence that there was no longer any emphasis being given to the specialized expertise required of a securities fraud investigator. It must be stressed that a knowledgable and competent bankruptcy investigator having no knowledge of the securities industry is not in a position to conduct an effective securities fraud investigation.

6.5 Expansion to Commercial Fraud Sections

By October of 1967 the securities fraud squads had been formally merged into the new commercial fraud sections. This precipitated some significant shifts away from the original proposed mandate for the section. The original feasibility study had outlined the intention to adopt a realistic salary scale to recruit and retain the qualified personnel. Firstly, RCMP managers chose not to fill the positions with senior ranking officers, and secondly, they delayed in hiring the specialized civilian members. On October 3, 1967 RCMP Deputy Commissioner W. Kelly wrote to Assistant Commissioner Cooper, the Director of Criminal Investigations:

> ***....The question arose as to the need for the ranks as set out in the Establishment figures, and particularly the rank of Inspectors, and even more particularly the establishment of two Inspectors in a place like Vancouver. It is obvious at this time that men are not going to be commissioned to the rank of Inspector solely to fill the Establishment positions. This does not mean that present commissioned officers qualified for the positions should not be placed in them. The main point at the moment is to get the best qualified men in the jobs so that we have the organizations going.***
>
> ***... A further point raised was the training of personnel, and we assured the Commissioner that there was a preliminary training programme established, and which would be augmented by appropriate courses within the Force itself. In relation to this, it was also agreed that where the Establishment called for Civilian Members of Grades 14 or higher we might even consider hiring people with lesser qualifications if they seemed to fit into Force requirements in the line of investigative ability. However, you will recall that it was pointed out that with a Grade 14 we could obtain a thoroughly experienced individual in the field of accounting and investigation, and this man's knowledge would be of immense value, not only in stock frauds, but in bankruptcy and other forms of similar investigations.***
>
> ***...It should be thoroughly understood that while we are now setting up squads to investigate offenses in the Securities field; that such a squad will also be responsible for investigating offenses in areas of "white collared" crime such as bankruptcy and other types of fraud, but certainly not at the expense of securities investigations. All personnel should consider themselves as part of the Securities Fraud Section and should be directed into channels where their abilities are required, subject of course to demands.*** (Kelly, W., Oct 3, 1967).

On October 6, 1967 RCMP Assistant Commissioner Cooper then provided further direction to the commanding officers of each division. Assistant Commissioner Cooper summarized some of the developments at that point:

> ***...It is expected that a nucleus of regular members for each section will have been selected and posted within the current month. No steps will be taken to fill the Special Constable Grade 14 positions until these sections become operative and the need for specialists from outside the Force is further assessed. In many instances, we are uncertain of the overall anticipated workload....***
> (Cooper, Oct 6, 1967).

Assistant Commissioner Cooper also had a few developments to report regarding training:

> ***...In the initial selection of members for the staffing of these squads, we were able to place a few members who have obtained university degrees in either law or commerce. Other members have taken the Canadian Securities Course sponsored by the Investment Dealers' Association of Canada, various business accounting courses, or have an excellent background of experience on C.I.B. investigations. We recommend that members employed on these Sections enrol in the Canadian Securities Course if they have not previously undertaken a similar course....***
>
> ***...In the early development of these sections, arrangements should be made for each member to spend about one week with the Securities Commission to gain an appreciation of its function and in addition, arrangements should be made to spend approximately one week in a stock exchange and further week with a reputable investment dealer. Members of your Securities Commission may be in a position to assist with these arrangements. The feasibility of introducing this type of training is of course contingent upon the co-operation you receive from the institutions suggested. This procedure was tested in "E" Division and is approved.***
>
> ***A two week training course is proposed for October 1968 to be held in Ottawa. It is anticipated that 20 members will attend. Lecturers from outside the Force will discuss topics related specifically to securities fraud investigations. Any suggestions for course topics or material would be appreciated.***
> (Cooper, Oct 6, 1967).

Assistant Commissioner Cooper had the following to say about the future plans for the section:

> ***...We are presently studying the feasibility of including investigations involving the Bankruptcy Act; frauds and conspiracies under the National Housing Act, Farm Improvement Loans Act; and any other fraud perpetrated against the Federal Government under the responsibilities of these Sections. The proposed name is the "Commercial Fraud Section". Your respective views were solicited in earlier correspondence. It is anticipated that a decision will soon be reached in this regard. It is quite in order for the Sections to carry out these investigations now, however, they should not lose sight of the fact that securities matters are their primary responsibility for the time being.*** (Cooper, Oct 6, 1967).

6.6 Summary

Immediately after the RCMP Securities Fraud Squads were formed, the RCMP senior management began looking at securities fraud as part of a larger picture. This was, after all, an era in which white collar crime was becoming prevalent in the Canadian economy. It appeared reasonable that the Securities Fraud Investigative Units become part of a larger organization with a mandate for investigating all white collar crime. The significance is that the academic qualifications and training for the Commercial Fraud Sections were no longer specific to the securities industry. This change in policy resulted in a disincentive for the RCMP to develop teams of specialized securities fraud investigators.

7.0 A REVIEW OF THE PERFORMANCE OF RCMP SECURITIES FRAUD SQUADS

A questionnaire was mailed to each known past and current RCMP securities fraud investigator. Appendix A contains a copy of the actual questionnaire and Appendix B contains an analysis of the response rates. The information obtained from these questionnaires along with that obtained from personal interviews of some of the more experienced investigators was used to prepare the following historical review of the performance of the Securities Fraud Squads. This chronology is intended to identify, as well as provide understanding of, a trend of decreased effectiveness of the RCMP Securities Fraud Squads. In the early years, the squads consisted of hand-picked, highly motivated, specialized investigators; investigators who had the tools and resources necessary to achieve their objective. They are believed to have had a strong deterrent affect on securities fraud. As time went on, changes in law, changes in RCMP human resource policy, and periods of severe economic restraint, all had a dramatic affect on the effectiveness of the Squads. The squads have become generally ineffective and the investigators frustrated.

7.1 The Mandate of the Squads

A common complaint of the securities fraud investigators was that they perceived a general lack of national focus or mandate to the securities fraud enforcement program. The desired output of the RCMP securities fraud enforcement program has never been clearly defined. From this stems a problem of the inability to measure the efficiency of enforcement strategies or initiatives.

There was found to be a general consensus with respect to question 11 and 12 of the questionnaire. Question 11 related to the perceived mandate of the squads during the respondents' period of employment, and question 12 related to an indication of what they believed the current mandate should be. There was found to be a strong consensus in that the unofficial mandate is, and always has been, to investigate 'Market Manipulations'. This is a common term used by securities fraud investigators and prosecutors to refer to that section of the criminal code that relates to artificially affecting the public market

price of a given security (The Criminal Code of Canada sections 380(2) and 382. The consensus was found to be somewhat surprising, in light of the fact that a common concern attached to a number of questionnaires was that there was no identified official mandate.

7.1.1 The Existing & Historical Mandate

The responses to question 11 were used to prepare the following list of objectives which are in descending order of priority and make up the unofficial mandate of the securities fraud squads for the past 27 years:

- **To investigate 'Market Manipulations' with emphasis on those investigations of national and international scope.**
- **To investigate other Criminal Code offenses relating to publicly traded securities.**
- **To investigate provincial Securities Act offenses and assist provincial Securities Commissions.**
- **To investigate criminal offenses relating to Registered Representatives or Stock Brokers.**

7.1.2 What the Mandate should be

The views on what the mandate should be were generally much the same as what the mandate is. The investigators indicated that they thought the RCMP should continue to follow the unofficial mandate. However, the responses were somewhat divided in terms of the priority of those investigations involving the Criminal Code versus provincial legislation. Some investigators thought that the RCMP should focus only on Criminal Code investigations while others thought that because of the lack of success in that area, the squads should focus on working with the provincial securities commissions in pursuit of Securities Act offense convictions.

Approximately 10% of the respondents expressed the opinion that Canada requires a national securities commission similar to the Securities & Exchange Commission in the

United States. However, the strong majority of investigators simply referred to the existing mandate and presented arguments for variations in the focus. The following are some exceptions to the normal responses.

> ***"more pro-active approach required"***
>
> ***"increased involvement of the provincial securities commissions"***
>
> ***"function might be better served by non-police personnel, US model of SEC is preferable"***
>
> ***"RCMP should get out of market manipulations and leave them to securities commissions"***
>
> ***"more emphasis on the market players such as the registered representatives"***
>
> ***"should include an intelligence gathering aspect"***
>
> ***"require a national securities commission matched with a national investigative body"***

7.2 The Historical Performance of the Squads

The RCMP seemed to adapt very quickly to its new role in 1967 and the squads quickly developed a reputation for being very dynamic. Even before a specific mandate for the squads had been defined, the individual groups were being set up at major centres across Canada. Investigators were hand picked through a centralized staffing process out of Headquarters in Ottawa. This resulted in very zealous and aggressive securities fraud squads. This first group of investigators were also selected according to some of the original criteria; securities fraud expertise, good police investigators and commerce and law graduates. For example, personnel searches were conducted and investigators with a prior background in the securities industry were asked to join one of the squads (Peters, Jan 28, 1994). These early days also made up the most active and effective period, a lot of which is thought to be attributed to some of the key personalities involved. Two of these key personalities were Sgt. George Wool of the Toronto Squad and Cpl. Rupert

Bullock of the Vancouver Squad.

The Toronto squad was well recognized throughout the RCMP as being very active with several wiretap operations while the Montreal squad was also busy monitoring the calls of the infamous Irving Kott and his brokerage firm. Prominent cases included the Toronto squad's investigation of the manipulation of a company called Somed Mines involving Irving Kott, and the manipulation of a company called Buffalo Oil & Gas Ltd., a stock listed on both of the Toronto and Montreal exchanges. It is important to recall that judicial authorizations were not required to monitor a suspect's telephone prior to 1974, and this resulted in 'rooms full of wiretap lines' (Wool, Feb 16, 1994).

A good example of the aggressiveness of the squads lies in a raid in 1972 which involved approximately 100 RCMP investigators, whereby, they raided the homes and offices of thirty-six brokers and mining promoters and eighteen company offices across Canada (Francis, 'Contrepreneurs', p. 102). The raid was part of a widespread sweep investigating the use of bribes to get brokers and floor traders to peddle and hike the prices of Buffalo Oil and Gas stock. These type of high profile and dynamic investigations would undoubtedly have had a strong and deterring effect on the public market in that it was clearly demonstrated that market abuse and corruption would not be tolerated.

In the mid 1970s investigators were flying all over the globe to investigate stock manipulations (Wool, Feb 16, 1994).

The investigators were highly motivated about their work and believed that they were definitely having an affect on the market. S/Sgt. Larry Park, who was a constable in the Toronto Squad from 1975 to 1978 comments:

> ***During my time the Market Groups were very effective. I assisted George Wool on about four cases - they were well noted in the press and within the Ontario Securities Industry.***
> ***...I also believe the practise of stock manipulation, wash trading, etc. was curtailed as a result of these investigations.***
> (Park, Survey Question #13)

Mr. Eugene Lewis, now employed with the Ontario Securities Commission, was also attached to the Toronto Squad from 1973 through to 1982. He too, spoke highly of the Squad:

> ***During the period from 1973 to 1982 the Toronto Market Group was very involved in criminal investigations and prosecutions with considerable success in manipulations. The mandate was not as clear as some thought, however we had excellent support from the local Attorney General's office at that time and a great incentive to pursue stock cases.***
> (Lewis, Survey Question #11)

In Vancouver, a separate Stock Fraud unit was not formally established until 1975. Cpl. Bullock was asked to head up the Vancouver Squad which quickly developed a reputation as an active force in investigating VSE companies. Cpl. Bullock was also responsible for a proposal that resulted in the development of a computer software package entitled 'SWAMP' or Securities Wash and Manipulation Package (Bullock, Jan 25, 1994).

It was also at this point in time that a two-week 'Commercial Crime' training course was established in Ottawa. However, the course was directed to all of commercial crime investigations and the emphasis of securities fraud was watered down to only half a day spent on stock-market manipulation (Bullock, Jan 25, 1994).

Cpl. Darryl McConnell led the investigation of the manipulation of a VSE company, Grand Prix Resources, and eventually convicted a major market player, Gunter Allman.

> ***In my experience the CCS ('Commercial Crime Sections') were most effective during the 1970's when the members were essentially hand picked, identified by "moccasin telegraph" and the staffing function, including promotions, was controlled by centralized staffing.***
> (Mcconnell, Survey Question #13).

Cpl. Nick Pross was part of the Montreal Securities Fraud Squad from 1973 until he retired to work for the Royal Bank in 1980. Pross had the following to say about the

Montreal Squad:

> ***In the 1970's, we were called RCMP Stock Fraud Groups. The Force('RCMP') took a very aggressive approach in this area. Getting funds and manpower was no problem. We worked closely with the provincial securities commission as there had been very little police intervention in this area.***
> (Pross, Survey Question #13).

Deterioration in RCMP effectiveness in securities fraud investigations became evident in 1977 when George Wool was transferred from the Toronto office to the Yukon to set up a commercial crime unit in the north, and in January of 1980 Rupert Bullock retired from the RCMP to become the British Columbia Superintendent of Brokers. Two prominent personalities were lost and along with them a lot of the dynamics of the securities fraud enforcement effort. Rupert Bullock left when he was at the rank of Staff Sergeant and was forced to leave because of the structure of the RCMP; he could not be promoted any further and remain in the securities fraud enforcement field (Bullock, Jan 25, 1994). The higher ranking positions outlined in the original feasibility study were not enacted to entice him to remain. Bullock left to a more senior position as the Superintendent of Brokers at the British Columbia Securities Commission, a post of which he held for another six years. George Wool also left the RCMP shortly thereafter. Diane Francis, in her book Contrepreneurs, describes George Wool's retirement as follows:

> ***Losing experienced white-collar cops like Wool cost a country. Such officers are the thin blue line separating capitalism from the jungle, and their departure can sometimes make all the difference in the world.***
> (Francis, 'Contrepreneurs', p. 119).

Comments made by past securities fraud investigators indicate that it was the early 1980s where things really began to sour. Some very key personalities had just retired or were transferred out of the squads. They had reached a plateau, in that they were at a point where they could go no further and remain within a securities fraud squad. The result was that there was a long learning curve facing a group of new inexperienced investigators. The RCMP was also now staffing the Securities Fraud Squads through a decentralised provincial staffing program. This meant that there were fewer qualified members to choose from.

There were a few cases still making their way through to criminal court, but they were fewer and fewer in number. In Vancouver in 1982, Cpl. Ross Fisher managed to demonstrate that the RCMP was still actively involved in the markets through his investigation of the alleged manipulation of the VSE 'Palliser' company.

This was followed by the 1985 investigation of the 1984 Black Friday VSE market crash, involving two Vancouver stock promoters manipulating the price of three VSE companies to the point that the subsequent market crash dropped $40 million off the value of the stock involved (O'Neil, July 17, 1985 p. 17).

S/Sgt. Gerry Garand was attached to the Montreal group from 1974 through to 1983. He had the following comments to say with regard to their effectiveness:

> ***In my days in the group it was very effective. However, as the years went on our effectiveness was reduced because our mandate was redefined or classified. Also these investigations are very expensive and time consuming. They require travel and experienced investigators...***
> ***...I found in my last years in the Force a very low priority was given to the selection of personnel for the Commercial Crime Unit and particularly the Market Investigation Group...***
> (Garand, Survey Question #13).

The RCMP was also faced with constant other emergent operational demands such as the Air India plane crash in 1985 and the World Exposition 'Expo '86' in Vancouver. These events would force managers to redeploy securities fraud investigators as required. At least three Vancouver investigators were temporarily deployed for extended periods to assist in the Air India investigation.

This issue is further exemplified in a interview by Diane Francis with Vancouver ad hoc Crown prosecutor Len Doust:

> ***Another problem is that policing is a hit-and-miss affair, and the RCMP seconds its commercial crime units to special duties such as security and surveillance or special projects. "The problem last year (1986) was everybody was busy with Expo'86. There was a lot of counterfeiting, mostly involving the passing of fake U.S. dollars at the exhibition," says Doust. About half of the stock market manipulation group spent months at the fair, followed by two-week long stints guarding VIPs at the first ministers' conference held shortly afterward.***
> (Francis, 'Contrepreneurs', pp 178).

In spite of these temporary secondments, by the mid 1980s the Toronto market group managed to undertake the 'Carter - Ward' investigation. This case involved the manipulation of numerous VSE stocks over a two year period and the payment of a $1.5 million secret commission to a US mutual fund portfolio manager. The fund purchased approximately $27 million in the shares of the manipulated companies. Approximately 8 person-years were invested in this particular investigation and two promoters were successfully convicted 4 years later. One was sentenced to three years in jail, while the other received seven years (Saunders, Nov 4, 1988, p. N4).

In 1986, the Vancouver squad also became involved in a major undertaking in the investigation of the manipulation of Audit Resources Inc., an Alberta Stock Exchange listed company. Approximately five person-years were invested in this investigation, however most of the accused persons were acquitted. Wiretap and documentary evidence crucial to the prosecution was ruled inadmissible by the court. Judge Craig of the British Columbia Provincial Court ruled that the RCMP had "practised deception upon a Justice of the Peace" in obtaining search warrants by claiming that the information for grounds for the warrants has come from a "reliable and confidential source", when in fact, that grounds had come from information heard in the wiretaps. The trial lasted 22 weeks and the only person convicted was the alleged ringleader after he pleaded guilty to conspiracy to manipulate the price of the Audit shares. He subsequently served a few months in prison (Heaton, Greg., Apr 25, 1988, pp. 22-23).

Needless to say, this was the period where securities fraud cases developed a reputation for their extremely high cost of prosecution coupled with lower than average probabilities of conviction. It became evident that the complexity of the cases necessitated securities law oriented (and expensive!) ad-hoc prosecutors, might involve anywhere up to one hundred witnesses, and require six months of court time.

On a more positive note, there was a particularly innovative advancement in the late 1980s with the RCMP's development of an expert computer software system for use in market manipulation investigations. This expert system came to be known as S.M.A.R.T., an acronym for 'Stock Market Analysis for the Reconstruction of Trades'. Whereas a typical forensic accounting type trading analysis might have taken as long as

six months to prepare, the SMART system could now produce a similar analysis in just a few days. This investigative tool has received extensive use, and although it is yet to be fully accepted by the courts, there are several current court proceedings underway.

Towards the end of the 1980s Market Groups across the country began to experience a very high turnover of investigators. Expertise built up over a number of years was almost completely wiped out on several occasions. Vancouver saw its five most experienced securities fraud investigators transferred or retired within a two year period. In 1989, almost all of the senior members of the Toronto Market Group either transferred or retired.

Entering the 1990s, the expertise was at an historic low, and the investigators were showing signs of frustration. The country was entering a period of severe economic restraint, and major investigations were considered a thing of the past. Travel budgets were limited, vacant positions were left unstaffed, and a 'generalist' staffing philosophy resulted in a serious shortage of qualified investigators. Fewer and fewer market manipulation investigations were undertaken. The securities fraud squads found that, for the most part, they were only able to manage one major investigation each.

By 1993, serious cracks began to show in the overall enforcement effort. It had become an overwhelming task just to initiate a major investigation. Investigators were still being redeployed for various other policing priorities. Consider the following comment as made by one current investigator from the Toronto squad in response to survey question 11:

Question: ***What do you feel was the mandate of RCMP market groups during your stay?***

Answer: ***To investigate Stock Market related offenses when not performing VIP duties.***

7.3 The Current Squads - Commercial Crime 'Market Groups'

The current Securities Fraud Squads are now referred to as 'Market Groups' and are located in Montreal, Toronto (Milton), Winnipeg, Calgary, and Vancouver. They are made up of RCMP members that are financed by both the Federal Government and respective provinces. Table 7-1 outlines a breakdown of the current positions.

Table 7-1
RCMP Commercial Crime
Market Groups

Location	Federal Positions	Provincial Positions
Vancouver	8	2
Calgary	4	1
Winnipeg	2	0
Toronto	9	0
Montreal	4	0
Total.....	27	3
Approximate Labour Cost.....	$1,600,000	$180,000

(Source: Bishop, Oct 7, 1993)

The morale has now deteriorated to extreme lows in all of the securities fraud units across the country. Investigators are generally frustrated with the lack of national focus for the enforcement program, the impeding human resources policy of the RCMP, the very limited financial resources, and the lack of 'prosecutorial will' as shown by crown prosecutors.

The following comments were made by Cst. Gord Fraser. He has been an investigator with the Calgary Market Group since April of 1986:

> ***The transfer of trained personnel out of market function through promotion (or frustration) seriously hampers continuity and loses expertise. At present, our efforts rely upon a few individuals. The complexity and long turnaround times serve to de-motivate and burn out those involved. The Force has failed to acknowledge or reward those involved, nor has it shown a grasp of the relevance of our role and diversity of our required job knowledge.***

The following comments were made by Cpl. Chris Perkins. He joined the Vancouver Market Group in November, 1992:

> ***We are basically ineffective. Why? - because of the staffing policy. Members have been promoted into market groups with no background in securities. Unless they have the desire to learn securities, they do not get involved or undertake a major investigation.***

The securities fraud investigators that did manage to push a case through to the crown prosecutors found that they were met with a serious lack of prosecutorial motivation. The provinces were facing their own economic restraint problem, and given the limited chances for success, securities fraud prosecutions were not welcomed. Consider the following comments made by Sgt. Mike Hubley. He joined the Toronto (Milton) Market group in 1989:

> ***Unfortunately, I feel that our effectiveness has been limited in the past few years. The constant demands on our resources for other non-related duties has had a negative impact. In addition, the continuing turnover of members assigned to the unit for various reasons has led to a serious decline in the level of expertise required to investigate these complex cases. We have also had a number of serious problems in obtaining convictions in the cases we have investigated. My opinion is that this is not a reflection of the quality of the investigations but rather a problem with the lack of related knowledge by the judiciary and the seeming unwillingness of the AG's departments to prosecute. This unwillingness seems to be more related to the attendant costs of prosecutions of this nature than anything else. Some serious consideration will have to be given to the continued use of our resources in this area unless the provincial governments begin to exhibit more political will in this area.***

S/Sgt. Tom Hunt joined the Toronto (Milton) Market Group in July of 1992 and adds:

> ***Lately, it appears the courts and prosecutors are not interested in "protecting the integrity" of the markets. This may be because of lack of knowledge or substantial costs associated with these investigations. The effectiveness will be substantially reduced or eliminated if we continue to lose or refuse to prosecute cases for purely economic reasons. The Canadian investing public expect and deserve more protection than they are presently receiving.***

The reluctance shown on the part of prosecutors would seem to be justified in that those investigations that are managing to make it into criminal court meet with dismal results. The Amswiss Scientific Inc. preliminary hearing in Vancouver lasted over 18 weeks and involved approximately 50 witnesses. In August of 1993 all seven charges against two accused were dismissed. Provincial court Judge E.J. Cronin stated within his decision that a "certain degree of market management, provided it's lawful, particularly in the promotion of a company, is not offensive to the fair market price principle. The promotion of a public company is a lawful exercise. To some degree it must affect the fact that (sic) the promotion is going to affect the price." (Regina v. Simonyi-Gindele 'et al' - Provincial Court of British Columbia).

Although Judge Cronin's decision was not citable, it has had national ramifications. It has been referred to by Crown Counsel in consideration of other market manipulation prosecutions across the country. The British Columbia Crown Counsel has requested a judicial review of this decision and this is expected to be heard in the British Columbia Supreme Court in the fall of 1994.

This problem was later compounded in October, 1993 with the Penway Explorations Inc. decision in Ontario. Three promoters were charged with manipulating the price of Penway Explorations Ltd., an ASE listed company. In his decision, Justice Blair of the Ontario Court stated that he accepted the thrust of the accused's testimony, namely, that what they engaged in was an attempt to promote the Penway stock, causing its price to rise in the process, to their own profit and advantage but also to the profit and advantage of those who followed them into the market to buy the stock. The promoters were acquitted and the criminal distinction between the promoter / manipulator roles remains undefined.

In March of 1994 the situation got much worse. A seven year investigation into the alleged manipulation of an ASE company Canadian Platinum Refineries Inc. ended on March 23, 1994 with all charges being dismissed after a lengthy preliminary hearing. A significant issue that arose in this particular case centred on the admissibility of the RCMP 'SMART' generated evidence. Judge Fradsham ruled that where the RCMP computer had processed and interpreted information to arrive at a conclusion which could be the subject to reasonable debate by humans, the computer had produced an opinion. That opinion was ruled inadmissible. It is estimated that there were approximately 8 - 10 person years invested in this particular investigation (Regina v. George, Alberta Provincial Court, Fradsham P.C.J., October 18, 1993. Final Decision March 23, 1994).

7.4 Criminal Code Market Manipulation Charges

Although there are no statistics available as to the number of charges sworn by the Securities Fraud Squads over the years, there was a trend reflected within the questionnaire results. Question 5 of the survey questionnaire was designed to elicit data for use in estimating the total number of major investigations each investigator was primarily responsible for during their tenure as a securities fraud investigator. Unfortunately, it was determined that the results were tainted by the subjective interpretation of the terms 'major' and 'primarily'. It became apparent that multiple respondents were claiming primary responsibility for specific investigations. Other investigators referred to simple charges of theft, while others limited their replies to 'major' market manipulations.

Unfortunately, there are no statistics available for use as a measure of performance such as the number of securities fraud criminal investigations initiated over the past 26 years. The RCMP has recently undertaken to develop a new management information system ('MIS') within its Economic Crime Directorate that will allow for some statistical performance measurement. For example, all investigative person-hours expended on securities related investigations are now captured. It is hoped that information gleaned from this system will provide RCMP managers with some means of measuring the performance of the Commercial Crime Market Groups.

It is emphasised however, that what is evident from the survey questionnaire comments and subsequent interviews is that there has been a trend of substantially decreasing numbers of all of major investigations, wiretap operations, search warrants, court briefs, and criminal charges. Appendix E contains a summation of the views of the investigators with respect to the overall effectiveness of the squads.

7.5 The Securities Fraud Information Centre ('SFIC')

In the early years, the RCMP did attempt to maintain a 'National Repository' of intelligence information as set out in the original feasibility study. This unit operated out of RCMP headquarters in Ottawa and was responsible for gathering and disseminating intelligence information to the provincial securities commissions. However, SFIC has slowly devolved itself from this function over the years. SFIC currently does not have the resources or systems in place to gather, store and disseminate either tactical or strategic information. There is only one regular RCMP officer and one public servant currently attached to SFIC. The current function is limited to providing criminal record checks and foreign indices checks to the provincial securities commissions (Bishop, March 2, 1994).

SFIC no longer meets the criteria set out by Treasury Board in its original directive of May 4, 1967 and the Federal Government has recently ceased funding it altogether. However, the RCMP continues to provide the service on a strict "100% cost recovery" basis. The role of SFIC in securities fraud enforcement continues to be diluted to the extent that as of April 1, 1994 it no longer exists as a separate unit within the Economic Crime Directorate at RCMP headquarters in Ottawa.

7.6 Summary

There have been just over 100 RCMP Investigators attached to the Securities Fraud Squads since their inception 27 years ago. The unofficial and primary mandate of these squads that developed through the years is 'to investigate market manipulations of national and international scope'. In the early years the Squads were thought to be very effective in their deterrence of securities fraud in Canada's securities industry. The effectiveness of the squads deteriorated over the years for which it is believed there are a number of causes.

There were changes to the law that made it more difficult to secure wiretap authorizations. There were also trends in the overall justice system that saw an increase in both the cost and length of trials. This high cost, coupled with unfavourable case law that suggests Judges have become reluctant to convict securities fraud offenders, is inferred to have led to a serious lack of 'prosecutorial will' on the part of the provincial Attorney General departments.

RCMP securities fraud squad investigators are very adamant in their view of the internal human resource policy; the current policy makes it extremely difficult to maintain a staff of specialized securities fraud investigators. The investigators were generally unanimous in their declaration that RCMP staffing, training, transfer, and promotion policies act as direct impediments to the effectiveness of securities fraud enforcement. Most investigators also felt effectiveness was being severely hampered by the constant redeployment of investigators to other unrelated policing duties. Comments made by current investigators suggests that they are obviously very frustrated and suffering from a general lack of morale.

The RCMP Securities Fraud Information Centre (SFIC) no longer meets the criteria as set out in the original RCMP commitment. The current function is to conduct criminal records checks and foreign indices checks for the provincial securities commissions on a per-query fee basis.

In summary, the effectiveness of the overall RCMP Securities Fraud Enforcement effort has deteriorated to a point where serious consideration must be given to the value this effort is having on the Canadian securities industry.

8.0 OBSTACLES TO EFFECTIVE SECURITIES FRAUD ENFORCEMENT INTERNAL TO THE RCMP

Information obtained from the questionnaire responses and personal interviews was also used to help prepare the following summary of internal obstacles or problems hindering the RCMP securities fraud enforcement efforts. The documentation of these issues is not intended as direct criticism of RCMP policy, to do so would require a full analysis of all of the different police services provided by the RCMP. Alternatively, this summary is simply intended to provide a narrow list of impediments or obstacles to effective securities fraud enforcement in Canada.

There are a number of obstacles that are inherent of the structure of a public agency. There are also a number of constraints that stem from the RCMP human resources policy. The RCMP has traditionally utilized a very generalized policing strategy to police a very complex and specialized field. Firstly, they have staffed the positions with 'generalist' police officers and followed this up with little or no securities industry related training. Secondly, they maintained a transfer policy that was, and is, a direct impediment to effective securities fraud enforcement. Thirdly, the RCMP promotional policy that is designed to encourage the development of general managerial skills is in direct conflict with the development of securities fraud investigational expertise.

8.1 RCMP Organizational Structure

8.1.1 The RCMP as a Public Agency

The organizational structure of the RCMP, being that of a public agency has certain characteristics that act as impediments to effective securities fraud enforcement. The absence of competition is generally known to affect the dynamic efficiency of all public agencies (Weimer, p. 135). Competition forces private firms to produce output at minimum cost. Firms that do not use resources in the most efficient manner are eventually driven from the market by firms that do. Because public agencies do not face direct competition, they can survive even when they operate inefficiently. It is also the usual case that public agencies have a weaker incentive to innovate than private firms.

The securities fraud squads have little incentive to be efficient or to innovate. Some managers may seek the prestige and career advancement that might result from being perceived as innovators. Some may also seek cost-reducing innovations to try and maintain output levels - this is particularly relevant in today's climate of severe economic restraint. These incentives, however, do not compare to the private enterprise profit motive and the competitive threats to firm survival.

8.1.2 Job Security

There are general civil service rules and protections that apply to the RCMP and these also tend to hamper efficiency. The rules that make it difficult to fire investigators also make it difficult to weed out the incompetent and unproductive. A slow and bureaucratic staffing system also tends to reduce the ability of RCMP managers to implement new programs. For example, it commonly takes three months or longer to fill or re-staff investigator positions.

8.1.3 Fixed Pay Schedules

Another characteristic of public agencies is that of fixed pay schedules. These tend to under-reward the most productive and over-reward the least productive. As the former leave for higher-paying jobs in the private sector, the agency is left with a greater and greater proportion of the latter. This can become a serious problem, particularly in periods of severe economic depression. The RCMP has not been exempt from such pressures and has seen a significant number of specialized securities fraud investigators retire within the past few years.

This is in contrast to the original strategy as derived from the securities fraud enforcement feasibility study that called for a realistic salary scale to recruit and retain the qualified personnel. (See Appendix D).

8.1.4 RCMP Rank Structure

The RCMP employs a para-military rank structure as follows:

Commissioner
Deputy Commissioner
Assistant Commissioner
Chief Superintendent
Superintendent
Inspector
Staff Sergeant
Sergeant
Corporal
Constable

The current commercial crime market groups are limited to investigator positions classified as Staff Sergeant and lower.

Figure 8-1

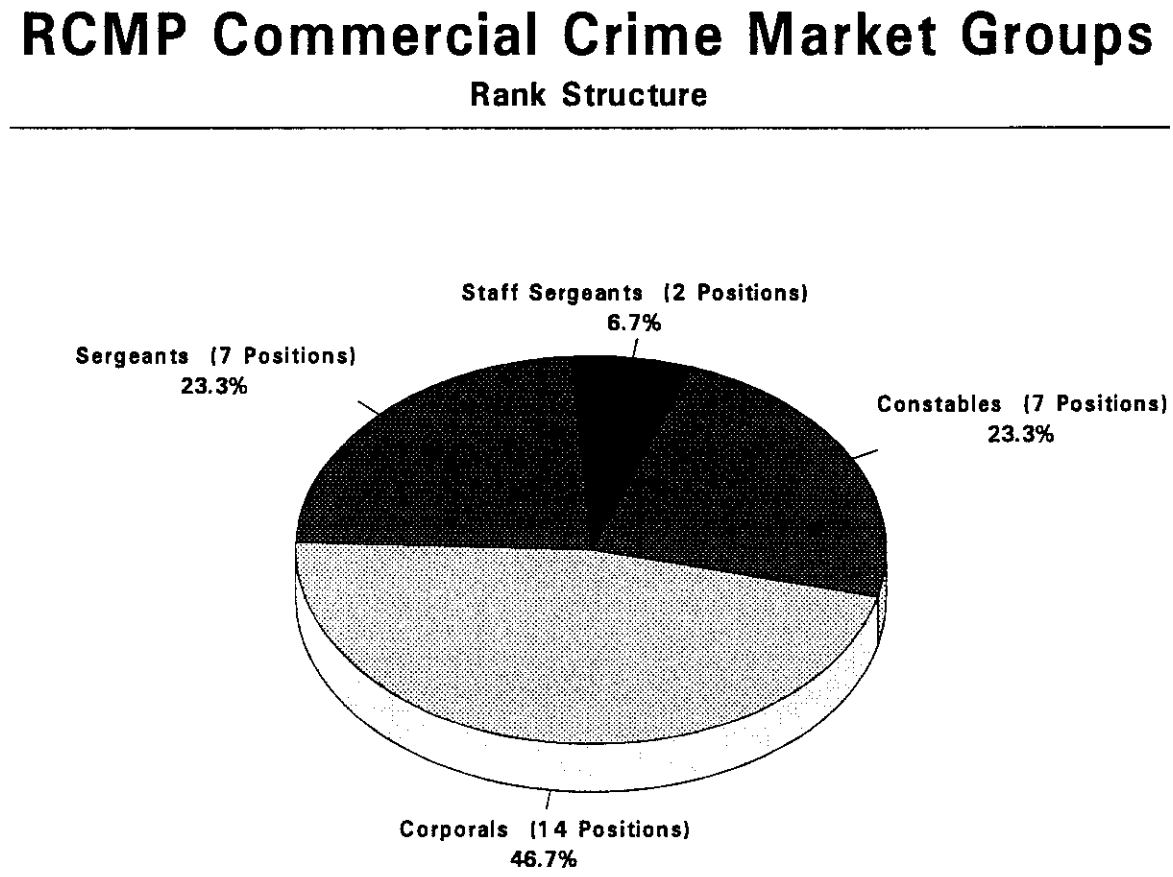


Figure 8-1 contains a pie chart reflecting the breakdown of the various positions. There are only two Staff Sergeant positions and as can be expected this places considerable strain on any promotional opportunities. The ramifications of insufficient promotions are discussed further in the review of the RCMP promotional policy.

8.1.5 Competition for Resources Between Police Services

There is also an obstacle stemming from securities fraud enforcement being just one of many different policing services provided within the RCMP organizational structure. There are essentially three different types of policing service for three different levels of government. It is these three types of policing that can be thought of as the company products which the RCMP markets to their customers. Firstly, there is a municipal policing service provided on a contract basis to municipalities. Secondly, there is a provincial policing service once again provided on a contract basis to various provinces. Thirdly, there is a federal policing service provided to the Federal Government. Securities fraud enforcement is considered a blended service in the sense that the benefit, and subsequently the cost, is shared between the Federal Government and the respective Provincial Governments. A majority portion is paid by the Federal Government. In periods of economic restraint this structure can lead to extensive competition for scant resources between the different types of police service. As noted in the preceding chapter, human resources allocated to securities fraud enforcement would sometimes end up being reallocated to other more pressing Federal and Provincial policing priorities.

RCMP policy and administration relating to the expenditure of financial resources in such areas as travel budgets, overtime, and support staff is generally standard across the various branches and departments. This can lead to competition for these resources particularly in times of severe economic restraint. For example, the policy relating to the payment of confidential sources providing information with respect to multi-million dollar securities frauds is basically the same as that for payments to persons providing information on break and enter offenses.

8.2 Securities Fraud Enforcement - Lack of a Mandate

In private firms, the mandate provides a focus or a vision towards which the company can establish strategic plans, set goals, and most importantly, measure the effectiveness of specific initiatives against these goals. Thus private firms with a clearly defined product are in a much better position to measure how efficiently output can be produced. In public agencies such as the RCMP, it can be very difficult to innovate or to maintain output levels in the face of economic restraint, if their services are not clearly defined. In the previous chapter it was pointed out that a common complaint of the securities fraud investigators was that they perceived a general lack of national focus or mandate for the securities fraud enforcement program. The desired outputs of the RCMP securities fraud enforcement program have never been clearly defined. From this stems a problem of the inability to measure the efficiency of enforcement strategies or initiatives.

8.3 RCMP Human Resources Policy

> ***No business could be run like the RCMP. Even when experience and talent come to the force, it seems as though the RCMP is bent on squelching or transferring it...***
> ***Doust says this plagues criminal investigations as well as prosecutions. It is something that also bothered George Wool and Rupert Bullock. It is something that should bother lawmakers.***
> (Francis, 'Contrepreneurs', p. 179).

8.3.1 RCMP Staffing Policy

The RCMP Securities Fraud Squads, or Market Groups, as they have now become known, are staffed through a decentralized or provincial selection process. In the historical review contained in the preceding chapters, it was noted that because of the sophisticated nature of this type of work, squads were to be staffed "in part by Law, Accounting and Commerce graduates" (Cooper, June 29, 1967, p. 2).

There is no current policy with respect to the specific staffing of securities fraud investigators, however, there is existing policy that pertains to overall commercial crime investigators. This includes the staffing of general fraud investigators in such areas as

bankruptcy, tax and counterfeit. The current policy for the staffing of 'commercial crime' corporal positions is contained in Table 8-1.

It will be demonstrated that the 'desirable qualifications' in candidates are infrequently met, and usually ignored, in favour of some general fraud investigative experience.

TABLE 8-1
'RCMP Commercial Crime Corporal'

Staffing Qualifications

Basic Requirements	
Education:	**Successful completion of courses from a recognized university /college in business administration/accounting/commerce/law/ computer science.**
Experience:	**Several years of operational policing experience.**
Desirable Qualifications	
Education:	**A degree from a recognized University in business administration/accounting/commerce/law/computer science.**
Experience:	**Several years of economic /commercial crime experience.**

Source: RCMP Career Management Manual
Appendix 5-8 Code 625 pp. 1-5.

The responses to the questionnaires contained substantial references to concern over the number of positions staffed with unqualified personnel. Investigators spoke of an increasing trend to transfer in police investigators from general uniform duty having little or no background in the securities industry. Some did not have any business background whatsoever.

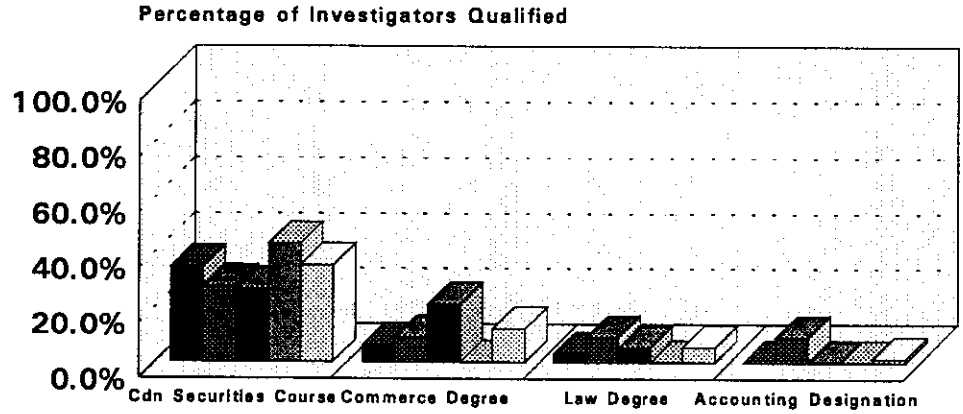
Figure 8-2 on the following page contains a graphical representation of the education level of the securities fraud investigators upon their entry into a given squad. The Canadian Securities Course was used as a measure of how many positions were staffed with investigators having some knowledge of the securities industry. This is not intended to suggest that an investigator completing the securities course should be considered 'specialists in securities fraud' as identified in the original feasibility study.

This qualification is used as a simple measure of investigators having some basic knowledge of the industry. The commerce, law, and accounting graduate categories reflect the other original feasibility study qualifications.

Figure 8-2

RCMP Securities Fraud Investigators

Education Level upon Entry



	Cdn Securities Course	Commerce Degree	Law Degree	Accounting Designation
Vancouver	34.3%	6.2%	3.1%	0.0%
Calgary	27.2%	9.1%	9.1%	9.1%
Toronto	26.3%	21.0%	5.3%	0.0%
Montreal	42.9%	0.0%	0.0%	0.0%
Average	35.0%	12.2%	5.4%	1.4%

Securities, Commerce, Law and Accounting Graduates

(Source: Survey Question 2)

Approximately 65% of all investigators do not have a basic knowledge of the securities industry upon their entry into a squad. It can also be seen that the commerce, law, and accounting graduates are a significant minority.

This stems from the generalist philosophy within the RCMP suggesting that all police investigators should be able to investigate any or all types of criminal code offenses. This philosophy dictates that boundaries be drawn with respect to the process of policing criminal offenses as opposed to the product. The product being in this

instance, a rather loosely defined federal/provincial securities fraud enforcement service.

This philosophy is not limited to the RCMP in that the attitude is believed to be a common handicap of effective white collar crime enforcement throughout the world. Consider the following comment of Dr. Barry Rider, President of the British Institute of Securities Laws:

> ***Unfortunately, few police officers have recognized the need for specialization. The myth, unfortunately perpetuated almost throughout the Commonwealth, that general police experience is to be preferred over the specialist, and that this will be recognized and extolled in promotion and career prospects, is one of the greatest handicaps to the creation and maintenance of effective and efficient anti-fraud policing. There are signs that this attitude is being increasingly questioned by governments and, as the need for specialization leads to the creation of specialized investigatory units outside the police, it is to be hoped the police will see their error.***
> (Rider, p. 12).

8.3.2 RCMP Training Policy

The RCMP has generally failed to acknowledge the specialized expertise required of securities fraud investigators. Therefore, it would follow that there be no recognized need for policy with respect to specialized training for securities fraud investigators. As previously noted the two week training course referred to in the original feasibility study was watered down to one half day of the overall RCMP commercial crime course. There was a recent national commercial crime course held in Vancouver from March 23 - 29, 1994. The instruction and discussion of Securities Fraud was limited to two hours. The Vancouver Commercial Crime Market Group has been making an effort in the past year to have the RCMP initiate a separate Securities Fraud Investigators Course. To this end, they hosted a preliminary two week in-house training course in May, 1993. Investigators from Provincial Securities Commissions, Stock Exchanges, and RCMP Securities Fraud Squads from across Canada attended. It is hoped that this effort will result in a formalized training course specifically designed for securities fraud investigators.

In some provinces there exists an informal policy that all members of the local securities fraud squad or market group will undertake to enrol themselves in the Canadian

Securities Course within one year of their entry into the group. However, as indicated above in the discussion of the organization structure, there exists no means of rewarding those who comply with this policy, or disciplining those who choose not to.

In spite of these motivational handicaps, there is indication that some securities fraud investigators have a tendency to pursue additional training in the securities field on their own professional initiative. In the past, there was an additional incentive that stemmed from an annual performance evaluation system that allotted higher performance points for courses taken. Successful completion of the Canadian Securities Course, for example, would earn an RCMP investigator an approximate .85% increase in his/her annual performance rating. Unfortunately, this has been eliminated with the introduction of a new promotional system in 1994. Consequently, the RCMP no longer offers any direct incentive that would encourage any police officer to seek additional training.

Figure 8-3

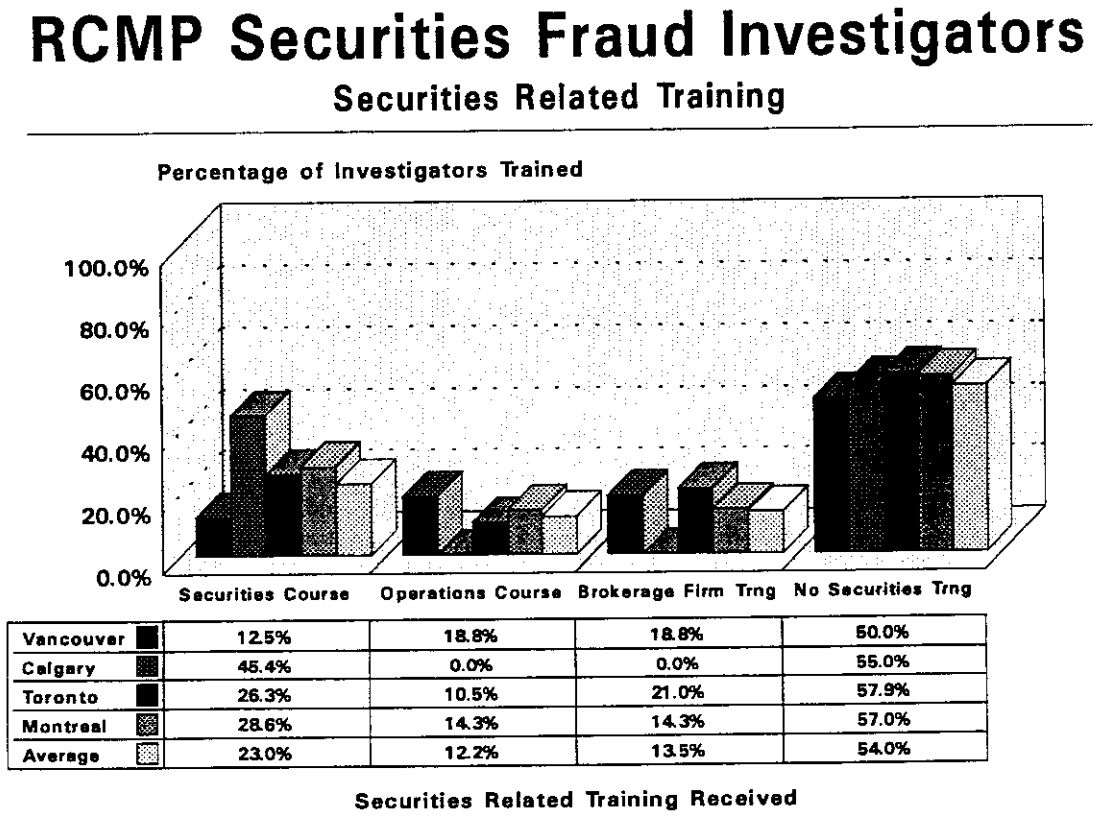


Figure 8-3 contains a graphical representation of the securities related training received or undertaken by RCMP securities fraud investigators. The securities and operations courses refer to correspondence courses offered by the Canadian Securities Institute. It is believed that the majority of this training would have occurred at the expense of the RCMP but on the investigator's own time. The brokerage firm training generally consisted of securities fraud investigators attending a brokerage firm for one week to learn the mechanics of equity trade transactions. It can be seen from figure 8-3 that an average of 50% of all RCMP securities fraud investigators did not receive any securities related training after their arrival into a market group.

8.3.3 RCMP Transfer Policy

RCMP investigators are subject to transfer anywhere in Canada according to the operational requirements of the Force. Consideration is balanced between the career development of the individual, and the operational needs of the RCMP. The average length of stay for those investigators that have left a securities fraud squad over the past 27 years is approximately 4.2 years. This information was sought in an effort to compare such to an similar estimate of how long it takes to become comfortable in undertaking a major market manipulation. The estimates from those investigators who had remained on a squad for five years or more were used to calculate an average 'comfort' time.[3] It is estimated that it takes an average of 2.2 years to become confident in handling a major market manipulation investigation. It should be noted that an additional 17% of the respondents felt that they did not have the opportunity to become comfortable before transferring out of their squad. The comfort statistic of 2.2 years does not reflect these persons. The next step was to estimate how long it takes to actually investigate a specific type of securities fraud.

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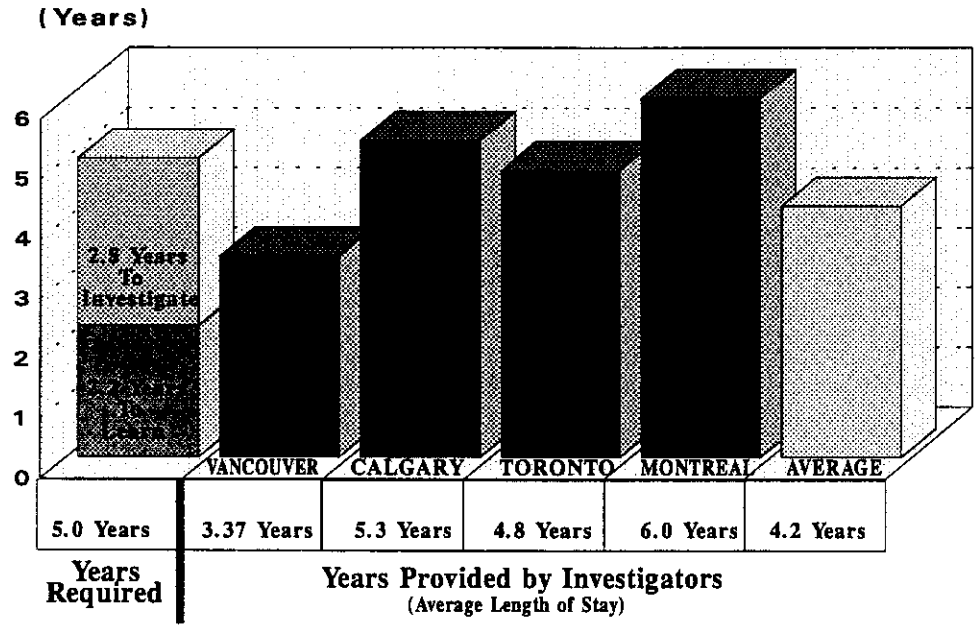
[3] This estimate changes to 1.7 years if the data from all respondents was used. However, this does not include those persons whom had transferred out before becoming comfortable with undertaking a major market manipulation investigation.

Figure 8-4

RCMP Securities Fraud Investigations

Length of Investigator Service

Years Required vs. Years Provided



(Source: Survey Questions 1,4 & 6)

Figure 8-4 contains a graphical summation of this data. It is estimated that it takes an average of 2.8 years to complete a market manipulation investigation. It was determined that it takes 2.2 years to get comfortable in handling such an investigation, and that it takes another 2.8 years to conduct the investigation, for a total process of 5 years. However, it was also demonstrated that, on average, RCMP investigators remain within a given squad for a period of 4.2 years. Therefore, it is argued that over the long run, the RCMP transfer policy is a direct impediment to market manipulation investigations. This is before any consideration is given to keeping investigators on for a longer period in order that they might undertake more than one major investigation or to train new members arriving into the squads.

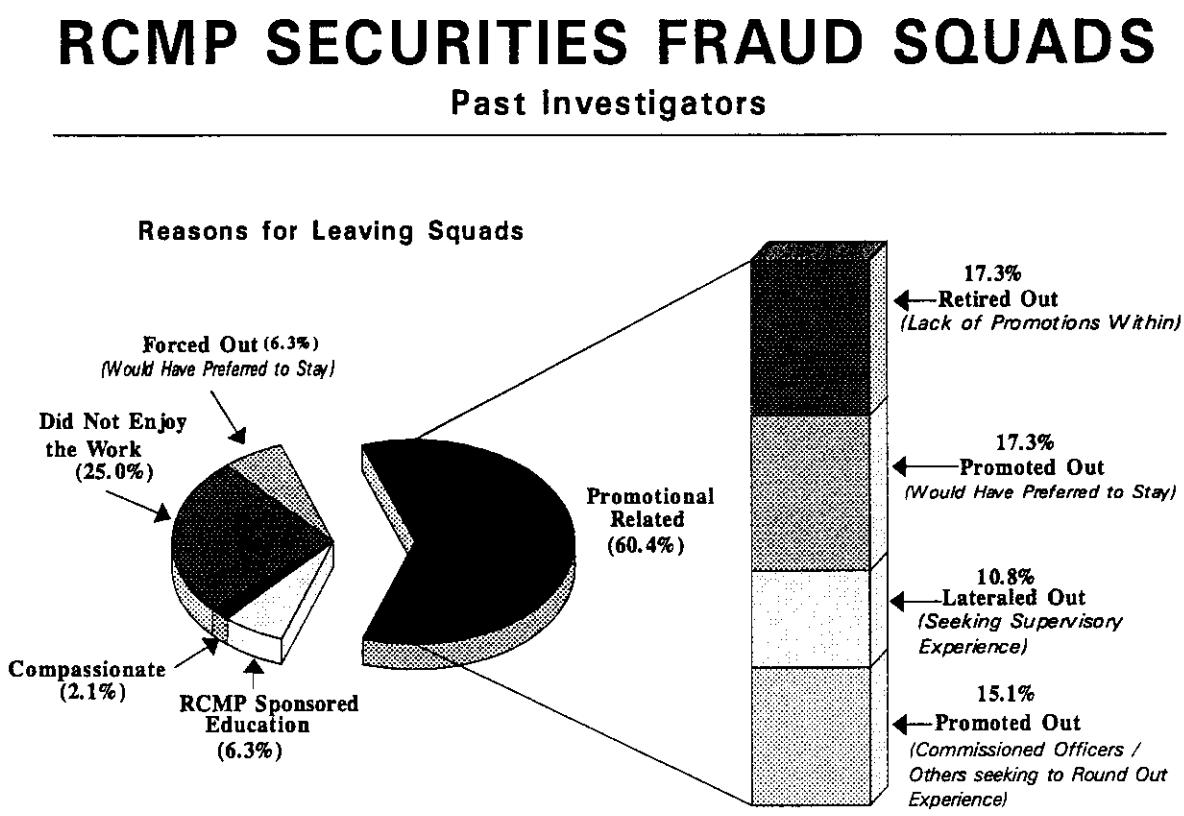
The current Market Group members were also asked to provide an estimate as to how long they expect to remain within the group. (See question 8 of the survey questionnaire in Appendix A.) Based on the information supplied, the existing securities fraud investigators believe that they will remain an average of a further 2.9 years. The statistics for each individual squad will not be provided in order to protect the confidentiality of the investigators. There are some squads with very few investigators and they do not wish their individual career plans to be made public.

8.3.4 RCMP Promotional Policy

The personal motivation of each investigator, or the lack of it, is a primary obstacle to securities fraud enforcement. It has been noted that motivation problems are common to all public agencies. However, because of the para-military type organization of the RCMP, promotions are considered by the majority of investigators to be the primary source of motivation. In 1994, the RCMP adopted a new promotion system based on examinations and interviews. Investigators are now promoted based on their estimated ability to manage a generalized squad of RCMP investigators. The emphasis is on 'generalized' as the process was designed for use by all RCMP members with no accommodation for specialization. In fact, the process is designed with a flavour for general detachment policing duties. For example, a uniformed patrol police officer from a small detachment in British Columbia goes through the exact same process as a securities fraud investigator in Toronto. The securities fraud investigator is examined on his/her estimated ability to manage general detachment personnel, but the detachment patrol officer is not examined on his/her ability to conduct securities fraud investigations. This policy leaves little or no incentive to become an expert securities fraud investigator and, in fact, such investigators now recognize that they are being penalized for doing so. Efforts put into becoming a specialized expert in securities fraud will undoubtedly result in a reduced opportunity to exercise ones detachment managerial skills. There is a strong and opposing incentive to become an effective general police manager. Hence, it is argued that the promotional process can no longer be thought of as a motivational instrument for securities fraud investigators.

Figure 8-5 contains a graphical representation of past RCMP securities fraud investigators.

Figure 8-5



Approximately 32% of the investigators were promoted out of the squads, i.e. received a promotion that consisted of a transfer to another function. Another 10.8% transferred out on a lateral basis at the same rank in an effort to become more promotable by seeking additional general supervisory experience. Another 17.3% of the investigators were forced to retire in their search for increased stature. In summary, approximately 60% of the investigators left the squads for promotion related reasons.

This issue has been frustrating investigators for some years now as indicated in the previous chapter. In fact, in 1988 the RCMP was openly criticized in the press for their human resources policy with respect to white collar crime investigations (Mathias, Philip, Mar 3, 1988 p. 24). Reference was made to an official within a provincial securities commission complaining that "It's been very difficult to get service from the RCMP lately because of their staffing policy". RCMP Commissioner Inkster was asked to respond to this criticism and he did so by referring to two difficulties in solving this problem.

- ***An officer's career comes first. If the officer applies for a promotion in another area we will not lock him into commercial crime.***

- ***An officer often cannot be promoted within commercial crime. In the RCMP, a rigid structure is enforced by Treasury Board, which controls the RCMP budget. Each job is assigned a rank and pay level. If no vacancies open at higher levels of commercial crime, an officer must move to advance his career. Inkster says there is nothing he can do to change the RCMP rank structure.***

(Mathias, March 3, 1988, p. 24).

8.4 Summary

There are a number of internal obstacles to effective securities fraud enforcement. Some of these obstacles stem from the structure of a public para-military organization. Others stem from internal human resources policy.

The RCMP has tried to police a very complex and specialized field with a very generalized policing strategy. Firstly, they have staffed the positions with 'generalist' police officers and followed this up with little or no securities industry related training. Secondly, they maintained a transfer policy that was, and is, a direct impediment to effective securities fraud enforcement. The average stay within a securities fraud squad is approximately 4.2 years, yet the investigators require a period of 5 years to effectively learn the job and complete one major investigation. Lastly, the RCMP promotional policy that is designed to encourage the development of general managerial skills is in direct conflict with the development of securities fraud investigational expertise.

9.0 CONCLUSIONS and RECOMMENDATIONS

9.1 Conclusions

9.1.1 Conclusions relating to the Securities Industry

A. The Canadian Securities Industry is going through a period of dramatic change brought about by the driving forces of deregulation and high tech globalization. An effective enforcement strategy will require ample investment in technology and investigations with increased international flexibility.

B. The Canadian Securities Industry is currently experiencing an economic boom in that Investment Dealers are earning record revenues and profits. Revenue grew by 61% and profits grew by 187% in 1993.

C. The Junior Markets within the Canadian Securities Industry have a reputation for being wrought with fraud and corruption. This problem has been identified as encompassing all of the VSE, the ASE and the Ontario Broker Dealers. The value of these markets is estimated at approximately $9.02 billion or 5% of the total equity value in the Canadian securities industry.

9.1.2 Conclusions Relating to the Suspected Offenders

A. The perpetrators of securities frauds are believed to be closely associated with the company although they are not likely to be in an official or regulated capacity. More often than not, the primary offender will be the company promoter, of which there are believed to be a small core of long term repeat offenders.

B. The provincial regulatory commissions and stock exchange investigative services sections are generally unaware of the true nature or extent of the perpetrators' relationship with the underlying public company.

C. The perpetrators of securities frauds orchestrate their schemes through the use of nominee trading accounts in a manner that requires the acquiescence of individual registered representatives.

D. The perpetrators of securities frauds who seek to engage in illegal or manipulative trading practises now commonly attempt to conceal their activities by conducting their trading through foreign firms.

9.1.3 Conclusions Relating to Provincial Regulation

A. The perpetrators of securities frauds are not being deterred from their criminal behaviour through the use of administrative penalties or prosecutions for regulatory violations. Serious securities fraud offenders prefer to remain anonymous and will go to great lengths to work outside of the regulatory structure. Persons willing to accept the risk of possible criminal prosecution are not seriously concerned with remaining lawfully within the industry.

B. The reliance on administrative penalties and provincial prosecution of regulatory infractions to deter market fraud has had the effect of allowing securities fraud perpetrators to successfully avoid being prosecuted for criminal behaviour.

9.1.4 Conclusions Relating to Self-Regulation Organizations

A. Strong and convincing disciplinary action against stock brokers found participating in securities frauds will have the effect of reducing such participation in the future. This is one viable method of preventing criminal securities fraud.

9.1.5 Conclusions Relating to RCMP Securities Fraud Squads

A. The RCMP maintains a staff of Commercial Crime investigators dedicated to securities fraud investigations with an approximate annual labour cost to the Federal Government of $1.6 million and to the Provincial Governments of $180 thousand.

B. The unofficial mandate of the existing Commercial Crime 'Market Groups' is to investigate stock market manipulations of national and international jurisdiction.

C. The RCMP securities fraud enforcement effort commenced in 1967. There has been a trend of substantially decreasing numbers of all of major investigations, wiretap operations, search warrants, court briefs, and criminal charges. The effectiveness of the overall RCMP Securities Fraud Enforcement effort has deteriorated to a point where serious consideration must be given to the value this effort is having on the Canadian Securities Industry.

D. The RCMP is attempting to police a very complex and specialized field with a generalized policing strategy. Current RCMP staffing policy does not include specific qualifications for securities fraud investigators. Approximately 65% of the RCMP members transferred onto a Securities Fraud Squad do not have a basic knowledge of the securities industry. Furthermore, the percentage of the RCMP members transferred onto a Securities Fraud Squad with university degrees in Commerce, Law or Accounting is a very small minority.

E. A national average of approximately 50% of the investigators ever attached to RCMP Securities Fraud Squads received securities related training. This training was limited to either the Canadian Securities Course or the Canadian Operations Course as sponsored by the Investment Dealers Association, or a short training program at an investment dealer firm.

F. The RCMP transfer policy is impeding the development of effective securities fraud enforcement. RCMP members have traditionally been transferred from the squads after a national average of 4.2 years. This is not of sufficient length; it is estimated that it takes a minimum of 5 years to become comfortable with investigating stock market frauds and to investigate one major incident.

G. The RCMP promotion policy that is designed to encourage the development of general policing managerial skills is in direct conflict with the development of effective securities fraud expertise. Approximately 60% of the investigators that have left the Securities Fraud Squads did so for promotion related reasons. Investigators are rewarded for their development of general policing managerial skills and not for their development of securities fraud expertise.

9.1.6 Conclusions Relating to Jurisdictional Issues

A. There is a jurisdictional problem in that provincial governments are fighting to retain jurisdiction over the securities markets while the stock exchanges are striving to extend their reach internationally. The securities fraud perpetrator is aware of economic and regulatory borders, and uses both to his/her advantage.

B. There is a jurisdictional problem with respect to the Federal Government paying the majority of the cost of RCMP securities fraud investigations and the Provincial Governments paying all of the cost of the securities fraud prosecutions. This has the potential for conflicting priorities between the two levels of government.

C. There is a jurisdictional problem with respect to Provinces being asked to pay the cost of prosecutions for which the majority of the offense has occurred in another province.

9.1.7 Conclusions Relating to Prosecutions

A. Provincial Attorney Generals Offices across the country have displayed a lack of 'prosecutorial will' with regard to securities fraud offenses. This is believed to be based on substantially lower probability of conviction and the significant cost of prosecution.

B. Judges appear to be reluctant to convict alleged perpetrators under sections 380(2) and 382 of the Criminal Code of Canada. Either the judges are of the belief that 'business crimes' have no venue in a criminal court room or they do not posses a sufficient understanding of the complex economic principles associated with securities frauds.

9.2 Recommendations External to the RCMP

The foundation for all of the following recommendations is based on the supposition that securities frauds will be recognized as criminal behaviour. It is suggested that criminal prosecution is the only viable option to effectively deter these fraudulent schemes. With a potential reward that can run into the hundreds of millions of dollars, perpetrators must be made to face the threat of seizure of their criminally generated profits and of being prosecuted and subsequently incarcerated; a threat that will require an aggressive enforcement strategy.

There is an obvious jurisdictional issue as to which level of government should be responsible for the criminal investigations and subsequent prosecutions. It is beyond the intended scope of this paper to make explicit recommendations with respect to government departmental responsibility. However, it is intended to suggest that there is a strong need for national enforcement. Criminal securities fraud investigations are generally international and are always national in scope.

There is a requirement for investigators to work closely with prosecuting attorneys, attorneys that are equally knowledgeable of the securities industry and specialize in these prosecutions. Therefore, the concept of a joint organization with federal prosecutors such as the Serious Fraud Office in the United Kingdom is particularly appealing.

It is recommended that the Federal Government Department of Finance, in conjunction with the Provinces, undertake a new review of securities fraud enforcement in Canada. It is time to review the original enforcement strategy resulting from the 1966 conference. It is suggested that in order to effectively deter the perpetrators of securities fraud, there must be a genuine risk of being discovered, prosecuted and incarcerated.

9.3 Recommendations Internal to the RCMP

The RCMP is currently the senior securities fraud investigative authority in Canada. It is suggested that the they might wish to undertake a complete review of this federal responsibility. Senior management should determine whether this responsibility fits within the overall future vision for the Force. Approximately $2 million is currently expended each year to provide a very nominal and ineffective level of service.
Should it be determined that the RCMP wishes to retain responsibility for securities fraud enforcement, it is further recommended that a significant restructuring would not only be prudent, but essential. The following recommendations are based on the assumption that they determine they wish to retain responsibility as the senior securities fraud investigative body in Canada. It is stressed that these recommendations are almost a duplicate of those contained in the original feasibility study of 1966.

9.3.1 It is recommended that the RCMP approach the Federal Government with a view to finance a complete restructuring of the existing Securities Fraud Squads

This restructuring would be aimed at creating a new team of highly qualified and effective securities fraud investigators. The following recommendations are estimated to represent a potential labour cost of approximately $1.5 million dollars. Over a period of several years the total labour cost of the squads would be expected to reach as high as $3.5 million. This cost would include 50 investigative and administrative personnel of a rank that will fluctuate, from that of Corporal to that of Staff Sergeant. These 50 investigators would represent an increase in number of 67% percent. The increase is not based on an analysis of caseloads or estimates of the amount of fraud, it is simply

intended to represent an increase in priority in attending to an area of national economic significance. It must be stressed that this financial burden should be kept in perspective, in that the new total cost would represent less than one half of one percent of the brokerage firms' 1993 net profits. Perhaps it is appropriate for the Federal Government to consider a market integrity protection tax.

The squads should be segregated from the general mainstream policing service and given increased autonomy over financial and human resources. This would remove 50 investigators from the general policing mainstream, and thereby reduce the number of police officers available for other short term policing priorities, such as the 1994 Commonwealth Games. Securities fraud is a very low-profile type of crime, in the sense that the benefits from increased enforcement are hard to measure and only in the long term can they be realized. Therefore, this type of enforcement will generally lose in an internal battle for increased priority, particularly in a climate of economic restraint. It cannot possibly compete with more pressing, short term policing priorities. The only solution is total segregation of financial resources. This segregation will help to ensure that required funds are available for required investments in technology and to maintain investigations with international flexibility. It will also ensure that the circumstances of the past 26 years are not repeated.

The squads should be staffed with experienced investigators who have a good knowledge of the securities industry, and a solid background in commerce. The investigators would also require additional specialized training. They should continue to be staffed from general uniformed police personnel, however a new rank structure and internal promotion system would entice a sufficient number of well qualified and aggressive investigators willing to give the effort the required long term commitment.

9.3.2 It is recommended that the RCMP Human Resources policy be modified to allow for a 10 year focus for Securities Fraud Squads

A focus of this length would dictate that the investigators make a career of securities fraud enforcement. It is suggested this is exactly how the RCMP should approach the human resources policy. The securities fraud investigative positions should be considered career positions as opposed to 'stepping stones' used to round out ones career.

The 10 year focus would permit an investigator to spend approximately 2 years in the learning mode, 6 additional years in which to conduct major investigations, followed by 2 years in which to teach new investigators arriving onto the squad. Investigators recruited onto the squad should be asked to commit themselves to a 10 year term. This would provide them the opportunity to establish a career within this specialized area.

9.3.3 It is recommended that the RCMP Securities Fraud Squads have the autonomy to maintain a flexible rank structure

The managers should all consist of commissioned officers but the investigative positions should range in rank from Corporal to Staff-Sergeant. The basic entry level would generally consist of the rank of Corporal and followed up with an appropriate promotion system. The basis for this is three-fold. Firstly, there would a substantial number of RCMP investigators who would be enticed by the high ranking investigative positions to apply to join the unit. Some of these would include those experienced investigators who were forced to leave the squads seeking promotion, while others would include inexperienced investigators, but who have the required job-skills. Secondly, other regulatory agencies have traditionally recognized the value of experienced RCMP Securities Fraud investigators and were able to offer higher salaries to entice them to retire from the Force. This loss would be decreased, and the RCMP could retain their experienced investigators. Thirdly, and most importantly, the managers of the squads would have the authority to promote investigators up to the rank of Staff-Sergeant based on their personal level of development and expertise. Investigators would be recognized

for their developed expertise, as opposed to their managerial ability. This would result in very professional and highly motivated investigators.

It is conceivable that implementation of this strategy would lead to the squads being made up of investigators all at the rank of Staff Sergeant within the next decade. This would result in an additional labour cost of approximately $300,000. However, it is suggested that this would also mean that the squads are effectively staffed with highly qualified and specialized securities fraud investigators.

Each squad should also be staffed with one civilian member who has a solid securities background. The civilian rank should be commensurate with that of at least the rank of Staff Sergeant. This will enhance the likelihood that each squad has a permanent source of securities industry expertise.

9.3.4 It is recommended that the RCMP staffing policy be modified to reflect explicit staffing qualifications for securities fraud investigators

There should be minimum qualifications established that would allow those RCMP investigators with specialized expertise an advantage in seeking entry onto a squad. Furthermore, investigators with university degrees in commerce, having an accounting designation, or having a securities background should be actively recruited into the squads. This will help to reduce the 2.2 year 'learning curve' existing in the current squads.

9.3.5 It is recommended that the RCMP adopt a specialized training program for securities fraud investigators

This training program could be orchestrated through the Canadian Police College and the cost shared with various provincial regulatory authorities. This will help to ensure that investigators are equipped with the tools necessary to undertake the task. A significant part of this training should be dedicated to introducing experienced investigators to in-house technology such as the RCMP SMART computer system.

9.4 Summary

It is recommended that both the Federal Government and the RCMP revisit the original 1966 strategy behind the RCMP involvement in securities fraud enforcement. The RCMP Securities Fraud Squads have become generally ineffective and the investigators are voicing their concern. There are a number of external problems that warrant consideration such as section 380(2) of the Criminal Code, the ongoing jurisdictional struggles between provincial and federal government departments, and with the huge trial costs associated with complex fraud prosecutions.

The RCMP also needs to confront some significant human resource related internal problems. These problems must be corrected should they wish to retain this federal responsibility. It is suggested that the squads need to be segregated from the general mainstream policing service and given increased autonomy over financial and human resources. They will then need to be effectively staffed with qualified investigators who are interested in making a career of securities fraud enforcement. It is realized that this strategy would be in direct opposition to the 'generalist' philosophy prevalent within the RCMP. However, it is hoped that senior management will see that a very specialized field cannot be effectively policed with a very generalized policing strategy; a serious issue now being addressed internationally by other police entities. The job requires attention, and the current strategy is not working. Failure to act will see the creation of specialized investigatory units within other governmental departments outside of the RCMP.

APPENDIX A

1

Royal Canadian Mounted Police
Commercial Crime Section
"Market Group" Investigator Survey

Please answer all of the following questions. If you can not recall specific numbers and dates please give your best estimate.

Name: _____ **Rank:** _____

Current Posting: _____

Telephone: _____

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1. What was your length of Stay in a C.C.S. Market Group?
   Start Date:_____ **End Date:**_____
   Start Rank:_____ **End Rank:**_____
   Physical Location:_____

2. The original Treasury Board initiative called for filling the investigator positions with policemen having legal and/or accounting backgrounds. For this reason, I am interested in your education level at the time you were transferred into a market group. (Check as many items as applicable.)

   High School: ____
   Cdn Securities Course: ____
   Cdn Operations Course: ____
   < 1 yr. College (Business): ____
   College Diploma (Business): ____
   < 1 yr. University (Commerce): ____
   1 - 2 yrs. University (Commerce): ____
   2 - 3 yrs. University (Commerce): ____
   University Degree (Commerce): ____
   University Degree (Other): ____
   University Degree (MBA): ____
   University Degree (Law): ____
   Accounting Designation: ____
   Other (please specify): _____

3. Did you receive, or are you currently receiving, training in any of the following areas while working within a market group?
(Check as many as applicable.)

Cdn Securities Course: ____
Cdn Operations Course: ____
< 1 yr. College (Business): ____
College Diploma (Business): ____
< 1 yr. University (Commerce): ____
1 - 2 yrs. University (Commerce): ____
2 - 3 yrs. University (Commerce): ____
University Degree (Commerce): ____
University Degree (Other): ____
University Degree(MBA): ____
University Degree(Law): ____
Accounting Designation: ____
Brokerage Firm Training: ____
Other (please specify): ____
No Training: ____

4. I would like your impression as to how long it takes to become an effective and knowledgable market investigator. i.e. How long before you were able to comfortably accept primary responsibility for a major market manipulation investigation?

I am currently a market investigator but do not feel able to comfortably accept responsibility for a major market manipulation investigation..... ____

I became comfortable after ..... ____**yrs** ____**mths**

Did not have an opportunity Before transferred out..... ____

5. I would like to estimate the number of major securities fraud investigations the RCMP has undertaken since 1966. Please use the table on the following page to describe those major investigations for which you had primary responsibility. I realize that those members who have been out of the section will have difficulty recalling the specifics of their cases, but please give this your best effort.

Most major files have more than one offense involved and, therefore, I ask that you follow the example and segregate each type of offence within each investigational file. The file exemplified below reflects that the offenses of market manipulation, fraud, and theft were all investigated. Search warrants were executed, and a court brief was submitted recommending charges of market manipulation and fraud. A charge of market manipulation was sworn.

Description of Offense												
		Type of Offense						Further Action Taken				
			Fraud									
			against	Theft		Securities						
		Market	Public	from	Secret	Act	Other	Wire	Search	Court	Charges	
File		Manipulation	Company	Treasury	Commissions	Offense	CC	Tap	Warrant	Brief	Laid	
1	a	X							X	X	X	
	b		X						X	X		
	c			X								

6. Please provide your best estimate of the average number of person years required to investigate each of the following types of offenses:

Market Manipulation: ____
Fraud against Public co: ____
Theft from Treasury: ____
Secret Commissions: ____
Securities Act Offence: ____

7. Did any of your charges result in a conviction?
Yes _____ **No** _____

If you answered yes, please complete the following to the best of your memory:

	Name of Case	Year
Market Manipulation:	_____	____
Fraud against Public co:	_____	____
Theft from Treasury:	_____	____
Secret Commissions:	_____	____
Securities Act Offence:	_____	____
Other Criminal Offence:	_____	____

8. Are you currently working within a 'market group'? If so, please indicate your best estimate as to how much longer you expect to remain.

Have left the group.... ____
Expect to leave in
0 years..... ____
1 years..... ____
2 years..... ____
3 years..... ____
4 years..... ____
5 years..... ____
> 5 years..... ____

9. Are you currently working within a 'market group'? If not, please indicate your reason for leaving:

n/a - am currently in a market group: ____
Have left because of:
Lateral transfer (my choice): ____
Lateral transfer (Force initiated): ____
Promotion: ____
Retirement: ____
Other: _____

10. Were you promoted out of the group? If so, would you have preferred to remain within the group had you been given the opportunity to do so? (e.g. been promoted, but remain within the group.)

n/a: ____ **am working within a market group**
Yes: ____
No: ____
Comment:_____
_____
_____
(You may wish to comment on what would have encouraged you to remain in the group.)

11. What do you feel was the mandate of RCMP market groups during your stay?

_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____

12. What do you feel the current mandate of the RCMP market groups should be?

_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____
_____

13. Please provide any comments on your view of the effectiveness of the R.C.MP. commercial crime 'Market Groups' in Canada.

I authorize Cpl. SLITER to quote from my notation in question #13 of this survey and attach the display of my name and RCMP rank.

Signed:_____ Date:_____

I hereby give authorization to Cpl. John SLITER to use the information contained in this survey on a collective and summarized basis only with the exception of question #13 as noted above.

Signed:_____ Date:_____

B.0 APPENDIX B

Profit oriented organizations are mindful to remain aware of both external and internal environmental factors that might affect their business. In the competitive economic climate of today it is simply a matter of survival.

Unfortunately, while many government institutions have knowledge of the external environment and the internal conditions in which they operate, they often are not able, or not willing, to commit resources to gather data that will substantiate this implicit knowledge. This lack of management information collection is particularly evident during a period of severe economic restraint such as that currently facing RCMP management. This makes effective policy analysis difficult as there is no immediate source of environmental information.

In order to achieve an effective policy analysis, this kind of information was needed to answer a few basic questions. Information such as whether the securities fraud investigators have access to the basic tools to effectively fight securities crime - tools such as formal education and specialized training. Information such as how the investigators feel with regard to the overall effectiveness of their securities fraud enforcement efforts.

B.1 Personal Questionnaire

One relatively simple method of obtaining environmental information is to solicit feedback through the use of surveys or questionnaires. Such a questionnaire was prepared for mailing to all current and past RCMP securities fraud investigators.(See appendix 'A'). Unfortunately, there is no RCMP record of the names of past securities fraud investigators. It was therefore necessary to rely on the memories of some of the senior investigators for these names, particularly those of whom had retired from the RCMP. However, it is believed that through this networking process, most, if not all, of the RCMP members that were ever attached to a securities fraud investigative unit have been surveyed. These questionnaires were mailed out to one hundred and twenty persons. Follow-up telephone calls were used to encourage respondents. Table B-1 provides a breakdown of the responses.

TABLE B-1

Survey Response Rate

Current Investigators:	Survey Sent	Response Received	Response Rate
Montreal	3	3	100%
Toronto	8	7	88%
Winnipeg	2	2	100%
Calgary	6	6	100%
Edmonton	1	0	0%
Vancouver	8	7	88%
Total.....	**28**	**25**	**89%**
Past Investigators:			
Montreal	10	4	40%
Toronto	22	13	59%
Winnipeg	0	0	--
Calgary	10	5	50%
Edmonton	8	3	38%
Vancouver	32	24	75%
Total.....	**82**	**49**	**60%**
Total Surveyed	**110**	**74**	**67%**

Ten questionnaires were returned with the respondent indicating that they had been incorrectly identified, as they had never been attached to one of the securities fraud squads. It is believed that upwards of 95% of all securities fraud investigators were successfully solicited for their opinion.

Generally, the response rate was considered quite good. By the cutoff tabulation date a response had been received from approximately 89% of the current investigators and 60% of the past investigators surveyed.

In summary, it is believed that the information obtained from this questionnaire contains the general views and opinions of approximately 65% of the investigators ever attached to a RCMP securities fraud squad. It is therefore considered a reliable reflection of the general opinions and views of RCMP securities fraud squad investigators.

The results have been summarized and incorporated into the analysis, and in particular, into the review of the performance of the squads in chapter seven and in the subsequent discussion of the obstacles in chapter eight.

B.2 Personal Interviews

The personal questionnaires were also used to identify senior investigators suitable for personal interviews. Interviews were sought with particular investigators who had been attached to a securities fraud squad for an extended period and were known to have developed a strong understanding of the securities industry. In particular, Mr. Rupert Bullock, Mr. George Wool and S/Sgt. Monty Peters are three such sources. These interviews were particularly useful in obtaining information on the performance of the squads during the early periods.

C.0 APPENDIX C

C.1 Securities Fraud Squad Group Information

Subjective statistical estimates were sought from each of the group leaders in charge of each existing Securities Fraud Group. These managers or 'group leaders' were asked to canvass their respective group and provide a collective opinion as to the groups' estimate of specific proportions of crime statistics. Firstly, an estimate was sought with respect to the proportion of offenses that relate to securities trading on each respective stock exchange. Secondly, an estimate was also sought with respect to the proportion of offenses of which certain professions were involved.

The estimates were then weighted according to the number of investigators in each group. The rationale for this is based on the determination that the estimates had been based on a review of investigative files. Therefore, it was felt that the best comparative ratio that could be used to estimate the proportion of investigative files was the number of investigators. i.e. It was assumed that each investigator investigates a similar number of files on a per-capita basis.

The weightings and the respective estimates are contained in table C-1.

TABLE C-1

Estimated Proportion of Investigations By Market

	Vancouver Squad	Calgary Squad	Toronto Squad	Montreal Squad	Weighted Average
Weights	.357	.179	.321	.143	
VSE	80%	10%	25%	50%	45.5%
ASE	20%	90%	00%	00%	23.2%
TSE	00%	00%	15%	00%	4.8%
MSE	00%	00%	00%	33%	4.7%
Broker Dealers	00%	00%	50%	00%	16.1%
NASDAQ	00%	00%	00%	17%	2.4%
Other	00%	00%	10%	00%	3.2%
Total	100%	100%	100%	100%	100%

Estimated Proportion of Investigations Involving Professions

Promoters	100%	50%	70%	40%	72.9%
Directors	30%	40%	10%	20%	23.9%
Lawyers	05%	00%	00%	00%	1.8%
Accountant	10%	00%	00%	20%	6.4%
Auditor	05%	00%	00%	00%	1.8%
Exec. Off	50%	40%	20%	00%	31.4%

D.0 **APPENDIX D**

FEASIBILITY REPORT ON THE PARTICIPATION OF THE ROYAL CANADIAN MOUNTED POLICE IN SECURITIES FRAUD INVESTIGATIONS.[1]

The Commissioner of the Royal Canadian Mounted Police is prepared to recommend to the Solicitor General that the Royal Canadian Mounted Police establish a national repository and form a specially trained investigative branch in the securities field.

(1) National Repository of Intelligence Information.

The Royal Canadian Mounted Police is prepared to establish and maintain a national repository of criminal intelligence information on fraudulent and illegal activities in the securities field. This repository would be part of the existing National Crime Intelligence Unit (N.C.I.U.) Central Repository in Ottawa. The function of this unit would be to gather, correlate, record and disseminate this information in co-operation with provincial securities commissions and investigators. Such a function would be an extension of the present responsibilities and duties of N.C.I.U in combating organized crime. The Royal Canadian Mounted Police will not assume responsibility for the establishment of a central registry concerned with registering legitimate salesmen and collecting information on companies.

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1 Reprinted from copy provided by Sgt. Bud Bishop as located in the files of RCMP Economic Crime Directorate -Securities Fraud Information Centre. (S.F.I.C.)

If the R.C.M.Police is asked to establish a national repository, information on fraudulent and illegal activities would be gathered and correlated on a national scale through the co-operation of the National Crime Intelligence Units, provincial securities commissions, stock exchanges and other industry sources, supplemented where applicable by other intelligence gathered by the National Crime Intelligence Units, from other field of crime. Liaison and exchange of this information between N.C.I.U field investigators and the provincial securities commissions would be a function of the field units of N.C.I.U. Such units now exist in most provinces in Canada. The national repository would also be responsible for directing enquiries and exchanging information of a criminal intelligence nature with foreign law enforcement agencies, both through the existing channels communication with Interpol and through liaison with other foreign agencies. This would not interfere with established channels of communication which now exist between provincial securities commissions within Canada, or between provincial securities commissions and foreign securities commissions.

The existing communication network of the R.C.M.Police, including telex and wire photo facilities, and possibly computer data processing, would be available for quick and efficient communication of such information to and from the national repository through the medium of the regional National Crime Intelligence Units.

(2) <u>Investigation of Fraud in the Securities Field and Other Related Offenses.</u>

The Royal Canadian Mounted Police is prepared to train and maintain a staff of specialized investigators which could be available

to conduct investigations under provincial Securities Acts, relevant sections of the Criminal Code, or any federal securities legislation if enacted. The Force is aware of the fact that such investigations can be a highly sophisticated and complex nature. For this reason the Force is prepared to train and maintain a staff of specialized investigators who have undergone extensive training in the securities and financial fields. While there are at present members of the Force who have university degrees in Commerce and Business Administration and who could become specialists in such an investigative body, there may not be a sufficient number of these members available, and the Force is prepared to recruit additional specialists from outside.

In addition to these specialists, trained investigators will also be required and will have to be oriented in this field. To enable these investigators to function efficiently, it will be necessary that they receive training within the Force, based on a syllabus of training geared to this type of offence. This aspect of their training could eventually become part of the planned Canadian Police College. Further training will also be required outside the Force and can possibly be obtained in conjunction with stock exchanges, brokers, investment dealers, etc.

It is intended that this investigative branch will include specialists in securities fraud, persons with accounting knowledge and legal experience, and investigators, all working in close co-operation. The function of those members of the branch possessing accounting knowledge would be to analyze and interpret financial records as an assistance to the field investigators. The legal advisers would be kept informed at all stages of the investigations of the evidence available

and any legal problems that might arise.

For efficient and effective enforcement, this branch must be highly mobile and will be posted in a central metropolitan locale to be available on short notice to travel to any part of Canada to undertake these investigations.

In the initial stages we estimate that 35 to 40 persons would be required to staff the investigative branch and the national repository. We must emphasise that our estimate is based on a preliminary survey which was not detailed and, therefore, inconclusive and subject to change.

In order to recruit and retain the qualified personnel which we feel are essential to our participation in these types of investigations, we intend to adopt a realistic salary scale to fulfil this dual purpose.

E.0 **APPENDIX E**

Views of Securities Fraud Investigators on the Effectiveness of RCMP Market Groups

The following represent the answers to question 13 of the survey questionnaire. The majority of the respondents authorized the quotation of their personal views and these are contained herein, sorted according to the date they entered into a Securities Fraud Squad.

McILVENNA, J. Supt. was a Corporal upon entering Toronto CCS Market Group for approximately 7 years from Sept. 1969 to Mar. 1976 and left a S/Sgt.

"Not very effective. Vancouver, specifically. David Baines, Vancouver Sun column says it all. Vancouver is the Las Vegas of the North and criminal acts are likely to be committed daily. But to be fair, some good files are being done considering the problems encountered. Because the market place survives on semantics and hyperbole, only a Part VI will actually lead to the proof of the Conspiracy and the act as therein."

DOUCETTE, N.A. A/Comm. was a Corporal upon entering Montreal CCS for 5 years commencing 1969 to 1974. He left as a Sergeant. A/Comm. Doucette is now the Director of Economic Crime in Ottawa.

"Our SMART program demonstrates the leadership the RCMP has taken to assist the industry in regulating their stock market activity. In the years to come we will strive to mould our partnership in joint training, developing crime prevention initiatives and concentrate on high profile cases."

JAY, C.B. Supt. was a member of the Toronto CCS Market Group for 3 years commencing 1970 to 1973. Supt. Jay is now the Officer in charge of 'O' Division Commercial Crime Branch in London, Ontario.

"During a recent discussion with a governmental official, I was informed that a study disclosed that less than 20% of investors were non-institutional. In other words, 80% of investors "playing the market" are institutional. If that is so, we should be reconsidering our original mandate which appeared to focus upon protecting the individual investor and preserving this very vital aspect of our economic system ie: the ability of the individual investor to purchase shares in large corporations. I stress that the conversation was somewhat casual. Nevertheless, there is no question about the facts and we are currently using that,

and related data, to serve as a basis for review of our complete program in "O" division."

LEWIS, Eugene S/Sgt. (Retired) was a Sergeant upon entering Toronto CCS Market Group for approximately 9 years from 1973 to 1982 and left a S/Sgt.

"Seems to be minimal effectiveness at the present time. Until government and management are wholly behind and seriously interested in fraud investigations (like in the early/mid 70's), then a lot of good men are left without motivation. Education is not a replacement for life experiences. With present day charter rights and disclosure requirements in the system, I submit that, even more than ever, experience is important. On-the-job training plus international meetings with contacts are necessary. We are at a time when more resources are required. More effort is needed in exchanging intelligence, experience and ideas, etc. etc."

PROSS, Nick Cpl. (Retired), was a Constable upon entering Montreal CCS Market Group for approximately 7 years commencing Apr. 1973 to Jan. 1980 and left a Corporal.

"The effectiveness is questionable due to poorly drafted laws to control stock manipulation. The type of crime involved is difficult to investigate. The U.S. is much more aggressive ie. case of Michael Milken, Junk Bond King. Insider trading, in my opinion, is still very prevalent in Canada. Very little enforcement. Brokers and investment dealers fall under provincial jurisdiction."

GARAND, G.R. S/Sgt., was a Corporal upon entering Montreal CCS Market Group for 8 1/2 years from Sept. 1974 to Feb. 1983 and left a S/Sgt.

"In may days in the group it was very effective. However, as those years went on our effectiveness was reduced because our mandate was redefined or clarified. Also, these investigations are very expensive and time consuming. They require travel and experienced investigators. These investigations do not require all kinds of university degrees but a good grasp of the required elements to prove a fraud case. I found in my last years in the force a very low priority was given to the selection of the personnel in the Commercial Crime Unit and particularly, the Market Investigation group. If they are to improve both the productivity and quality of investigations a priority must be given to the type of personnel you have in your group. No brain with a multitude of university degrees, but good seasoned investigators."

BULLOCK, Rupert L., was a Constable upon entering Vancouver CCS Market Group for 10 years from 1970 to 1980 and left a S/Sgt.

"I feel their effectiveness has been reduced by too many transfers in and our of the section and inadequate training. It probably needs more advanced facilities (corporate), etc. Too much emphasis is placed on large cases that are too time consuming. Look for simpler solutions, otherwise too much rests on a decision to prosecute or the obtaining of conviction. Costs are too great to rely on large investigations. This results in less effectiveness."

PARK, L.F. S/Sgt., was a Constable in Toronto CCS Market Group for 3 years from 1975 to 1978.

"During my time the Market Groups were very effective. I assisted George Wool on about 4 cases and they were well noted in the press and within the Ontario securities industry. I have not reported the statistics on these cases as they were primarily George's responsibilities. I believe convictions were obtained on all 4 cases. I also believe the practice of stock manipulations, was trading, etc., were curtailed as a result of these investigations."

MILLER, S.R. S/Sgt. was a Constable upon entering Vancouver CCS Market Group for 1 year in 1976, and then returned for 4 years from 1981 to 1985. He left as a Sergeant.

"Vancouver CCS Market Group has had limited success. Investigations are lengthy. With limited manpower, the number of people charged is very small compared to the number of offenses being committed. By their nature, these files are lengthy due to the paper trail. It takes a new member a good year to become comfortable with the paper flow of the industry and the banks and how to go about obtaining the relevant documentation. Training time in a brokerage house is invaluable. Also invaluable, although controversial, is trading in securities yourself to develop a full understanding of the average investor."

McCONNELL, Darryl Sgt. (Retired), was a Corporal upon entering Vancouver CCS Market Group for 5 years commencing July 1975 to Sept. 1980.

"It's had its highs and lows. It is very expensive to pursue and requires a heavy commitment of resources with a low probability of conviction. It requires a high degree of commitment from investigators and without a high interest and long term commitment, has not prospects of success. It may reflect my particular bias but in may opinion, human resources are really the only resources of value that the

Force possesses. The record of the Force in best utilizing those resources is atrocious. In my experience, the CCS groups were most effective during the 1970's when the members were essentially hand picked, identified by "moccasin telegraph" and staffing functions, including promotions, controlled by centralized staffing. It is a specialized field requiring education, investigative ability, particularly adaptability and deductive reasoning, and the commitment to go the extra mile to get the job done. A command structure that is detachment oriented tends to view an experienced CCS investigator as a man with two heads, neither of which can be comprehended. A staffing policy and structure which requires mobility and transfer to detachment locations to facilitate promotion is supremely counter productive to the specialized career path required to effectively pursue this area of law enforcement."

BLAKEY, H.C. Mr., was a Constable upon entering Calgary CCS Market Group for 2 years from 1977 to 1979 and left a Corporal. He is now the Director of Market Standards with the Alberta Securities Commission.

"To date, the results have been disappointing. Perhaps a focus on lesser charges will have a bigger impact than the "big trial case". As a current regulator, any conviction generated by a police agency makes it easier to screen out the undesirables."

HANBURY, Reg S/Sgt., was a Corporal in Vancouver CCS Market Group for approximately 4 years commencing Sept. 1977 to 1981.

"They provide a pleasant, convivial atmosphere for their staff. Apart from that I do not believe that in any way they justify the expense of their existence. The number of successful prosecutions is minuscule. Even those are in respect to offenses of relatively minor nature. It is like shooting ducks with a bb gun.
I am also of the opinion that the "Stockholm" syndrome has had its effect in that most of our charges are actually in defence of the Brokerage Industry. To that extent the programme has been co-opted to serve the very individuals who benefit most from manipulative activities."

FOTHERINGHAM, J.G. Insp., was a Corporal in Calgary CCS Market Group for 4 years from 1979 to 1983.

"The market groups could be more effective by concentrating on reducing the length of time required for these investigations. The SMART program is a good start. Changes in the law are required to facilitate the introduction of computerized evidence. Other investigational techniques need to be employed

more aggressively, such as: undercover operations, PT VI authorizations, and use of informants. Members with an interest and a proven ability in market investigations need to be retained in this area and transferred to different divisions to share expertise."

RETEFF, Brian M. Insp. was a Constable upon entering Toronto CCS Market Group for approximately 13 years commencing July, 1979 to May, 1992. He left as an Inspector.

"The question of maintaining a successful "Market Enforcement Effort" in Canada, in my opinion, can only be handled in one of two ways. The first option is for Canada to have a National Securities Commission which would have total enforcement responsibilities, including criminal aspects. In this case, the RCMP would cease its "Market Program". The second option, and the one I support, again would include the formation of a National Securities Commission, however, the RCMP would be the criminal investigative arm of this Government Agency. Similar to the working relationship between the RCMP and the Supt. of Bankruptcy. I believe the second option is a very workable system because the RCMP is the only criminal investigative agency in Canada that can handle the task. Our national infrastructure and our international relationships clearly provide the RCMP with advantages and some of the tools required to conduct such investigations. I further believe that the various Provincial Crown Law Offices should examine the possibility of sharing the costs of such prosecutions. For example, the Carter/Ward prosecution which was funded entirely by the Province of Ontario should have been undertaken on a cost sharing basis with the Province of British Columbia. In the simplest of terms, it was not fair that the taxpayers in Ontario paid to clean up the backyard of B.C.'s public market. Although this is only one case, there are many "Market" cases which are spread through more than one Canadian jurisdiction. If such an arrangement is not possible, then perhaps these cases could be prosecuted by the DOJ by way of an MOU between the Federal and Provincial Governments. The damage or fall out done to our financial markets and Canada's international image must be considered when discussing the funding for Market Enforcement.

Recent court decisions have not been favourable in relation to our Market Investigations. For the RCMP to abandon Market Enforcement and leave the spoils to provincial securities commissions or municipal law enforcement is clearly not the answer. Both the domestic and international investor must be assured that Canada is a safe place to invest and that abuse of our Public Markets will not be tolerated. The fact that our Market Units have been bringing cases to the Crown Law Offices and the courts demonstrates that there is abuse. Having said this, our emphasis should be on the long term management of our market positions and their training.

MONTAGUE, Peter, Sgt., was a Corporal in Vancouver CCS Market Group for 1 year commencing Jan. 1979 to Jan. 1980.

"Members of "market section" should have the formal education and experience. With these attributes, plus tenure on the job, the RCMP will be more effective in combating market fraud. Continuous courses and good communication with the industry are real necessities."

BRAUN, Gerry Insp., was a Constable upon entering Calgary CCS Market Group for 6 years from 1979 to 1985 and left a Corporal.

"I suspect that this function would be better served by non-police personnel. So long as the RCMP approach of transfers or rotation is used, little will be accomplished. The job should be done by full-time staff with specialized skills including law, accounting, EDP, and, most important, a market background. There is no question that a national body responsible for investigations is required but the present RCMP organization cannot perform the duties adequately. The USA model is preferable."

FISHER, Ross S/Sgt., was a Constable upon entering Vancouver CCS Market Group for approximately 5 years commencing May 1980 to October 1985 and left a Corporal.

"Unless we become pro active we only clean the barn after the cows have been stolen. Then, the money from the sale of the cows pays for the bad guys' lawyers and life styles."

SMILGIS, Harry S/Sgt.(Retired), was a S/Sgt. in Calgary CCS Market Group for 8 years from 1980 to 1988.

"My observation during tenure was that the requisite "intent" could only be proven if an informant who was willing to be a witness came forward, or was otherwise convinced to give evidence, or wire tap evidence was available. Both these events were rare, therefore, effectiveness of CCS Market Groups was not impressive, especially where multiple jurisdictions were a factor."

RICHTER, Frank A. C/Supt., was a S/Sgt. upon entering Vancouver CCS Market Group for 16 months commencing May 1980 to Sept. 1981. He left as an Inspector.

"I think that the RCMP must maintain a level of expertise to deal with market investigations. Effectiveness would probably depend on the desired result. While the investigations are sometimes long, complex and difficult to prove, you have to think that our presence offers a big deterrent to many people who may be afraid of going to jail. I don't think the numbers of major cases or prosecutions should be the measure of effectiveness, but that there are prosecutions and convictions in order to provide a measure of integrity into the public trading arena."

MALONE, Ernie Sgt. was a Corporal in Vancouver CCS Market Group for 2 years commencing Aug., 1981 to Aug., 1983. He was promoted back into the section as a Sergeant in Sept., 1990.

"The Market program is largely ineffective. There is no mission statement for market enforcement, nor is there any discernable direction from HQ Ottawa. Long range planning in respect to developing expertise (other than computer crime knowledge), encouraging specialization or creating career paths is non-existent in ECD. Market Groups are reactive not proactive. There is no central voice to speak for the program and we do not adhere to the 1966 agreement. There exists a crisis situation in that the level of investigative expertise in the market area in Canada is dismally low. It is feasible that within a few years there may be less than a handful of members who can handle a market manipulation file. Market Groups do not know the real extent of the problems in the industry and we will likely not have the resources to commit person years to this crucial issue. Crown counsel, the courts and the public do not view our files as priorities and this will continue to be an issue. Future prospects for improvements are negligible. HQ Ottawa will continue to give "lip service" to specialization and their priorities do not include the securities industry. I foresee the provincial agencies assuming the mandate we refuse to fulfil similar to the encroachment Canada Customs has made vis-a-vis C&E."

BISHOP, Bud Sgt. was a Constable in Vancouver CCS Market Group for 10 1/2 years commencing June, 1981 to Nov., 1991 and left as a Corporal.

"There is little evidence to suggest the RCMP Commercial Crime "Market Groups" have had any effect on improving or maintaining the integrity of the stock markets located at Vancouver, Calgary, Toronto, and Montreal from 1981 to 1994. (There is evidence to suggest the Winnipeg Commercial Crime "Market Group" has effectively improved the integrity of their Commodities Exchange in the period 1983 to 1994.)

Though the "Market Groups" in Vancouver and Calgary each have a small "provincial" complement the "Market Groups" are paid for by the federal government. There is no written accord between the Federal and any of the Provincial governments or any law that suggests the Federal government has any responsibility to investigate securities frauds. The provincial securities acts and the Constitution Act of 1867, delegating enforcement of the criminal law to the provinces, clearly give the provinces a mandate to investigate securities frauds. In 1967, after discussions with the provinces the Federal government directed and funded the RCMP to create and maintain a central repository and securities fraud squads. This direction, though never rescinded, lost its momentum prior to 1981. One obvious reason is that a federal securities act envisioned and drafted in the 1970s never became a reality. This lack of interest and direction has led to ineffectiveness. The groups themselves are not responsible for the lack of effective results since 1981. As the duties of the Commercial Crime Sections became more general in nature it became impossible to staff these units with the expertise envisioned in 1967. Market investigations received low priority as the Sections diversified into other facets of Commercial Crime."

<u>WOOD, Murray S/Sgt.</u> was a Staff Sergeant in Toronto CCS for approximately 6 years commencing Aug. 1982 to Sept. 1988.

"In my 32 years of policing it was the most interesting but frustrating years of service. I often felt we were very much on our own. There was very little support from upper level management. For the most part, I feel it was because they simply did not understand the complexities. While I worked in this area I often said this is where the RCMP should be placing a far greater commitment. From a criminal activity point of view it appeared to be rampant. At the same time, the complexities were many. I realize it is a multi-billion dollar business in the Vancouver area market alone. But so corrupt! The political will simply isn't there as well. When one offender can pay in excess of $700 million in fines you get some perspective of the extent of the problem. While in the market unit, three of the investigators: Secord, Gunn and Reteff received C.O.'s commendation for their efforts. They certainly deserved it as not only did they give greatly of themselves, but I am sure their families also suffered because of the time they contributed to get the job done. Being vastly under resourced, 17 stocks were manipulated by two primary figures with a lot of industry people willing to participate while others turned a blind eye."

NORMAND, Denis Cpl., joined the Montreal CCS Market Group from 1982 to 1988, and again in November, 1992 to date.

"The Evidence Act should be amended to ease the burden of proof relating to stock market fraud. Unfortunately, the last conviction in Canada that I can remember relating to that specific type of offence goes back to 1976 - Irving Kott. It is not very encouraging for attracting new investigators to the market group."

REID, John Sgt., was a Constable in Toronto CCS Market Group for approximately 3 years from Aug. 1983 to Dec. 1986.

"We couldn't even begin to touch on the problems that exist out there."

BOWLBY, Richard Insp., was a Corporal upon entering Vancouver CCS Market Group for 4 1/2 years commencing Aug. 1983 to Apr. 1988 and left a Sergeant.

"I would suggest the Market Groups have not been very effective. When one examines the number of cases that have gone to court and been successful since 1966, I believe you will find the numbers small, thus, indicating limited effectiveness at a high cost. When I say this I wonder what difference there would be in the public markets today if there had been no market groups. If, by the market groups being there, we have caused there to be improvements in financial markets to a substantial degree, then they are effective. If the investing public are not concerned about the presence of the RCMP Market Groups, then there seems little benefit to have them, no matter the number of convictions. It seems more for the politicians to be able to say we have the RCMP investigating. To be more effective, education, training, experience and direction have to be improved."

PETERS, Monty S/Sgt. joined Vancouver CCS Market Group in August, 1984.

"We have not been particularly effective in fulfilling our mandate for two distinct reasons that I refer to as the internal and external cause. The internal cause is our management who do not understand the complexity of the securities industry nor have they recognized the need for the development of expertise to investigate securities fraud that is without doubt one of the most difficult criminal offenses to investigate and prosecute. Although securities fraud was the thrust in establishing our Commercial Crime Sections across Canada, it never received the necessary support and most often received a secondary role to other criminal complaints, or in some instances, has been completely ignored. Enforcement action has historically increased and decreased dependant upon the expertise and motivation of the Market Manipulation Group members. Our Staffing Branch does not

consider securities fraud expertise or motivation when transferring or promoting members for Market Manipulation Group duties.

The external cause is more complicated and somewhat out of our control. Although stock fraud is common place on the venture capital market (VSE and ASE), it is rarely reported by the general public (shareholders) as they have no way of determining if the market is rigged. The member firms on the other hand, aware of who the manipulators are, look the other way as they benefit from the increased trading activity. This market (venture capital) continues to be dominated by "insiders" with the emphasis being on the "stock play" over fundamentals. Those cases that do got to court either get bogged down in our cumbersome legal system (successful manipulators usually have unlimited financial resources) or get thrown out by a justice who does not understand the venture capital market. There will be no change until such time as the Government, securities industry and the justice system make a sincere effort to provide an acceptable standard of integrity to this market. There should be sufficient controls in place that stock fraud is the exception and those cases that are identified are dealt with severely."

SCHELLER, Ray Sgt. was a Corporal in Vancouver CCS Market Group for 2 years commencing Jan., 1984 to Jan., 1986.

"The Market Group has become ineffective because it does not have the tools to do the job as it is now. That is, trying to put a case together after the fact. The Market Group must become proactive and target-oriented. They must resort to covert operations and the development of reliable sources in the industry."

FINNER, Patrick Sgt., was a Corporal upon entering Vancouver CCS Market Group for approximately 6 years commencing Oct. 1985 to Aug. 1991 and left a Sergeant.

"I think we have little or no impact on market related crimes. The circumstances are complex multi-jurisdictional. I think that we have managed to educate investigators for the purpose of successfully investigating such crimes. However, the costs related to prosecution has detracted from the courts and prosecutors being aggressive in dealing with these types of crime. I am also of the opinion that the force is reluctant to dedicate resources to investigations that appear to go nowhere. Attitude is everything and it is difficult to be positive when, historically, the results are not there."

<u>BLAIS, Peter Insp.</u>, was a Corporal in Vancouver CCS Market Group for 4 years commencing May 1985 to June 1989.

"I am not certain that RCMP Market Groups will ever be as effective as they should or need to be. I believe that this state of affairs is a two-fold reflection.

First, the primary (and virtually only) tools available to RCMP investigators are those of the criminal justice system. It has become evident to me over the years that the courts have demonstrated great reluctance to view market frauds and thefts as criminal activities. Rather, the large grey area which separates acceptable business practice from criminal deceit tends to obscure the criminal prosecution and makes judges reluctant to place the manipulators in the same category as offenders who warrant incarceration. To a similarly large extent, I believe this is also a reflection of society's views on the subject. Coupled with that is the inherent, accepted expectation of gains and losses when "playing the game". A "balance of probabilities" and civil sanctions approach to achieving the objective would likely produce stronger results.

Secondly, the Market Group concept cannot provide more than a temporary incentive to most members. While it is usually successful in attracting and acquiring members with the requisite skills, it can be viewed only as a stepping stone in the career scheme. Opportunities for promotion or the need to vary one's background, result in a turnover which is unacceptably high for a specialization which requires a long learning curve.

From both these perspectives a Canadian version of SEC, with proportionate provincial, federal and private sector funding, and an administrative and investigative hierarchy to permit full career streaming would most surely provide greater effectiveness and more concentrated resources to market enforcement."

<u>HURKETT, J.T. Cpl. (Ex)</u>, was a Corporal in Vancouver CCS Market Group for 7 years commencing Sept. 1986 to Aug. 1993.

"I would suggest the effectiveness on a scale of 1-10 would be a "0". You are wasting your time. Without an elite group and maybe 4 teams (of 4 investigators per team) and also Crown that is on your side and has the expertise, you don't have a chance. From 1986 to 1993 -- no convictions."

FRASER, G.N. Cst., joined the Calgary CCS Market Group in April, 1986.

"The transfer of trained personnel out of market function through promotion (or frustration) seriously hampers continuity and loses expertise.

— At present, our efforts rely upon a few individuals. The complexity and long turnaround times serve to de-motivate and burn out those involved. The Force has failed to acknowledge or reward those involved, nor has it shown a grasp of the relevance of our role and diversity of our required job knowledge.

— In my view, the RCMP must take a lead role in pursuing the criminal aspects of market manipulation by actively assisting our client agencies (ASE, ASC) and working more closely with ADP, drugs and organized crime investigators. Fully developing support of the SMART system, including methodology and processes, admissibility, and development of in-house expertise will demonstrate our willingness to play our role.

Public relations in community based policing model.

Direct reporting to the directorate.

Centralized staffing of market investigation.

Staffing senior management positions with officers reflecting appropriate securities knowledge.

EDWARDS, RICK Cpl. joined Winnipeg CCB in March 1986.

"RCMP market group in Winnipeg has, through past enforcement efforts, caused significant changes to the Rules and Regulations governing the futures market (commodities) and has opened a door to a financial closet which was once closed to all but a select few, even though daily transactions occurring in this market have considerable impact on the western economy. Due to limited resources, market groups can only scratch the surface when it comes to enforcement in an area which is global in nature and respects no territorial boundaries. With expanded trade agreements and new financial markets emerging in third world countries, coupled with new domestic awareness in financial instruments (mutual funds), I expect we will once again be playing "catch-up" when it comes to required expertise in the market area. The prosecution environment is changing in Canada in that as more market frauds are put before the courts, the level of defense attorney expertise rises, resulting in more challenges and less convictions. The level of expertise in market groups must continue to increase through Force sponsored training courses, information sharing and brokerage firm training."

GUNN, George Sgt. (Retired) was a Corporal upon entering Toronto CCS Market Group for approximately 6 years from Sept. 1986 to Dec. 1992 and left a Sergeant.

"In recent years the major focus has been on violent crimes. There has been an increasing awareness in regards to these crimes, as there should be.

Unfortunately, frauds and related offenses have been seen as "not so serious". Additionally, in market cases you have numerous victims that may or may not be seen as real victims due to personal greed. Then, the law is not so clear as to what is a manipulation and what is market making and this leaves the courts with the uncertainty of whether a crime was committed. This also leaves the investigators as lone wolves trying to obtain justice. It is extremely frustrating when you spend time in what appears to be a fraud and all you do is spend time trying to convince your superiors, crown and court that there really is an offence. In the end, one has to wonder why we even bother when nobody else seems to care."

TARIO, Brian Sgt. joined Winnipeg CCB in September 1986.

"I believe we are too reactive. We wait for complaints as opposed to using sources to determine where the problems are and developing operational plans to attack the problem. We have to use more highly trained undercover operators and wire taps to obtain evidence. We have to be prepared to take risks and be inventive in our approaches. I believe my market group is ahead of the pack in Canada. We look at all situations now from an operational perspective."

POPOVIC, Alec Sgt., was a Corporal upon entering Toronto CCS Market Group for approximately 7 years from Dec. 1986 to Jan. 1994 and left a Sgt.

"I believe we are of limited effect. Our investigators take too long and our conviction rates are less than stellar. To be effective, more resources are required and better training for the members. There is also a pressing need for continuity within the units. In six years I have yet to see a major file completed by the members who initiated same."

MACAULAY, Peter A. Sgt. was a Constable upon entering Toronto CCS for 5 years commencing 1987 to 1992 and left as a Sergeant.

"I feel that Stock Market fraud offenses and the resulting investigations are unique. If we are going to establish an effective unit we must be cognizant of this uniqueness when we are staffing the positions and in the approach we take in our investigations. I have broken down some of the area's that I feel need to be addressed if we are to be more effective.

1. Experience. After 18 months on the Toronto Stock Market Unit I felt comfortable with taking on a major investigation. The only reason that I felt comfortable after that period of time was because of the interaction with the

experienced members on the unit. The key is that I felt that I was ready, however, the learning curve did not stop there. In hindsight, I feel that it was not until I had several years of experience within the group and was able to see a large variety of criminal activity, that I became a seasoned stock market investigator.

After being in the unit for approximately two years I initiated an investigation that included a wiretap, 27 search warrants and countless hours of surveillance. Human resources varied with the amount of surveillance or searches, however, for the proactive portion we averaged around 7 investigators. After the proactive portion of the investigation was completed the investigative body shrunk to four and by the time the case went to court there was only one member left on the unit who had any direct knowledge of the investigation and he was not on the unit when the investigation commenced.

This was a common occurrence in the market unit and there seemed to be more cases turned over to new investigators than ones that were completed by the initiating investigator. By the time an investigator was conversant enough in the market to undertake an investigation on his or her own, that person would be transferable. At any time you can do a head count of any of the market units and you will see a large portion are in the "learning mode". Training and experience is expensive and in these financial times I do not feel that we can financially afford to let this knowledge go to waste.

To be effective we must retain our expertise. We cannot afford to have someone spend several years learning to do the job only to have that person leave shortly thereafter. The learning curve in this industry is continuous and the more exposure you have the more knowledgable you become. In the Toronto area there were several cases where agents for the Attorney General ("AG") stated that they wanted the RCMP to investigate the offence because of their expertise even though they did not have primary jurisdiction. There were also several cases referred to us from other police forces who had primary jurisdiction, but who felt that they did not have the expertise to complete a proper investigation.

If a member is doing a good job in the market unit and there are no extenuating circumstances then we should make every attempt to keep that member within the unit. We may have to let that member get promoted and then bring him or her back. This could cause classification problems under our present system, however, I feel that a unique approach and some unique rules must be put in place if we are to be effective.

2. <u>Communication with Attorney General's Office</u>. A common approach for the RCMP is that we identify a crime, investigate the offence and then turn the matter over to the AG's office for prosecution. There are many reasons why it is important that we keep at arm's length from the AG's office, however, as stated

the market is unique and unique rules must be made.

There is very little case law in the securities area to deal with. As such, every case we deal with has an above normal average of being potential case law. This causes the AG to strive for a higher probability of conviction rate than the norm. This problem is compounded by the budgetary restraints that the AG's office is under. The AG is looking at these cases and deciding whether or not they are cost efficient. Will the results set an example or standard that the general public and securities industry can relate to? Stock Market investigations and prosecutions are extremely expensive and the AG is trying to justify these expenses. The RCMP are in the same financial bind and we cannot afford to expend the human resources on an investigation only to have the AG's office decide that the guarantee of a successful prosecution is not high enough to proceed.

It is imperative that we have the AG's office on side as soon as possible and thus, we can terminate an investigation that they have no intention of prosecuting. There are many conflicting views pertaining to the involvement of the AG's office, however, I believe that to become more effective this area must be addressed.

3. <u>Training</u>. RCMP training in the securities area is almost non-existent. From my experience with the Toronto Market Unit and from discussions with other unit members over the years, the only worthwhile training that any one has received has been as a result of unit initiatives. We need to set a force investigative standard and training program so that we are not continually trying to reinvent the wheel. In the recent court cases defence council has made an issue of the testifying members' educational background and training in the securities area. Credibility is very hard to establish when you do not have longevity and the only training that you have had is two hours on a Commercial Crime Introductory course. This training is even more important when we start to deal with testifying in regards to the SMART system.

4. <u>Coordination</u>. The Stock Market players know no boundaries. In one phone call a player in Toronto can place orders initiating a scam in Vancouver, Toronto, Montreal, Calgary and/or New York. As it stands now, our knowledge of players in the market, their scams and trends are documented locally, however, this knowledge is not being coordinated on a national scale. We must coordinate our efforts and investigations. I have witnessed countless investigative hours being spent by different market units on the same target. This again requires a unique approach, however, to be more effective I feel that we have to look at this as a national problem and not a provincial one.

5. Resources. I feel that we need to apply more resources into our investigations. This means human as well as financial resources. This may mean that we may have to shelve some investigations to consolidate our resources, however we would be more productive to have one major investigation completed in 14 months than we would to have 4 on the go for four years. A quicker turnaround time would alleviate some of the transfer and judicial problems.

6. I believe that the RCMP is at the turning point in investigating stock market offenses. We must address the concerns that have been addressed by the market units for several years or get out of the business. I believe that at this time we are giving the investing community and the general public, who we are paid to serve, a false sense of security."

MUNRO, R. Sgt. was a Constable in Vancouver CCS Market Group for 2 1/2 months commencing May 1 to July 13, 1987.

"The effectiveness of the RCMP Market Groups is minimal, considering the length of investigations and eventual minimal sentence. I noted on stock manipulations, even if a $1 million fine was levied the accused is smiling considering the $20 - $30 million he manipulated. Investigative costs and court costs are tremendous. Does the end justify the means? The number of offenses only allows for a "band-aid" solution for the few files investigated. There was overlap in responsibilities with the S.S.C. investigators. I realize my minimum tenure limits my actual knowledge of the inner workings of C.C.S. at the time."

MATTE, Norm Sgt., was a Corporal in Montreal CCS Market Group for 4 years commencing March, 1987 to May, 1991.

"If we look at the jurisprudence that exist for all the commercial crime market offenses, we have to conclude that we were not very effective. We should leave market offenses to provincial securities commission agencies to investigate under statutory laws. We should proceed under usual sections of commercial crime (fraud, theft, uttering, forgery) in interprovincial and international cases only."

SENUM, Rick Cst., joined Vancouver CCS Market Group in October, 1987.

"It is our purpose to catch thieves and any time that is done it will affect the public view of what it can and cannot do."

TAYLOR, John Cst., joined Montreal CCS in May, 1988.

"The RCMP is nobly committed to enforcing market offenses, and the market investigators are a dedicated group of good investigators. However, we are handicapped by the following:

- *lack of understanding of the brokerage industry in the detail necessary.*
- *inability to prove ownership of offshore accounts.*
- *requirements for search warrants for each brokerage firm and service agency (as opposed to a blanket authorization which would enable us to obtain all trading records).*
- *lack of guidelines as to what is acceptable business practice and what is criminal.*
- *charter arguments that overturn good cases despite the good faith of the investigators.*
- *bad judgements.*
- *reluctance of Crown to undertake an expensive trial (at least in Quebec).*

Overall, the RCMP market groups do not perform in a vacuum. The policing of market fraud in Canada is done in concert with the securities commissions and the stock exchanges. With the diligence I have seen from the commissions, exchanges, and the RCMP, I believe (for the most part) that we are effective in maintaining a level playing field for the Canadian investor."

DUNCAN, S.A. Insp., was an Inspector in Edmonton CCS from 1988 to 1991 working on a market investigation.

"I feel it is imperative that the RCMP: 1) get a firm commitment from Ottawa as to resources committed to securities i.e. man power, training, research; 2) develop dedicated investigators with proper experience and training; 3) commit to training; and 4) deal with securities commissions on a daily basis i.e. make it very clear that we are their investigators. Anything less will cause the securities commissions to develop their own investigators and the crimes will be treated under the Securities Act vs. Criminal Code where they more appropriately belong. Also, the complications we currently have in the criminal justice system will deter the commissions from reporting the serious offenses."

WILLMS, P.R. Cpl., was a Corporal in Vancouver CCS Market Group for 3 years commencing Aug. 1989 to Sept. 1992.

"In my, albeit, limited exposure to market cases, I would say the RCMP are highly effective in dealing with criminal offenses within the securities industry, but ineffective in market manipulations. There are a number of reasons to account for this ineffectiveness.

Firstly, there is little political will to expend the time and effort necessary to investigate and prosecute a market manipulation. For the most part, there seems to be an underlying public attitude that we have the securities market we deserve. Considering the press coverage of the VSE (and to a lesser extent, the ASE), domestic investors/victims don't vote -- end of story. In a climate of cutbacks, it is hard not to agree that market investigations are not a high priority. Not too many widows and orphans losing their money here.

A second reason for our ineffectiveness is probably our lack of expertise (both RCMP & Crown). Notwithstanding this year's training session, learning about market manipulation investigations is rather hit and miss. If working on other files prevents you from teaming up with a 'lone coyote', you could spend a number of years in market group and never learn about manipulation or even many of the mechanics of the market. The present 'osmosis' approach leaves gaps in industry knowledge and demands a steep learning curve when suddenly faced with a manipulation file. Unfortunately, as with much RCMP training, you receive the courses you need only after you have tripped around too much. I feel the reason many members new to the section become disenchanted is that they are left to their own devices too early. Jr./Sr. members should be partnered up, and stay that way for at least a year. For most members, the securities industry is a whole new knowledge base. We cannot continue with "here's a map, if you have any questions, ask" approach.

A final problem with effectiveness is the RCMP approach to staffing and promotion. Other than at the S/Sgt. level, there is no acknowledgement that market work is very specialized. in the unlikely event that a Constable working in market group is actually promoted in market and stays, there is little chance he/she will be able to stay and become a Sergeant. The result is, Sergeants' positions often going to Corporals who have no background, or worse, no interest in, market group. To get ahead, you have to leave, probably at the point where you are most effective. But this problem is not exclusive to market group. The RCMP does it everywhere; the assumption generally being that a Corporal is a Corporal, a Sergeant is a Sergeant, no matter what the job. Because of this, I think market group is doomed to 'efficiency cycles' where, through more luck than design, the right combination of individuals at relatively constant points in their careers are posted to it and work well for a number of years peaking the cycle.

The rate at which they are transferred out or retire will determine where the group is on the cycle, but slumps are inherent to the system. This reason, more than any other, may spell the end to investigating market manipulations. It will be hard to compete with expertise with 'career' securities commissions."

RANNAOJA, Ole S/Sgt., was a S/Sgt. in Toronto CCS Market Group for approximately 1 year from Jul. 1989 to Sept. 1990.

"Unfortunately, effectiveness is minimal due to limited size and expertise of market units. Time taken to investigate any one major case is excessive, if not unacceptable, from the public interest/policy standpoint. The SMART system itself is not the answer, it is qualified and dedicated investigators in sufficient numbers to 'speedily' conclude the investigative stage. It is a fact that market investigations represent a 'token' sample of what ought to be actioned. Failing this, another body similar to SEC with full-time, long term resource commitments is the only answer. Talent, such as market members possess, can be eagerly invested in other mandated functions in the RCMP."

DZURKO, Doug Sgt., was a Constable upon entering Vancouver CCS Market Group for 1 year commencing Sept. 1989 to 1990 and left a Corporal.

"It is difficult for me to evaluate the effectiveness of the RCMP commercial crime 'Market Groups' in Canada because of my very limited exposure. During the year I was in the Market Group, my major responsibility was computer support.

My general observations would include the following relating to the effectiveness of the program:

- *poor regulatory policy within the industry itself which often complicates investigations.*
- *complex nature of the industry and business transactions make it difficult for criminal prosecution.*
- *nature of investigation dictates that the cases are long in duration, and volume of document evidence overwhelming.*

THOMPSON, Paul S. Cpl., was a Constable upon entering Toronto CCS Market Group for approximately 3 1/2 years from Sept. 1989 to Jul. 1993 and left a Corporal.

"Five years ago in Toronto the market group was highly regarded within CCS. Today, with the break up of Toronto, Milton has taken the members of the market

group. They don't get the proper support from Milton Detachment and should be a Divisional resource. These investigations are complex and time consuming, thus, the cost is astronomical. However, they must be done to ensure the world standing of our stock exchanges. The force should think about centralizing the market positions from Ottawa and start holding onto its expertise in those investigations. I think that we are not as effective as we once were. The creation of a national regulatory board and the centralization of market investigators would assist in surpassing old effectiveness standards."

HUBLEY, M.A. Sgt. joined Toronto/Milton CCS Market Group in March, 1989.

"Unfortunately, I feel that our effectiveness has been limited in the past few years. The constant demands on our resources for other non-related duties has had a negative impact. In addition, the continuing turnover of members assigned to the unit for various reasons has led to a serious decline in the level of expertise required to investigate these complex cases. We have also had a number of serious problems in obtaining convictions in the cases we have investigated. My opinion is that this is not a reflection of the quality of he investigations but rather a problem with the lack of related knowledge by the judiciary and the seeming unwillingness of the AG's departments to prosecute. This unwillingness seems to be more related to the attendant costs of prosecutions of this nature than anything else. Some serious consideration will have to be given to the continued use of our resources in this area unless the provincial governments begin to exhibit more political will in this area."

BROSTER, R.J. Cpl., joined the Calgary CCS Market Group in September, 1989.

"I feel the RCMP, at all levels of management, approach the area of securities investigations as they would any type of minor complaint from the general public. This shows up in the lack of internal training, recognition of the team concept and soft support for, or sponsorship of, technical innovation as aides to the investigation. Although a federally mandated program, each group seems to operate on its own, creating a quasi provincial entity, resulting in a lack of consistency in operating structure and a fragmented approach to dealing with common problems. Industry feedback is the best test of our effectiveness. In an area used to conducting business in a matter of seconds, they have an understandably tough time resolving why it takes up to 4 or 5 years to present a case to court, then several more in the court process. Unfortunately, most of these concerns come through the informal feedback mechanism."

SHEPEL, Dan Cpl. joined the Edmonton CCS in January, 1990.

"Cooperation between stock exchanges and security commissions has improved. However, egos are a major concern within these groups, including the RCMP."

MAINWARING, Bob. Joined the Calgary CCS Market Group upon its inception in 1990.

Historically investigations pertaining to security related offenses have suffered from a lack of resources and expertise. The time required to investigate security related matters often results in the investigation being reassigned (investigating member promoted, resigns, transferred) or designated to a lower priority. Several different Crown Prosecutors may be involved in the prosecution. (Continuity of the Crown's theory is lost). Consequently, years may elapse before the matter is finally brought before the Courts. The matter has become a non issue, no one is interested in the final outcome.

Individuals employed throughout the securities industry are definitely aware of the RCMP's presence, however, hold the opinion our enforcement role is ineffective and inefficient due to the length of time that is required to investigate security related offenses. Regulatory enforcement personnel have a great deal of difficulty in understanding why it takes so long to bring criminal investigations before the courts.

The acceptance of SMART reports by the Courts will certainly correct this time lapse.

The success of investigations conducted by Market Groups are directly tied to the resources and commitments of their respective Commercial Crime offices and AG's Depts. due to the high costs associated to prosecuting market related offenses.

CATTON, M.J. Cst. joined Toronto/Milton CCS Market Group in February, 1991.

"Overall, I do not think we are very effective at all. We have some very devoted and interested members doing the files but we are provided with virtually no training. Funding is always a problem as is equipment. The Force must commit itself to doing these investigations properly or we should abandon them. We should be much more proactive and attack these types of offenses as early as possible. We should employ undercover tactics where possible and we should routinely explore the files from 'conspiracy' and 'proceeds of crime' angles."

JESTADT, J.W. Sgt. joined Toronto/Milton CCS Market Group in September, 1991.

"During my short tenure with the unit, it seems the same suspects continue to surface, time after time. These repeat offenders should be targeted. I think the overall effectiveness of the Market Groups could be improved with a greater emphasis being placed on "project style" - "joint forces" investigations with the regulatory agencies, ie the Ontario Securities Commission. Investigations of this nature would allow for the pooling of resources and expertise and would result, I believe, with more effective enforcement from both the regulatory and criminal perspectives."

RASMUSSEN, John Cpl., was a Constable upon entering Vancouver CCS Market Group for 6 months commencing Jul. 1991 to Jan. 1992 and left a Corporal.

"I feel we are/were very limited in our effectiveness in investigations or prosecuting major commercial crimes. We are hampered by our limited resources both within and outside our controls. We are also hindered by very restrictive court decisions and charter case law. To be effective, I feel VCCS Market Group must be organized and operated as a team approach to major files. Strong leadership is a definite requirement. Organization must work from top down, not fragmented at the investigative level."

ARD, W.C. Sgt. was a Corporal upon entering Edmonton CCS for approximately 2 years from May 1991 to July 1993 and left a Sergeant.

"The cases are too complex to be investigated efficiently to the standard required by the Canadian judicial system. Because of this, large resources are dedicated to an investigation, preventing the investigation of all of the cases that should be looked at. Therefore, RCMP investigations are not an effective deterrent."

BLANCH, R.J. Cpl. joined the Calgary CCS Market Group in June, 1992.

"In terms of investigating alleged market offenses, I would say the CCS Market Groups in Canada are effective, however, in terms of successful prosecution of these alleged offenses, I would say our Market Groups are not effective. The number of successful prosecutions of market manipulation charges can be counted on one hand. This is partly due to factors outside the control of the CCS Market Groups: 1) prosecutors not versed in securities-related prosecutions; 2) judges and/or juries who don't understand the evidence; and 3) vague wording of Sec. 380(2) CC."

HUNT, Tom S/Sgt. joined the Toronto/Milton CCS Market Group in July, 1992.

"Lately, it appears the courts and prosecutors are not interested in "protecting the integrity" of the markets. This may be because of lack of knowledge or substantial costs associated with these investigations. The effectiveness will be substantially reduced or eliminated if we continue to lose or refuse to prosecute cases for purely economic reasons. The Canadian investing public expect and deserve more protection than they are presently receiving."

OGDEN, Jim Cst., joined the Vancouver CCS Market Group in July, 1992.

"When I first came here I did not think that this group in Vancouver was working as effectively as it could. In retrospect, I think that this group was working as effectively as it could based on the state of the market and recent judicial decisions. With the expected recommendations of the Matkin Inquiry and, hopefully, new tools to assist investigators, and with the renewed attitude I think has come about in the past year, I know the level of effectiveness will change. I believe that the national market fraud workshop was instrumental in bringing about this change locally and nationally. We can all feel isolated and the workshop I think made us all realize we were part of a team, working together towards a common goal. I think we are more effective now, however, we are waiting for material results, a conviction for market fraud."

COTTER, W.J. Cpl., joined the Vancouver CCS Market Group in April, 1992.

"These comments primarily concern Vancouver CCS Market Group. I think we are mostly ineffective. The Force must bear some responsibility for this problem. The community and business of the Vancouver Stock Exchange (VSE) is considerably different than other markets in Canada and our mandate should reflect this by including preventive and proactive enforcement. We should not be spoon fed by the VSE directly or through the B.C. Securities Commission. There is a serious lack of human resources and current criminal intelligence available. Technical expertise in securities fraud, law, and accounting is essential in this job and will be sufficient to investigate the inevitable historical paper case. Less conventional methods of investigation should be reconsidered. A proactive and preventive approach which compliments our current efforts could significantly and positively impact on our effectiveness."

LEMON, Rob Cst., joined Vancouver CCS Market Group in November, 1992.

"Although I've only been in the Market Group for a short time (1 year), I have been able to observe the results of some of the past and present cases. Basically, all the results have been negative. In a lot of our investigations the complainant and the suspect seem to be not much different. It's like sharks biting sharks, while the big 'whale' gets away. It almost seems like a lot of time, effort and public expense, and for what? Things have to change and I feel they have started."

PERKINS, Chris Cpl., joined Vancouver CCS Market Group in November, 1992.

"We are basically ineffective. Why? - because of the staffing policy. Members have been promoted into market groups with no background in securities. Unless they have the desire to learn securities, they do not get involved or undertake a major investigation. The Force must only take members into market groups which have demonstrated a desire to do securities work, and have the background, otherwise it is a complete waste of time for everyone. The only solution is to make it a specialized group with promotional opportunity from within."

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