



Focused Enforcement

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Overview

- Background: Why focus on focused enforcement?
- What is focused enforcement?
- A model for focused enforcement
- Application in a corporate governance context
- Challenges: the risks of risk-based enforcement

Why focus on focused enforcement?

- An interest expressed in this Roundtable and others
- Worldwide interest among regulatory authorities
 - But also debate about what's possible in varying legal frameworks
- Focusing on the greatest threats to achievement of objectives:
 - Makes more efficient use of limited resources
 - Promotes investor confidence
- Systematic prioritisation of cases promotes fairness:
 - Consistent and objective treatment of cases
 - Reduced regulatory burden for compliant participants

Focused enforcement is ...

- Risk-based
 - Enforcement resources focused where greatest risks to achievement of regulatory objectives lie
- Cost-sensitive
 - Costs and benefits of pursuing particular cases are considered
- Systematic, objective and less reactive
- Used at different stages in enforcement process, *e.g.*
 - Surveillance
 - Decision to escalate case for full investigation
 - Decision to commence formal enforcement proceedings
 - Decision/recommendation about sanctions
- Usually part of a broader risk-based regulatory approach

A model for focused enforcement

- Ontario Securities Commission published risk-based case selection criteria in 2002
 - Staff Notice 11-719
 - Outlines how staff decide which cases to fully investigate
- Combined with a “Credit for Cooperation” Policy
 - Staff Notice 15-709
- Part of a broader approach that includes risk-based supervision (described in the same Notice)
- Combined with regular reports on OSC priorities and achievements measured against priorities

Overview of OSC's case selection criteria

- Types of activities and participants
 - Impact and urgency
 - Case costs versus case value
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- ↑ Exacerbating factors
 - ↓ *Diminishing factors*

Activities and participants

- ↑ Participants are key players in regulated markets
- ↑ Multiple parties involved in allegedly improper activities
- ↑ Behaviour appears to be planned, covert and/or conspiratorial
- ↑ One or more parties previously warned
- ↑ Activities carried out over a long period of time
- ↓ *Activity appears to have been inadvertent*

Impact and urgency

- ↑ Large number of investors involved
 - ↑ Value of losses (individually or collectively) is high
 - ↑ Allegedly improper activity is continuing
 - ↑ Investors' assets are at risk
 - ↑ Concern that evidence may be destroyed
 - ↑ Other regulators have requested assistance
 - ↑ Due to media attention or public profile, the issue is affecting public confidence
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- ↓ *Events occurred a long time ago*
 - ↓ *This is not the primary jurisdiction*

Case cost versus case value

- ↑ Activity appears to be pervasive
- ↑ Industry has been put on notice about the issue
- ↑ Involves a high priority issue
- ↑ Staff investigation is largely complete, so few additional resources required
- ↑ Resolution of case would have precedent value for future cases

- ↓ *Case referred to other law enforcement authorities*
- ↓ *Very high case cost, relative to potential case value*
- ↓ *Related matters under review in other cases*
- ↓ *Appropriate alternative remedies are available*

Credit for Cooperation Policy

- Clarifies OSC policy that market participants should have an incentive to self-police, self-report and self-correct misconduct
- Formalises/discloses staff's policy on what cooperation is ... and isn't
- Provides guidance on how cooperation can be translated into credit during investigation and litigation processes

A focused enforcement policy for corporate governance

- Identify objectives and greatest threats to those objectives
- Use identified risks to develop criteria for making decisions throughout enforcement process
- Develop/formalise decision-making processes & records
- Publicly disclose a general outline of your approach
- Monitor and follow up
- Incorporate into a broader risk-based regulatory approach

Identifying objectives and risks in a corporate governance context

- Identifying objectives
 - OECD Principles of Corporate Governance ...
 - ... situated in the context of your jurisdiction's regulatory framework and your mandate/responsibilities
 - Discussions with authorities with overlapping or shared responsibility in the sector
- Identifying/prioritizing risks
 - OECD Roundtable: studies, discussions
 - Other country and regional studies and assessments
 - Discussions with relevant authorities and private sector
 - Formalise existing institutional knowledge
 - Outside consultants

Decision-making process

- Decide who should participate in assessment, e.g., representatives from:
 - Referring team (e.g. Corporate Finance)
 - Receiving team (e.g. Litigation Team)
 - Teams that supervise regulated entities who are alleged wrongdoers (e.g. Market Intermediaries)
 - Management/senior management
 - Other relevant authorities (e.g. stock exchange)
- Decide who shouldn't be involved in assessment, e.g.
 - Staff who will actually be assigned to investigate/prosecute the case
 - Those who might serve as adjudicators/decisionmakers



Record and follow up

- **Develop formats for:**
 - Reasons for referral/recommendation
 - Detailed note of decision made
 - Short note for reporting to others on decision made
- **Design follow-up/monitoring procedures for:**
 - Assessing whether criteria applied consistently
 - Validating risk-based decision-making models in future
 - Following up on matters referred to other teams or other authorities
 - Providing useful data for supervision and law reform efforts



Decision-making formats

- Options
 - Flexible framework for discussion/analysis
 - Score sheets with point values assigned to risks (weighted or unweighted)
 - Statistical methods (*e.g.* for escalation of certain anomalies to more detailed investigation)

Risks of risk-based enforcement

- Hoarding resources for the perfect case
 - ★ *Pursue important but less-than-perfect cases, too*
- Media interest/public profile: a factor that can swallow all others
 - ★ *Discipline in responding to external pressure and pressure from your governing board*
- Good guys (or small fry) might get lazy
 - ★ *Include random inspections in risk-based supervision*
 - ★ *Build compliance activities into routine supervision*
 - ★ *Disclose principles (but not details) of focused approach*

The greatest risk – unfairness

- Transparent risk-based approach is a visible target for complaints about enforcement practices
- Overweighting largest/most visible market participants
- Why use me to set an example for others?
- Blurring the compliance/enforcement distinction
- Allowing specific risk-ratings to influence subsequent decisionmakers

- * *Consistent application of criteria*
- * *Scrupulously fair processes, regularly re-evaluated*
- * *More transparency – address misunderstandings head-on*

Questions for discussion

- Does your legal framework permit the regulator to focus its enforcement efforts?
- Confidence in regulatory authorities:
 - Are there integrity concerns about the regulator exercising discretion to focus its enforcement efforts?
 - How can systematic and objective processes, combined with public disclosure, enhance confidence in the regulator's integrity and effectiveness?
 - How much can the regulator disclose about its policy without the disclosure becoming counter-productive?
- How can authorities with shared responsibility work together to prioritise/focus enforcement efforts?

Resources

- OSC Staff Notices available at www.osc.gov.on.ca
 - Go to “Policy and Regulation” and click on “Rules, Policies and Notices”
 - Click on “Category 1: Procedure and Related Matters”
 - Scroll down to Notices 11-719 and 15-702
 - See also annual Statements of Priorities
- UK FSA Publications available at www.fsa.gov.uk
 - FSA Handbook (Regulatory Processes: Enforcement Manual) and recent proposed amendments (CP05/11)
 - Report: *Enforcement Process Review* (July 2005)
 - See also annual Business Plans