Goodmans LLP Update

Corporate Securities Law

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Recent OSC Sanctions Highlight Importance of Compliance with Internal Insider Trading Policies

The Ontario Securities Commission (the "**OSC**") recently approved a settlement agreement that imposed penalties on a Bogota-based partner of an international law firm for trading in securities of one of his clients – an Ontario public company – in violation of the firm's internal insider trading policy, despite finding that the trades did not contravene the insider trading restrictions in the *Securities Act* (Ontario) (the "**Act**"). The situation is another example of the breadth of the possible assertion by the OSC of its public interest jurisdiction (particularly in cases involving allegations of improper trading). The settlement – and the OSC Staff's allegations that led to it – also serve as stark reminders to professional advisors and others of the importance of strictly complying with their organizations' insider trading and similar policies.

Background

Under the Act, the OSC has a broad power to impose sanctions, even in the absence of a technical violation of the Act, where it concludes that it is in the public interest to do so. Essentially, the public interest jurisdiction is an overarching power that permits the OSC to take a broad range of actions that it determines is necessary to fulfill its mandate of protecting investors and fostering fair and efficient capital markets (and public confidence in those markets).

In this case, the firm's insider trading policy, among other things, prohibited trading in securities of any public company recorded on its restricted trading list. The policy required all trades in securities of public companies to be pre-cleared with the firm's compliance committee. Despite having received the insider trading policy, the partner traded in securities of his client (as part of an investment strategy that he had pursued since a time prior to the adoption of the policy) without pre-clearing the trade. The partner did not know the client was, at the relevant time, on the firm's restricted list and, significantly, Staff's allegations concede that the partner did not contravene the insider trading restrictions (or any other provisions) in the Act. In particular, there was no allegation that the partner (i) was in possession of any material undisclosed information about the client at the time of the trade, (ii) engaged in any abusive, willful or knowing misconduct, (iii) knew any information that would explain why the client had been placed on the restricted trading list, or (iv) had been encouraged to trade in securities of the client by any other person who was in possession of material undisclosed information about the company.

The Settlement

The partner agreed to settle the matter notwithstanding the absence of such allegations. The settlement involved a voluntary payment of $10,000, costs of $20,000 and other sanctions that included a prohibition on trading any securities or derivatives in Ontario for 18 months (subject to limited exceptions).

The publicly available materials do not indicate why the partner agreed to the settlement (perhaps to avoid the publicity and cost of a more protracted enforcement proceeding) or how the matter came to the attention of OSC Staff. The reasons issued by the panel of Commissioners that approved the settlement concluded that the partner's failure to "read, understand and comply" with the firm's insider trading policy was contrary to the public interest "as he failed to adhere to the high standard of conduct expected of him in the circumstances", as:

- "the particular circumstances of this case do engage the animating principles of the Act, and therefore the Commission's public interest jurisdiction";
- the firm's policy was "a prudent one" and "[p]olicies such as this one recognize the firm's gatekeeper role and contribute to the integrity of the capital markets";
- the partner was in a "special relationship" with the client (the status that engages the insider trading restrictions under the Act where the person in the special relationship is in possession of material undisclosed information about the issuer) by virtue of engaging in professional activity on behalf of the client and was therefore obligated to be "particularly cautious" when trading in securities of the client; and
- as a lawyer, the partner is "in a position of trust and is subject to a high professional standard to avoid any appearance of conflicts of interest and any appearance of misuse of confidential information obtained in the course of the solicitor-client relationship" and should have taken reasonable steps to ensure that he was complying with the firm's policies before trading in publicly-listed securities of a client.

Key Takeaways

There have been a number of high-profile examples of the OSC using its public interest jurisdiction to sanction conduct involving trading in securities that the OSC, despite acknowledging did not constitute a technical breach of the Act, determined was contrary to the animating principles underlying the insider trading restrictions in the Act. However, in each of those cases the OSC had alleged that the individual in question had either been in possession of material undisclosed information regarding the issuer or had been encouraged to trade in securities by a person whom the individual would reasonably have known to be in a special relationship with the issuer.

Since this case was settled before a hearing, it is unclear whether the OSC would have ultimately determined that the impugned trades were in fact contrary to the public interest. Regardless, the case sends a clear message that trading by professional advisors and others in special relationships with issuers will be carefully scrutinized, and that failure to comply with internal insider trading policies may lead to enforcement proceedings by OSC Staff.

Organizations whose members may be in a special relationship with public companies should ensure that appropriate policies are in place regarding trading in securities of those companies and that persons intended to be subject to those policies are aware of, and undertake to comply with, their terms. Those subject to such policies should read, understand and comply with the policies. The very allegation that trading may have been undertaken that is contrary to such a policy – and potentially contrary to the public interest – can have significant reputational, and potentially legal, consequences for the individuals and organizations involved. While the OSC specifically noted that the insider trading policy in this case was a prudent one, its focus on the terms of this particular policy (as opposed to some other objective standard) reinforces the need for thoughtfulness in drafting insider trading and similar policies. Given that the terms of such policies may set the standard by which regulators judge conduct that falls within the scope of the policy, it is important to ensure that these policies are crafted in a way that achieves their objectives (including compliance with applicable laws) while ensuring that compliance is reasonably achievable in the circumstances.

For further information on the OSC's decision and its potential implications, including the review or preparation of an insider trading policy, please contact any member of our Securities Group.