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Introduction

The last decade witnessed an unprecedented level of securities fraud committed by the executives of some of Canada's largest brokerage firms. Senior executives from Thomson Kernaghan & Co, Norbourg, Essex, Farm Mutual, iForum, and Triglobal were all either tried and convicted by the criminal justice system (CJS) for committing *Criminal Code* offences, or were sanctioned by the provincial securities commissions ("Commissions") and self-regulatory organizations ("SROs") for violating regulatory offences (see Canadian Foundation for Advancement of Investor Rights (FAIR Canada), 2011a, p. 17-20). In the cases where criminal convictions were secured, the sentences imposed and the actual time that the executives spent in prison was too lax to offer any serious deterrent effect (p. 27). The fines imposed by regulators for regulatory offences were often not collected, and the laxity of sanctions imposed, if any, did not send a sufficiently strong deterrence message to market participants or the public" (FAIR Canada, 2011a: 27; also see Lokanan, 2014a, 2014b). One of the many complaints is the "command-and-control" rule book oriented strategies that dictate regulatory goals. The punitive enforcement approach engenders resistance, which creates a reduced incentive for market participants to cooperate with regulators.

Perhaps, a more systematic and innovative approach to securities regulation is found in Ayres and Braithwaite's (1992) work on responsive regulation. Ayres and Braithwaite's (1992) model focuses on dialogues and collaborations that maximize the role of responsive regulation, and minimize the role of the CJS. This is not to say that the

model explicitly minimizes the role of criminal charges per se, but rather the use of punitive measures more generally (criminal or otherwise). It is contended that regulatory objectives can be met when enforcement agencies display a pyramid with varying degrees of interventionism. The pyramid of sanctions as it is called, “suggests that the greater the heights of punitiveness to which an agency can escalate, the greater its capacity to push regulation down to the cooperative base of the pyramid” (p. 40).

Ayres and Braithwaite’s (1992) preferred strategy to entice compliance is for regulators to display an enforcement pyramid of mixed regulatory sanctions – ranging from persuasion at the base of the pyramid, through to warning and civil penalties, up to criminal penalties, license suspension, and then license revocation at the apex. The pyramid of sanctions assumes that managers are rational actors. As such, compliance is more likely to occur with a “benign big gun” strategy (Parker, 2006, pp. 592-593). Regulatory agencies are more likely to secure compliance when they have tougher sanctions at the apex of the pyramid. That is to say, regulators will be able to speak more “softly” when they carry big sticks. Paradoxically, the bigger the stick, the greater the success regulators will achieve by speaking softly and therefore, it is less likely that they will have to impose tougher sanctions (Ayres & Braithwaite, 1992: Ch. 2).

Responsive regulation has some weaknesses and its application to securities regulation can be strengthened by recognizing these weaknesses and the implementation of actions to address these problems (Freedman, 2011, p. 628). These weaknesses have to do with proportionality and constitutionality, two components that are integral to the right for fair and equal treatment (Freigang, 2002; Yeung, 2004). The very fact that different cases are dealt with differently in Ayres and Braithwaite’s (1992) pyramidal model is

hard to reconcile with the legal principle of equality. Not only compliance, but also equality, predictability, stability etc., are among the normative pillars of the law. The adverse consequence is the law losing its legitimacy and compliance being compromised (p. 106). To some extent, these limitations relate to the way in which responsive regulation is applied in financial regulation; but, there are more fundamental objections that require further examination (Freedman, 2011, p. 628). This article seeks to open a preliminary conversation of responsive regulation within an inter-agency framework in the financial sector. To be more specific, the article discusses the problems associated with the adversarial regulatory state response to securities law violations, together with possible responses informed by the networked governance model that may help to appease critics of responsive regulation (Nielsen, 2006; Kingsford-Smith, 2011).

To start, I use the SRO that is responsible for governing Canada's investment dealers and brokerage firms – the Investment Industry Regulatory Organization of Canada (“IIROC”) as a prototype example where responsive regulation can be applied. My thesis is simple: I argue that responsive regulation, that is, regulators willingness to be responsive to the context, culture, and conduct of market participants, is a promising strategy to regulate in the public interest. More specifically, the paper argues that Ayres and Braithwaite's (1992) model of governance can be used to discover and develop strategies for deterring investment fraud through the network of relations and capacities within the securities industry. To be responsive would require IIROC to indicate a willingness to escalate intervention up the pyramid, or to deregulate down the pyramid in response to their members' compliance with regulatory objectives.

There have been few if any attempts to extend Ayres and Braithwaite's (1992) model to the financial sector. In this sense, the paper makes both a theoretical and practical contribution to the existing literature. Theoretically, the effort to situate IIROC within the larger context of securities regulation in Canada, and to acknowledge the impact of inter-agency dynamics including forms of both conflict and mutual interdependency, is a move that has never been attempted by regulatory scholars before. This inter-agency dynamic further complicates the responsive regulation framework, which has been developed largely in reference to single agencies. The present paper transcends this approach and pays attention to jurisdictional boundaries to ensure that local-level information is valued and that inter-agency relationships have some legitimacy in the governance of financial markets (Ford, 2013).

Practically, the paper builds on the theoretical discussion and responds to recent calls (Kingsford-Smith, 2004, 2011; Braithwaite, 2013; Williams, 2013; Ford 2013; Findlay, 2014) for studies to recommend ways in which responsive regulation as a governing mechanism may be encouraged within an inter-agency regulatory framework. While the theory aspires to general applicability, particular consideration is given to its ability to govern market participants with stakes in the regulatory game (see Ford, 2013).

The rest of the paper is organized as follows: To flush out the responsive regulatory framework, I situated the analysis within the larger context of securities regulation in Canada and the U.S. Through this discussion, Ayres and Braithwaite's (1992) framework yielded more nuanced. I then address the consumer-oriented aspects of the regulated community, with particular emphasis on the connection between regulators and the public interest. Next I examine the problem of regulatory capture and the

manipulation of regulatory bodies by special interest groups. The paper is then informed by the lessons from IIROC's enforcement activities and identifies the critical factors that contributed to the laxity of sanctions imposed by IIROC's hearing panels. This is followed by a theoretical discussion on interagency relations and the antecedents' problems of interagency conflicts and collaboration. I then examine the suitability of responsive regulation as a regulatory technique to secure compliance. Here it is argued that IIROC is well positioned within Canada's inter-agency regulatory framework, to apply the two key elements of responsive regulation: the role of the regulator (in Canada's case, the Commissions and the Royal Canadian Mounted Police's (RCMP) Integrated Market Enforcement Team (IMET)) as the "benign big guns" that carry big sticks, and the ability of IIROC to start at the base of the pyramid and "speak softly" to secure compliance (see Ayres & Braithwaite, 1992). Finally, the conclusion highlights areas for future research.

Securities Governance and the Problem of Regulatory Failure

The Wider Context of Securities Regulation in Canada

The absence of a federal regulator in Canada means that self-regulation plays a compensatory role in policing its securities markets (Jordan & Hughes, 2007: 218). To fill the void, several regulatory agencies share the responsibility for enforcing securities laws. These agencies are embedded in a maze of regulations that are made up of the police, Commissions and SROs, who are all involved in a complex and fragmented system of regulation comprising multiple rules and decision makers (Bhattacharya, 2006, p. 6). The sheer number of players operating in the securities arena, demands a brief review of the

relationships between these agencies, the manner in which they seek to enforce their statutory mandates, and their scope and jurisdictions.

Within the Canadian regulatory landscape, the Commissions and SROs have their own rules and regulations that govern the markets. Securities law violations can be effected through administrative proceedings by the Commissions and SROs.

Administrative decisions and sentence orders meted out from administrative hearings range from disgorgement, fines (up to \$1million for individuals and \$5 million for Member firms per contravention) and cost payments, reprimands, and conditions and orders prohibiting individuals from trading in securities (FAIR Canada, 2011a, p. 23).

Violations of provincial securities legislations and SROs' rules can also be prosecuted in provincial courts as quasi-criminal offences. A quasi-criminal offence is a misconduct that has an element of criminal or quasi-criminal activity attached to it.

Quasi-criminal offences include but are not limited to fraud, forgery, false endorsement, misappropriation of funds, and securities act breaches (see IIROC, 2009, pp. 16-20).

Quasi-criminal offences are punitive in nature, and as such, their proceedings are commenced in provincial courts under provincial securities acts rather than under the *Canadian Criminal Code* (FAIR Canada, 2011a, p. 23). Sanctions for quasi-criminal offences include “fines (up to \$3 million in British Columbia and \$5 million in several other provinces); prison terms for a maximum of five years less a day; payment of triple the amount of the profit made or the loss avoided; disgorgement; and payments of restitution or compensation” (p. 23).

As with most white-collar crimes, the more serious securities violations can stimulate a range of official responses from SROs and provincial securities commissions’

investigations and hearings, to criminal prosecution (Beresford, 2003, p. 93). It is rare however, that all three agencies will commence a hearing on a criminal offence. By law, the provincial securities commissions and SROs are required to refer the cases with evidence of criminal activities to IMET for further investigation. The prosecutions for violations of Canadian *Criminal Code* offences such as fraud affecting the public market, market manipulation, and false prospectuses can carry sanctions that include up to fourteen years imprisonment and fines (FAIR Canada, 2011a, p. 23).

This “enforcement mosaic” has been criticized for being lax and in need of repair (see Bhattacharya, 2006; FAIR Canada, 2011a; Williams, 2012; Lokanan, 2014b). A myriad of reasons has been put forward for the claim that securities regulators have fallen short of their governance mandates in Canada. For many, the issues are not so much inefficiencies by the agencies, but perceived unfairness and bias in the regulatory process itself (Cory & Pilkington, 2006; Williams, 2012). Here, regulators are chided for taking on only the overly egregious cases, which puts the market into disrepute, while at the same time, subjects so-called legitimate industry players to overly aggressive and unfair regulatory encroachment (Williams, 2012, p. 3). There is also the problem of which agency has jurisdiction over the cases. In the regulatory game of securities regulation, cases often get juggled around, with multiple overlapping sources of regulatory scrutiny that creates a regulatory burden (Beresford, 2003; Lokanan, 2014a). From the investors’ point of view however, the issue is not so much the burdensome nature of the regulation, but the failure of the regulatory agencies to investigate, prosecute, and provide restitution in cases of misconduct brought forward by investors (Williams, 2012, p. 3).

Securities Regulation in the United States

In the U.S., the securities market is governed by the SEC and the Commodity Futures Trading Commission (CFTC). Both have similar goals: to ensure safety and soundness in the market and to protect investors from fraud and abuse. That said however, neither the SEC nor the CFTC have complete control over conduct regulation in the U.S. market. Much like Canada, SROs play a vital role in policing the U.S. market. While the SEC is responsible for investor protection and the integrity of the securities market (i.e., exchanges and over-the-counter markets), the Financial Industry Regulatory Authority (FINRA) is tasked with regulating brokerage firms and stock brokers whose main business is trading in stocks and bonds. FINRA is by far the largest SRO with 4,750 firms and 639,265 brokers registered to sell securities (FINRA, 2014). It is no surprise therefore, that self-regulation continues to play an integral role in the U.S. financial market and seems likely to continue despite mounting international pressure fueled by market evolution.

The creation of FINRA centralized regulation of broker dealers and subjected its regulatory activities to direct oversight and intervention by the SEC. Some may argue that the CFTC is a competing regulator, however, it only has jurisdiction over derivatives, a specified investment product that the SEC never had control over. While tension remains between the SEC and FINRA, their shared responsibilities are key characteristics to ensure safety and soundness in the U.S. market (Jordan & Hughes, 2007, p. 223; Carson, 2011, pp. 23-25). The U.S. problem however, is that regulators in the financial sector have become too responsive to the regulated communities and are unable to balance consumer issues to maintain the public interest (Yackee, 2006; Kelleher & Yackee, 2009). Kelleher & Yackee (2009) made the point that the access to decision-

making by special interest groups leads to regulation that favours industry participants, many of whom enjoy surprising favours at the hands of regulators (also see Yackee, 2013). Consequently, industry participants, particularly large financial organizations, benefit from the pro-industry laxity exhibited by the enforcement arm of regulators (Hoffmann & Cassell, 2010). Financial regulation therefore, may come to reflect the kind of situation where lax penalties are synonymous with regulatory policies designed to protect industry participants rather than the consumer-oriented aspect of the regulated community.

Regulation and the Public Interest

Consumers and the Regulated Community

The nature of self-regulation applicable to market infrastructure institutions is intimately connected to the concept of the public interest (Jordan & Hughes, 2007, p. 214). It is strange however, to suggest that the “public interest” is at play in market regulation. In fact, one may be hard pressed to find any literature that would realistically make such an assertion. Indeed, the existence of the public interest is debatable. The extent to which the public interest is at play largely depends on the regulatory body involved. But, while the “protection of the public” interest is used as a justification for the existence of SROs’, legal scholars have charged that “the call for self-regulation comes from the professions themselves and not the vulnerable public” (Brockman & McEwen, 1990, p. 3). Perhaps the question to ask is whether the public interest can be effectively protected by SROs without any accountability mechanisms in place to negate the benefits associated with self-regulation. While this is heavily dependent on the particular regulatory context, it is understandably the case that private interests are often

equated with the public interest, whose members seek the sponsorship of SROs to promote their own interests (Etzioni, 2009; Yackee, 2013). The battle cry for public support then comes from the SROs themselves, and not the vulnerable public. The argument that SROs can lead to more efficient regulation, and thereby be more effective in securing compliance, has very little to do with protecting the public interest and more to do with the industries trying to protect their members from coming into contact with the justice system for non-compliance. If the SROs play “hardball” with their own members, they will be open to criticism from within (Brockman & McEwen, 1990, p. 33).

Given the failure of regulators to protect the public interest, some argue that consumer empowerment is perhaps a way forward (Ayers & Braithwaite, 1991; Schwarcz, 2012; Yackee, 2013). This line of reasoning has its roots in Ayers & Braithwaite’s (1991) work on tripartism. Ayers & Braithwaite’s (1991) argue that to counteract industry influence, public interest groups (PIGs) must be fully informed on regulatory issues and allowed to participate in the negotiation of regulatory outcome (Schwarcz, 2012, p. 6). To legitimize their existence, they must be permitted to challenge industry behaviour through the same mechanism as the regulator (p. 6). The role of empowered PIGs is contestable in that if they are captured by regulators or co-opted by other stakeholders, other PIGS can be empowered (Ayers & Braithwaite, 1991). The risk of being captured however, is limited by both their self-identification and the contestability of their position (Schwarcz, 2012, p. 6). At the same time, government must also do their part by establishing internal mechanisms to ensure that PIGs’ leaders are held accountable to putative beneficiaries of regulation (Ayres & Braithwaite, 1991;

Schwarcz, 2013; Potter, Olejarski, & Pfister, 2014). Regulators, who do have the statutory authority to enforce their rules but are resorting to lax penalties for market participants, may either be captured by the very members they are regulating, or alternatively, if capture does not exist, are protecting their members from harsher penalties (Carpenter, 2010; Etzioni, 2009).

The Problem of Regulatory Capture

Regulatory capture stems from the premise that regulators' behaviours can be influenced and not all groups have equal opportunities to influence their behaviours. For some, capture regulation will be stronger by imposing rigid entry barriers into the market (Stigler, 1975). Entry limiting regulation resonates with large firms, many of whom may be primed to limit entry and prevent market access to their competitors (Carpenter, 2013, p. 153). Capture then occurs when large firms push the regulatory process in a weaker direction, not by reducing market entry, but with the aim of reducing the effect of costly rules and their antecedent's enforcement actions on firms (p. 153).

While capture is achieved in many ways, the objective here is to explore the assertion that our current regulatory structures are already too amenable and flexible to regulated communities (see Etzioni, 2012). What we have seen with regulators of late, is that when the interest of the public clashes with the interests of their members, regulators usually put their members first (Etzioni, 2009; Dal Bó, 2006). Their responsibilities to the public gets downplayed or eliminated, with no safeguard in place to prevent regulatory capture from happening (Rosen & Rosen, 2010; Carpenter, 2013). The argument that regulators get morphed into serving their members may be attributed to them being more interested in protecting the reputation of their respective industry, rather

than the public interest (Schwarcz, 2013). The close connection between regulators and industry professionals puts pressure on them to function in the best interest of their members and the industry, rather than the public (Carpenter, 2010; Etzioni, 2009, 2012).

Regulatory agencies are perhaps in a better position to focus their expertise and accommodate industry diversity, but also more likely to lead to “capture” by the discrete industry group from which their staff are drawn and to which they may return after their service (SEC Division of Investment Management 2011, p. 33). Inherent in this argument is that regulatory staff may expect to be employed by the more affluent firms that they regulate after their stint as regulators (see Carpenter, 2010; Schwarcz, 2014). This concern is particularly applicable to SROs, because they are not only funded by the industry that they oversee, but may also include industry representatives in their governance structure or otherwise have a different relationship with industry than an independent government regulatory agency (SEC Division of Investment Management 2011, p. 33). The inherent relationship between SROs and the industry could work to enhance susceptibility to industry capture (p. 33). All of these factors invite questions about due process and SROs’ governance. Together they work to reduce the incentive to impose adequate penalties on firms who circumvent regulations (Etzioni, 2012; Schwarcz, 2012).

IIROC’s Enforcement

IIROC’s Weak Enforcement with no Compliance Impact

Anecdotal evidence posits that IIROC is very reluctant to go after the big banks and brokerage firms that it monitors (also see Lokanan, 2014a, 2014b). Given the burden of evidence to prove a case against one of the bigger firms (along with their team of high

powered attorneys), it could very well be that the cases against the larger firms may be much more difficult to prove in a court of law (Williams, 2012, p. 101). Hence, IIROC may tread carefully and choose a more conservative approach to pursuing cases as the cost of getting it wrong is pretty high (p. 101). Then there is the alternative argument of regulatory capture – which argues that IIROC and the other Canadian SROs (in this case the MFDA and the Autorité des marchés financiers (AMF) in Quebec) are routinely captured to serve the interests of their members (i.e., brokerage firms and investment arms of banks and their registered employees) who are supposed to be regulated by them or by regulators (many of whom were former banks employees) who write these regulation (Rosen & Rosen, 2010; Lokanan, 2014a, 2014b). Regulation capture serves the interest of these groups rather than the public interest (Etzioni, 2009, p. 319). Regulatory capture often takes place through weak enforcement (Carpenter, 2010, 2010; Etzioni, 2009).

The results from IIROC’s enforcement reports provide an illustrative example of regulation through amenable and flexible regulation.

Table 1 Regulatory Violations Prosecuted by IIROC for Individual Registrants

Types of Violations	2103		2012		2011		2010		2009	
	N	Percent								
Due Diligence/Suitability	19	29%	26	28%	20	23%	15	18%	12	30%
In appropriate financil dealings	7	11%	10	11%	9	10%	10	12%	5	13%
Misappropriation	3	5%	8	9%	5	6%	2	2%	2	5%
Misrepresentation	3	8%	9	10%	5	6%	9	11%	3	8%
Discretionary trading	5	5%	6	6%	5	6%	4	5%	0	0%
Forgery	3	5%	6	6%	2	2%	4	5%	1	3%
Unauthorized trading	1	2%	6	6%	7	8%	5	6%	0	0%
Manipulation	3	5%	4	4%	9	10%	2	2%	0	0%
Outside business activities	4	6%	4	4%	2	2%	1	1%	0	0%
Supervision	4	6%	4	4%	5	6%	2	2%	4	10%
Gatekeeper	2	3%	3	3%	5	6%	6	7%	4	10%
Fail to cooperate	3	5%	2	2%	7	8%	7	8%	4	10%
Trading conflict of interest	0	0%	2	2%	0	0%	4	5%	0	0%
Off book transactions	5	8%	1	1%	3	3%	6	7%	2	5%
Trading order violation	0	0%	1	1%	2	2%	0	0%	0	0%
Trading without registration	1	2%	1	1%	2	2%	3	4%	1	3%
Fraud	2	3%	0	0%	0	0%	1	1%	0	0%
Undisclosed conflict of interest	0	0%	0	0%	0	0%	2	2%	2	5%
Total	65	100%	93	100%	88	100%	83	100%	40	100%

Source: IIROC's (2013). "Enforcement Report," page 27.

According to its annual enforcement report, IIROC oversees about 200 Dealer Members and 29,000 investment advisors across Canada (IIROC, 2013). One yardstick to measure IIROC's success in policing its members is to look at its enforcement activities. As can be seen in Table 1, over 50% of all complaints brought against individual registrants from 2009 to 2013, related to suitability violations, inappropriate financial dealings, misrepresentations, and misappropriation of funds.

Table 2: Regulatory Violations Prosecuted by IIROC for Dealer Members

Type of Violation	Firms									
	2013		2012		2011		2010		2009	
	N	Percent	N	Percent	N	Percent	N	Percent	N	Percent
Supervision	5	42%	10	50%	9	36%	2	33%	6	38%
Expedited hearing - Firms winding dow	1	8%	3	15%	0	0%	0	0%	0	0%
Failure to handle clients accounts	0	0%	2	10%	2	8%	1	17%	0	0%
Failure to meet best price obligations	0	0%	2	10%	3	12%	2	33%	0	0%
Inadequate books and records	0	0%	1	5%	4	16%	0	0%	0	0%
Internal controls	2	17%	2	10%	3	12%	1	17%	3	19%
Capital deficiency	4	33%	0	0%	4	16%	0	0%	7	44%
Total	12	100%	20	100%	25	100%	6	100%	16	100%

source: IIROC's (2013). "Enforcement Report," page 27.

Enforcement work pertaining to Dealer Members revolved around familiar themes from previous years. As can be seen in Table 2, Failure to Supervise (brokers for marketing and selling nontraditional investments) made up more than one-third of all of the violations committed by Dealer Members.

Table 3 Fines, Costs, Disgorgement and other Non-Monetary Penalties Imposed on Individual Offenders

Sanction Imposed by IIROC's Hearing Panel on Individual Offenders									
Year	Monetary Penalties				Non-monetary Penalties				Total non-monetary penalties
	Decisions	Fines	Costs	Disgorgement	Suspension	Permanent bar	Warning letter	Conditions	
2009	28	\$ 1,535,000	\$ 422,178	\$ 29,076	8	7	8	16	
2010	45	\$ 2,704,853	\$ 536,500		17	17	17	15	
2011	58	\$ 6,413,129	\$ 815,050	\$ 627,039	19	11	5	25	
2012	56	\$ 9,770,355	\$ 623,167	\$ 142,189	34	9	18	20	
2013	45	\$ 4,382,500	\$ 655,454	\$ 220,117	25	8	5	23	
Total	232	\$ 24,805,837	\$ 3,052,349	\$ 1,018,421	103	52	53	99	307
Percentage of Non-Monetary Penalties					34%	17%	17%	32%	100%

Source: IIROC's (2013). "Enforcement Report," page 28.

Table 3 and 4 shows the penalties imposed on individual registrants and Dealer Members. On average, IIROC's hearing panels heard about 46 cases involving individual registrants per year. The average fines imposed on individual registrants per year was \$4,961, 167. When one does the math, this translates to about \$107,851 in fines levied per decision. The same logic applies to Dealer members. On average, IIROC heard about 13 cases per year and imposed average fines of about \$598, 987. When the \$32,530,000 in fines levied for the market-timing offences and the mis-selling of Asset Backed Commercial Papers (ABCPs) for 2009 are excluded, the average fines for Dealer members decreases to \$492, 628. How can one comprehend these numbers when the maximum amount of fines per contravention for individual registrants and Dealer

Members are \$1 million and \$5 million respectively? Is the investment public made to believe that the offences were not serious enough to warrant higher fines? When one takes a closer look at Table 1, more that 65% or close to two-thirds of the offences committed by individual registrants (i.e., suitability, inappropriate financial dealing, misappropriation of funds, discretionary trading, forgery, unauthorized trading, market manipulation, and fraud) can be classified as serious in nature. It is evident from the findings that IIROC rarely imposed larger fines. Perhaps the close relationship between IIROC and the industry allowed enforcement officers to be captured by market participants and levy fines that were not proportionate to the offence (e.g., see Etzioni, 2012).

More perplexing is that close to one-half of the non-monetary sanctions (i.e., warning letters and terms and conditions) imposed on registrants were on the lighter side of the penalty structure. IIROC seems to rely on more compliance oriented penalties to deal with the offences committed by individual registrants and Dealer Members. The more serious non-monetary penalty (i.e., permanent bans) only accounted for 17% of enforcement activities. This would suggest that IIROC failed to use its full enforcement strength to regulate its members. In summary, it would appear that the more severe sanctions were used only occasionally, while intermediate sanctions occupied a larger share of IIROC's enforcement activities.

Table 4 Fines, Costs, Disgorgement and other Non-Monetary Penalties Imposed on Dealer Members

Sanction Imposed by IIROC's Hearing Panel on Dealer Members								
		Monetary Penalties			Non-monetary Penalties			
Year	Decision s	Fines	Costs	Disgorge ment	Suspension	Termin ation	Warn ing letter	Total non-monetary penalties
2009	15	\$ 32,530,000	\$ 369,853		4	1	6	
2010	6	\$ 1,297,500	\$ 369,853		1		2	
2011	18	\$ 1,525,000	\$ 162,000	\$ 1,768	1	2	1	
2012	16	\$ 1,361,667	\$ 259,333		4		1	
2013	12	\$ 2,220,000	\$ 100,000	\$ 310,000	3	2	2	
Total	67	\$ 38,934,167	\$1,261,039	\$ 1,768	13	5	12	30
Percentage of non-monetary penalties					43%	17%	40%	100%

Source: IIROC's (2013). "Enforcement Report, " page 28

This enforcement strategy leads to criticisms of IIROC as an ineffective and lax regulator (FAIR Canada, 2011a; 2011b). Central to these criticisms is that penalties imposed by IIROC are often not proportionate to the offences, resulting in there not being any deterrent effect (FAIR Canada, 2011a, p. 27). Given the nature of the offences, penalties such as warning letters, terms and conditions, and limited suspensions are seen as nothing more than a regulatory wrist-slap (Lokanan, 2014b). With the exception of Dealer Members (and the proportion of permanent suspensions imposed), IIROC seldom imposes harsher sanctions, thereby attenuating its reputation and rendering ineffective its effort to regulate in the public interest (also see Etzioni, 2009). The availability of rules and penalties are important not so much for their deterrent effect, but because of their moral impact in legitimating the substantive content of the message (Parker, 2006, p. 617).

Lack of Legitimacy Leading to Emasculation

When special interest groups are unable to persuade regulators to dilute the regulations that restrict their behaviours, they affect the regulatory regime by playing regulators against one another (Etzioni, 2009). Nowhere is this behaviour more evident than in the current regulatory structure in which IIROC operates. As mentioned earlier, IIROC is embedded in a maze of regulation where it depends on the Commissions and IMET to successfully execute its mandate. The Commissions and IMET are distinguished by their enormous power: the Commissions to revoke licenses and enforce fines levied on market participants; and, the power of IMET to pursue criminal convictions. As core members of Canada's securities regulatory landscape, the Commissions and IMET almost never use their powers (see Williams, 2012, 2013; Lokanan, 2014b).

IIROC's inability to escalate sanctions to more serious penalties, arguably, could be a direct result of the Commissions and IMET's failure to wield their powers and cooperate with IIROC's mandate. Given the degree of overlap in the regulatory system and the need for cooperation to secure compliance, a frequent complaint by IIROC is that the Commissions are prone to step on its turf and assume control of cases that are rightfully in its jurisdiction (Williams, 2012, p. 75). Of course, these cases will only be shifted to the Commissions (who are noted for being flexible regulators) upon the requests of the market participants (Marquis, 2009). One would assume that there is some collegiality in the "enforcement mosaic," but as the following reveals, there does not seem to be any (Bhattacharya, 2006). The possibility of the Commissions stepping in to take over cases is highlighted by one of IIROC's regulators:

We have got personal experience with that where very interesting cases come up and we were in the process of doing something and inform them because there's

going to be a piece of it that's coming to them, and it's just taken. And nothing's happened (interviewee's response, as cited in Williams, 2012, p. 75).

The move to step on IIROC's turf and adopt a non-cooperative stance toward compliance goals has critical implications. Most profound among these, is the limiting effect that the turf war has for IIROC as a regulator. IIROC is dependent upon the Commissions to act as a "benign big gun" and address cases where registrants refuse to comply (see Ayres & Braithwaite, 1992). However, the inter-agency conflict between the Commissions and IIROC, and the former's reluctance to cooperate in the regulatory mix, contributes to IIROC's failure to secure compliance in some of the more serious cases of transgression.

Neither IIROC nor the Commissions have the legislative authority to pursue criminal prosecutions. Ordinarily, individual registrants and Dealer Members who are involved in cases with provisions that may under normal circumstances be enforced by criminal prosecution, and failed to comply despite cooperative efforts, will have their cases forwarded to the police. However, there is evidence to suggest that the police in general and IMET in particular, are not at all interested in taking on cases from IIROC. Exactly the kinds of cases that IIROC is castigated for in failing to secure compliance. As one securities fraud lawyer noted,

one of the most common complaints directed by regulators towards IMET is their unwillingness to take on smaller files with clear criminal overtones: 'IMET don't touch anything unless it involves multi-millions of dollars whereas the small frauds, they don't have time for'" (interviewee's response, as cited in Williams, 2012, p. 72).

Perhaps this is because the cases typically referred by IIROC for criminal or quasi-criminal charges tend to involve fairly small, marginal players who have proven unresponsive to previous disciplinary measures. These types of charges are rarely if ever contemplated for the larger, mainstream players engaging in what are arguably more

damaging activities (e.g. unsuitable investment advice), not because the Commissions and IMET are unwilling to take them on but rather because these are viewed by IIROC itself as non-criminal matters. Consequently, it may very well be the case that IIROC is a lax regulator; however, this is not necessarily reducible to the failure of the Commissions and IMET to pursue criminal charges at the agency's behest.

In the absence of support from the Commissions and IMET, IIROC's other option is to enforce the law "softly" and therefore ineffectively (FAIR Canada, 2011a, Lokanan, 2014b). Generally, this means that IIROC is pigeonholed into a position where it is pursuing just enough enforcement to satisfy the requirement of its governance mandate, but not necessary to prevent investment fraud. Following from this, the more accurate conclusion would thus be that IIROC may be ineffective because it is unable to address the more serious and systemic industry problems, not because of its failure to regulate in the public interest. Adopting this course of action results in IIROC being forced to address cases that should have been given harsher sanctions with more compliance oriented strategies. Responsive regulation takes into account this problem and is positioned to envision a framework that stresses the importance of this distinct challenge that regulators face in the regulatory process (Ford, 2013). In thinking about how responsive regulation can work within an inter-agency framework in the financial sector, the question may be the degree to which it can tackle the problem of inter-agency conflict and collaboration.

The Theoretical Take on Interagency Relations

What is seen as interagency collaboration is a matter of function. The term collaboration in itself has been used interchangeably to mean co-operating, networking,

mutual agreement and partnership (Sussman, 2000; Gray, 1989, 2002). This paper uses the term collaboration, first, in the sense that government administrators use it: as a technique to foster cooperation between agencies or between professionals from various agencies that are intended to promote the public interest, better than any one agency or professional can do alone (Bardach, 1998; Kaiser, 2011). A provisional definition of collaboration in regulation would be that it is a framework designed to reduce policy fragmentation and mitigate competition among agencies in order to enhance their efficiency and effectiveness in environments that are often characterized by greater levels of logistical complexity, shared responsibilities and overlapping jurisdictions (e.g., see Kaiser, 2011; Ford, 2012).

Interagency collaboration is one of the central challenges of modern governance. Cases and issues that belong to multiple jurisdictions are often caught between different systems that may not understand the need for collaboration and perhaps more importantly, may not know how to collaborate (Williams, 2012). Gray (1989) argues that under certain conditions, agencies may not see it fit or be willing to work in partnership. This inability to cooperate and share resources results in interagency conflicts or what is often characterized as “turf battles” (Kaiser, 2011, p. 17). Interagency conflicts occur for a variety of reasons. Among them are situations where power imbalances exist between agencies, which can make it difficult to reach a consensus on how to resolve existing problems (Torjman, 1999). Power differentials are usually confounded by personal rivalries among officials from representative agencies (Kaiser, 2011, p. 17). Officials’ ideological differences (Gibbs, 1999) and changes in political environment (Bardach, 1989) also works to perpetuate interagency conflicts.

Perhaps a more serious impediment to interagency collaboration concerns issues related to funding and resources (Kaiser, 2011). These issues can include conflicts over funding within and between agencies; a general lack of funding for multi-agency work around procedural issues and costs associated with service delivery (Cheminais, 2009, p. 27). Even when there is adequate funding, conflicts usually arise over ownership of the activity. Disagreement over ownership of the activity or which agency should be expensed for the appropriated activity results in organizational differences that impede collaboration (Laurent, 2009, p. 4). The lack of flexibility in funding streams limits the ability of agencies to ‘braid’ sources together to finance interagency/inter-program initiatives (Patti et al., 2003: 10). Unless cost saving measures is put in place, inter-organizational partnership can represent significant costs to participating partners (Stokes & Tyler, 1997, p. 19; also see Bardach, 1989). The resulting effects of these are the “failure of or limitation of interagency cooperation” (Kaiser, 2011, p. 17). There is no doubt that the advantage of multiple regulators is stronger oversight, but interagency conflict is a problem and firms are known to shop around for flexible regulators who make decisions in their favour.

It is possible however, to discern the conditions and mechanisms that will enhance the likelihood of successful collaboration between agencies that have shared responsibilities and overlapping jurisdictions. Gray (1989) identified certain measures that must be undertaken before consensual decision-making between organizations can be implemented. These include the need for collaboration in which the stakeholders involved, actively seek out a mutually determined solution to their problem, being adaptive and accommodating to different organizational interests and enabling

collaborative designs for solving shared problems. Prefontaine et al. (2000) further Gray's (1989) work and opined that successful collaboration requires as a precondition two key factors: coordination and compliance with government interests and the sharing of resources and expertise to carry out their mandate as a coordinated body. Others explore the difference between interagency success and failure (Mattessich, Murray-Close, & Monsey, 2001; Gray, 2002). Mattessich et al. (2001) specified twenty factors that have been proven to influence collaboration between agencies with overlapping jurisdiction. Central to these factors were the notion of shared visions and interagency collaborative arrangements intended to enhance cooperation between the participants. Others have touted efficient, accountable, transparent and standardized structures as integral mechanisms to facilitate interagency collaboration (Sussman, 2000). These mechanisms are particularly useful for organizations with diverse obligations and overlapping jurisdiction.

Responsive Regulation within an Interagency Framework

The empirical illustration shows how IIROC's command-and-control enforcement strategy fails in an interagency context. The interagency problems between IIROC, IMET and the Commissions, foster values and norms that hinder compliance. A regulatory framework anchored with the fundamental features of responsive regulation can assist these agencies to transcend their interagency problems and foster collaboration. Far from the existing current regulatory fragmentation (Bhattacharya, 2006), a more profound interagency collaboration can be developed that will take the jurisdictional scope of the Commissions, IMET, and IIROC into account and develop a more responsive framework that will nip non-compliance in the bud, and negotiate and persuade registrants to return

to compliance (see Kindsford-Smith, 2011, p. 734). Because the Commissions and IMET are equipped with the legislative power to impose harsher penalties, they can act as “benign big guns” to IIROC (see Ayres & Braithwaite, 1992). The principle here is to project IIROC as a regulator with invincibility and teeth that has the power to escalate sanctions to more punitive penalties for non-compliance. To break this down, a more relational agreement is created where IIROC’s enforcement duties are complemented by both the Commissions and IMET, who have the legislative power to take action on cases deemed contrary to the public interest from the SROs (Williams, 2012, p. 63).

As seen in Table 1 above, IMETs’ inability to deal with criminal or quasi-criminal charges meant that IIROC had to prosecute a significant proportion of these violations. A responsive regulatory framework underpinned by restorative justice values will respond to these interagency conflicts with a minimum level of intervention (Braithwaite, 2008). The presence of the Commissions and IMET, projects power, i.e., can use a big stick and simultaneously, compel IIROC to “speak softly” to market participants while having a credible threat of more severe sanctions up the pyramid. So instead of cultivating an expectation that the more serious cases will be sent to the Commissions and IMET, a relational agreement is made between the latter two regulators and IIROC, and thereby promoting interagency collaboration. Securities violation is now more streamlined. Whereas before, the Commissions and IMET were bombarded with cases from IIROC, regulating responsively meant that they only received the minority of recalcitrant cases where the registrants have decided not to comply. Securities governance is hinged on a regulatory collaboration that will enable IIROC to regulate by using the “carrot” to open the regulatory barn door at the base of the pyramid, and close it with the “stick” wielding

“benign big guns” at the tip of the pyramid (e.g., see Ayres & Braithwaite, 1992). Much like the regulatory relationship between the SEC and FINRA in the U.S., this strategy demonstrates that even with the imperfect arsenal that IIROC has at its disposal in imposing sanctions and collecting fines, it still has the power to rule with a “big stick” when the situation arises.

For those familiar with the application of the general theory of responsive regulation, the compliance strategy is one that best reflects the behaviour of the regulatees. When applied to IIROC, the enforcement pyramid works on the basis that most market participants (i.e., individual registrants and Dealer Members) would voluntarily comply with the rules and regulations governing their conduct. Many more can be regulated by way of persuasion in the context of cooperation, i.e., IIROC’s compliance officers giving advice when market participants are confused of the rules, rather than imposing a penalty (see Murphy, 2004; Ford, 2012). As can be seen in Figure 1, the cooperative and compliant market participants form the majority at the base of the pyramid. These are individual registrants and Dealer Members who are willing to comply with rules and regulations governing market practices. Here, IIROC’s compliance officers have an important role to play in supporting market participants to comply, by providing them with the tools such as seminars, guidelines, and other face-to-face services, on technical compliance matters. Investors’ protection is best achieved when IIROC’s compliance officers identify misconduct from the onset and deal with them proactively through dialogues with regulatees. The framework being proposed here provides an opportunity to develop this role further.

FIGURE 1

IIROC's compliance staff will not rely solely on investors' complaints to address potential problems, but takes a more proactive stance to review the operational, financial and trading compliance systems of investment dealers and address potential wrongdoing before investors or the markets are harmed. This strategy will allow IIROC to focus its efforts on market participants heading to the top of the pyramid and who engage in more risky behaviour. By focusing on those who do not comply, IIROC is in a position to leverage its resource to monitor compliance and create a more even playing field for market participants, while at the same time instilling public confidence in the market.

The lower middle layer of the pyramid is occupied by market participants who wish to be compliant, but might need more persuasion to comply. It is likely, however, that some individual registrants and Dealer Members within this layer, consider themselves to take advantage of the "grey" areas of the law and believe that they are being compliant (within their interpretations) of the law, even though they may be aware that their views are quite contentious (Freedman, 2011, p. 631). Where necessary, IIROC will send reminder letters, offer record-keeping visits, make special arrangements to assist Dealer Members who are experiencing financial or technical deficiencies, or assist in any other ways it can to conciliate the problem and facilitate early resolution. The assumption is that registrants and Dealer Members are rational, autonomous, and coherent actors who will comply given the opportunity to do so (Lee, 2008; Ford, 2013; Findlay, 2014). By offering assistance, IIROC also benefits because it can participate in regulatory design in order to implement legislation that is responsive to the needs of its members.

In the upper middle layer of the pyramid, are individual registrants and Dealer Members who are less responsive to particular compliance incentives. Where there are significant concerns about protecting the investing public, or the willingness of market participants to improve their behaviours (i.e., they do not want to comply with regulatory standards), a higher level of scrutiny and more powerful interventions in the form of investigations and inquiries are applied. Detecting non-compliance through intervention is intended to have a general deterrent effect by encouraging registrants to do the right thing and comply and deter those who do not (Ford, 2013, p. 13). Non-compliance is detected through analysing the books and trading activities of the Dealer Members and matching information reported to IIROC. Where possible, IIROC's compliance staff will be expected to collaborate with the Commissions, IMET and other third parties such as financial institutions, to obtain relevant information. The information will then be analysed to identify discrepancies and transgressions of IIROC's rules and regulations governing its members. In cases where non-compliance is detected, registrants will be given an opportunity (within a reasonable time frame) to rectify the problem.

In the minority of recalcitrant cases where the registrant refuses to comply, more punitive actions at the tip of the pyramid will be applied. Working in close collaboration with IMET and the Commissions, a range of strategies, including criminal persecution will be used to deal with registrants who are involved in market abuse and other serious conduct that are against the public interest. Since IIROC does not have the statutory authority to prosecute criminally, collaborative or integrative work with these agencies is critical to the success of IIROC's enforcement mandate. The purpose of working together is to improve the experience of investors who used joint services and depend on

regulators to regulate in the public interest (Gray, 2002; Kaiser, 2011; Carpenter, 2013). Having a commitment to integrated working across IMET, the Commissions and IIROC is integral to the imposition of adequate penalties for securities rule violations.

Conclusion

In the absence of support from the Commissions and IMET, IIROC's enforcement activities failed to have any serious compliance impact, and perhaps more importantly, have weakness trust upon its enforcement mandate (leading to emasculation). In line with this analytical posture, the evidence seems to suggest that under the adversarial regulatory state model, IIROC's failure to garner support from the other agencies led to "soft" enforcement (also see Kingsford-Smith, 2004; Parker, 2006). Effective enforcement requires regulators to use both compliance and deterrence oriented strategies to secure compliance (Braithwaite, 2013). Generally, this means that regulators should have a full range of sanctions, including the imposition of harsher penalties and criminal sanctions available to them for those who fail to comply. However, as was evident from the foregoing discussion, escalatory responses present specific challenges for IIROC, especially when there is a complex mix of regulatory agencies involved. IIROC's inability to deal with the more serious securities fraud cases is symptomatic of a much larger industry wide problem. It could very well be that IIROC and perhaps SROs that operate in the securities industry in general, are ineffective because they are not equipped (i.e., they do not have the political support as FINRA does in the U.S.) and is therefore unable to deal with the more serious cases of transgression. Taken together, these outcomes are representative of a much larger systemic industry wide problem.

It follows then that there is more mileage for IIROC to elicit compliance through responsive regulation. The application of responsive regulation within an inter-agency framework is an idea that has potential, providing it is done properly and not pushed too far. Ultimately, however, the question of whether or not IIROC can be a responsive regulator hinges on a closer examination of the agency itself, its ability to work in partnership with the Commissions and IMET, its regulatory will, and its willingness to utilize its own powers and sanctions in responding to breaches and escalating charges. Defection from cooperation is less likely to be an attractive proposition when individuals and entities faces an agency with an explicit enforcement pyramid of sanctions, rather than when confronted with a regulator with only one deterrence option (Ayres & Braithwaite, 1992, p. 36; also see Freedman, 2011; Ford, 2013). A more difficult task is to find the right mix, where regulatory compliance based on restorative principles can be aptly backed up by deterrent oriented strategies. Responsive regulation does just that. It allows regulators to rely on cooperation at the base of the pyramid, and more punitive measures for the minority of recalcitrant registrants at the top of the pyramid. The enforcement pyramid recognizes that responsive regulation, deterrence, and incapacitation are all theories of compliance that have their flaws. The pyramid accounts for this by “covering the weaknesses of one regulatory strategy with the strengths of another” (Braithwaite, 2003, p. 32).

By way of closing, I would like to reiterate that responsive regulation has always been a powerfully grounded theoretical idea, used to understand how regulation should be undertaken efficiently (Kingsford-Smith, 2011, p. 741; also see Nielsen, 2006; Ford, 2013). The challenge ahead is to build on this grounded theoretical approach and conduct

research to explore how responsive regulation might be applied to securities regulation in a broader continental or international context, and what incipient opportunities are there for responsive regulation to be introduced as a regulatory strategy within an interagency context. In particular, more qualitative research is needed in order to truly follow through on the ideas presented in this paper. There also needs to be more scholarly work on the reflection back from the field of securities regulation to general theories of regulation, including responsive regulation. For example, what does this area and the failures that occurred in 2007/08 tell us about why people comply or do not comply and what sorts of regulatory designs will work or not work? How can we criticize or develop existing theories of regulation to take account of what has happened empirically in this field? All these questions need systematic exploration. In order to be able to design regulatory strategies in the securities industry that are able to act responsively in the manner outlined by Ayres and Braithwaite (1992), there needs to be new immediacy on research that examines the unresolved questions outlined above.

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