2008 BCSECCOM 257

Hypo Alpe-Adria-Bank (Liechtenstein) AG

Section 161(1) of the *Securities Act*, RSBC 1996, c. 418

Hearing

Panel	Brent W. Aitken	Vice Chair
	John K. Graf	Commissioner
	Suzanne K. Wiltshire	Commissioner
Hearing dates	January 30 and February 26, 2008	
Final submissions filed	April 1, 2008	
Decision date	May 20, 2008	

Appearing

C. Paige Leggat	For the Executive Director
Gordon R. Johnson	For Hypo Alpe-Adria-Bank (Liechtenstein) AG

Decision

I Introduction

¶ 1 This is an application under section 161(1) of the *Securities Act*, RSBC 1996, c. 418 for an order prohibiting Hypo Alpe-Adria-Bank (Liechtenstein) AG permanently from trading in, or purchasing, any securities or exchange contracts in British Columbia.

¶ 2 On August 28, 2007 the executive director issued a notice of hearing and temporary order under sections 161(1) and (2) against Hypo (see *Hypo Alpe-Adria-Bank (Liechtenstein) AG* 2007 BCSECCOM 511). The temporary order prohibited Hypo from trading in, or purchasing, any securities or exchange contracts in British Columbia.

¶ 3 On September 14, 2007 a commission panel extended the temporary order until a hearing is held and a decision rendered (see *Hypo Alpe-Adria-Bank (Liechtenstein) AG* 2007 BCSECCOM 555) and on October 15, 2007 issued its reasons (see *Hypo Alpe-Adria-Bank (Liechtenstein) AG* 2007 BCSECCOM 622).

¶ 4 On December 19, 2007 the executive director issued an amended notice of hearing that:

- extends the allegations in the original notice of hearing to Hypo's trading through 11 British Columbia investment dealers where it held accounts
- alleges that some or all of the beneficial owners of the securities purchased and sold through the accounts may have manipulated the market, contrary to section 57 of the Act
- alleges that Hypo has failed to provide to commission staff the names and contact information of the beneficial owners, and as a result commission staff are unable to determine whether some or all of the beneficial owners have contravened the Act or acted contrary to the public interest

II Background

¶ 5 Hypo is a bank operating in Liechtenstein.

¶ 6 From November 1, 2006 to August 31, 2007, Hypo had accounts at 11 investment dealers registered in British Columbia: Blackmont Capital Inc., Canaccord Capital Corporation, First Canada Capital Partners Inc., Gateway Securities Inc., Golden Capital Securities Inc., Global Maxfin Capital Inc., Graydon Elliott Capital Corporation, Haywood Securities Inc., Research Capital Corporation, Union Securities Ltd., and Wolverton Securities Ltd.

¶ 7 During this 10-month period, Hypo traded through these accounts a total volume of about 463 million shares, representing about $165 million in value. Over 90% of this volume was in shares of issuers quoted on the US Over-the-Counter Bulletin Board or the Pink Sheets, representing about 82% of the total value of the shares traded. About 90% of the total volume was sales.

¶ 8 Some of the trades were in securities of issuers that were the subject of unsolicited promotional email, known as "spam".

¶ 9 In the course of investigating this trading activity, Commission staff has sought from Hypo and the Liechtenstein financial regulator the information necessary to identify the beneficial owners of the shares being traded in Hypo's accounts. Their inquiries started in July 2007 but they have been unsuccessful. Hypo says it has been constrained in providing information as a result of Liechtenstein's banking secrecy laws.

¶ 10 Although there is a procedure under that regime for disclosure to foreign regulators, it is lengthy and cumbersome and, in any event, does not appear to allow disclosure in these circumstances. In November 2007 the Liechtenstein regulator ordered Hypo to give commission staff the information it seeks but

Hypo appealed that order because, it says, commission staff's request was too broad, and complying with the order would have had adverse implications for its other clients. The court granted the appeal and suspended the regulator's order, finding that the empowering legislation limits the regulator's authority to order disclosure to cases where the securities have been traded on a regulated market in Europe (which would not include the OTC BB or the Pink Sheets). The court remanded the matter to the regulator for "a possible extension of the proceedings and a new ruling."

¶ 11 Apparently the legislation in question is to be amended to address this issue. In any event, it does not appear that commission staff will be getting the information it seeks any time soon.

¶ 12 Absent information about the beneficial owners of the accounts, the executive director says, commission staff are unable to investigate the trading they consider suspicious.

¶ 13 Hypo says that since the commission extended the temporary order, it has closed its accounts and no longer trades securities through dealers anywhere in Canada. The executive director says that if Hypo were to undertake to the commission not to trade securities in British Columbia (which would be enforceable under section 57.6 of the Act), it would withdraw this application. Hypo has not made that undertaking because, it says, it is concerned about its permanence. It says that if it or a successor entity were to wish to return to British Columbia years hence, it would be prevented from doing so by the undertaking.

III Analysis

¶ 14 The commission has a broad public interest mandate to protect investors and maintain confidence in our capital markets, a mandate that has found strong support in the courts. (See, for example: *Brosseau v Alberta Securities Commission*, [1989] 1 SCR 301; *Pezim v British Columbia (Superintendent of Brokers)*, [1994] 2 SCR 557 at 589; *British Columbia Securities Commission v Branch*, [1995] 2 SCR 3 at 26; *Global Securities Corp v British Columbia (Securities Commission)*, [2000] 1 SCR 494; *Committee for Equal Treatment of Asbestos Minority Shareholders v Ontario (Securities Commission)*,[2001] 2 SCR 132; *Re Cartaway Resources Corp*, [2004] 1 SCR 672.)

¶ 15 In considering whether it is in the public interest to make the order sought by the executive director in these circumstances, the commission must assess the risk to the capital markets. As observed by the panel that extended the temporary order:

> If that risk assessment is hampered because commission staff cannot obtain information on a timely basis about the trading of individuals

> whose identities are protected by foreign banking secrecy laws, the balance of interests must be tilted in favour of protecting our capital markets. Otherwise, persons intent on engaging in activities that would damage our capital markets could have a free pass simply by conducting their activities through the offices of a financial institution located in a jurisdiction with banking secrecy laws that suited their purposes. That would be an outcome inconsistent with the public interest.

¶ 16 We heard extensive evidence and submissions about whether or not a market manipulation contrary to section 57 may have occurred, how much of the impugned trading activity was associated with spam, and whether staff's assessment of what they consider to be suspicious trading is reasonable. In our opinion none of these issues is relevant.

¶ 17 Because the executive director has been unable to gather the evidence necessary for the investigation, there is no evidence that a manipulation has actually occurred. (In the amended notice of hearing, the executive director alleges only that a manipulation *may* have occurred.)

¶ 18 In any event, what is suspicious, and therefore worthy of investigation, is within the discretion of the executive director. So is the scope of that investigation. Unless it is established that the executive director has acted without jurisdiction or in bad faith, the commission has no reason to interfere in the executive director's exercise of discretion in connection with investigations.

¶ 19 Here, there is a reasonable basis for investigation. The high volume of sales from Hypo's accounts is a trading pattern that on its face appears consistent with patterns present in abusive trading schemes in the US over-the-counter markets. That the trading, in some cases, was contemporaneous with a spam campaign raises suspicion even further.

¶ 20 The commission has stated that trading abuses in the US over-the-counter markets conducted through British Columbia securities dealers damage the reputation of our capital markets (see BC Notice 2007/24 *BCSC Response to Abusive Practices in British Columbia Involving US Over-the-Counter Markets* published June 25, 2007). Damage to the reputation of our markets puts their integrity at risk.

¶ 21 Hypo says it would release the information required by the executive director were it able to do so under its domestic laws. We also heard submissions as to whether it was reasonable for Hypo to appeal the Liechtenstein regulator's order to release the information requested by commission staff. These issues are not relevant to our decision.

¶ 22 What is relevant is that commission staff has been unable to obtain the information required for their investigation on a timely basis. When, as in this case, commission staff encounter circumstances that, in their opinion appear suspicious, it is in the public interest that they are able to investigate, and to do so on a timely basis. The passage of time is often significantly damaging to an investigation. It is also potentially damaging to the markets, because, absent appropriate orders, the risk of continued misconduct continues until the investigation uncovers enough information to identify the parties and the nature of their conduct, or to conclude that further regulatory action is not required.

¶ 23 Hypo suggests that an appropriate approach might be for this commission to make some allowance for the standards of foreign jurisdictions in obtaining the information necessary for the investigation. This raises the question, "Should commission staff's usual investigation practices be restricted because the trading has been executed through a foreign financial institution subject to banking secrecy laws?"

¶ 24 The answer must be "no".

¶ 25 The banking secrecy laws of foreign jurisdictions cannot serve as a shield against the legitimate exercise by the commission of its powers to enforce securities regulation in British Columbia, as stated by the commission in *Stephen C. Sayre et al* [2000] 21 BCSC Weekly Summary 75 in language approved by the British Columbia Court of Appeal (see *Exchange Bank & Trust Inc. v. British Columbia Securities Commission*, 2000 BCCA 389 (QL) at paras. 14, 15; *Exchange Bank & Trust Inc. v. British Columbia Securities Commission*, 2000 BCCA 549 (QL)):

> [T]he property subject to the Orders is in British Columbia and it is the securities laws of British Columbia . . . that are alleged to have been contravened. [Exchange Bank and Trust] chose to locate assets outside the jurisdiction of Nevis and must accept that those assets are subject to laws of the jurisdiction in which they are located, in this case British Columbia. It would be an utter abandonment of the public interest if we were to conclude that a party subject to secrecy laws in another jurisdiction could use those laws to shield themselves from the legitimate exercise of powers to enforce securities regulation in British Columbia. In short, the Nevis privacy laws are not relevant.

¶ 26 What order, then (if any), is in the public interest in these circumstances?

¶ 27 The commission has the responsibility to protect investors and the integrity of our markets. In these circumstances, we have two options:

- allow the temporary order to lapse, and let the chips fall where they may while commission staff's request for information wends its way through the Liechtenstein legal process
- make the temporary order permanent – the only reasonable step available to us to protect the market in the face of the uncertainty associated with the suspicious trading in the Hypo accounts

¶ 28 Hypo says we should make no order and allow the temporary order to lapse, because

- there is no allegation that it was involved in any improper conduct or activity for its own account
- the order sought by the executive director will not advance the objective of learning the identities of the beneficial owners of the shares traded
- if those who were trading through Hypo's accounts were in fact doing so improperly, the likely effect of the temporary order is that they have moved on to another financial institution, probably in another jurisdiction, and so a permanent order will have no effect on them
- there is no need for an order because Hypo has ceased operations in Canada and closed its accounts here

¶ 29 We disagree. In our opinion it is in the public interest to make the order sought by the executive director.

¶ 30 There is no allegation that Hypo was involved in any improper conduct or activity for its own account. However, as observed by the panel that extended the temporary order, that is beside the point. Whether or not Hypo is guilty itself of wrongdoing, it has allowed itself to be used as a conduit for trading activity that the executive director considers suspicious. If its domestic regime prevents it from providing the executive director with the information necessary to investigate those who are associated with the suspicious trading, Hypo is the only entity against whom we can make orders that will be effective to address the potential risks to our markets arising from the trading by these individuals through Hypo. Indeed, the order sought is the only practical remedy available – Hypo, and the information staff seek, are outside British Columbia.

¶ 31 A permanent cease trade order will not assist in revealing the identities of the beneficial owners. However, we are faced with suspicious trading activity, and commission staff is unable to complete its investigation until it gets the information about the identities of the beneficial owners.

¶ 32 We cannot ignore the potential risk to our markets in these circumstances. Although making the order permanent may have limited effect because, as Hypo argues, the wrongdoers (if there are any) may well have moved on, it will at least forestall the use of Hypo as a conduit for any further suspicious trading.

¶ 33 Hypo argues that because it has decided to stop operating in Canada, there is no need for an order. Our responsibility is to make whatever order is necessary to ensure our markets are protected. Having determined that our markets are best protected by prohibiting Hypo from trading in them, the appropriate thing is not merely to rely on Hypo's statements of intention about its future conduct, but to make the order that will ensure the desired outcome.

IV Decision

¶ 34 Considering it to be in the public interest, we order that Hypo permanently cease trading in, and be prohibited from purchasing, any securities or exchange contracts.

¶ 35 May 20, 2008

¶ 36 **For the Commission**

Brent W. Aitken
Vice Chair

John K. Graf
Commissioner

Suzanne K. Wiltshire
Commissioner