PROTECTING INVESTORS IN JAMAICA: ARE CIVIL REMEDIES IN THE ENFORCEMENT OF SECURITIES REGULATION THE SOLUTION?

By
Sherika Ellis

Submitted to
Department of Public Policy
Central European University

In partial fulfilment of the requirements for the degree of Master of Arts in Public Policy

Supervisor: Professor Lajos Bokros

Budapest, Hungary
2014

Declaration of Authorship

I, the undersigned Sherika L.L. Ellis hereby declare that I am the sole author of this thesis. To the best of my knowledge this thesis contains no material previously published by any other person except where due acknowledgement has been made. This thesis contains no material which has been accepted as part of the requirements if any other academic degree or non-degree program, in English or in any other language.

This is a true copy of the thesis, including final revisions.

Date: June 10, 2014

Name (printed letters): Sherika L.L. Ellis

Signature: *Sherika L.L. Ellis*

ABSTRACT

From 2006, several unregistered financial organizations operating in breach of Jamaican securities laws infiltrated and realized exponential growth in the securities markets. Around the same time, licensed securities market participants also contravened securities laws. The Financial Services Commission ("FSC"), the non-banking regulatory agency, failed to significantly reduce investors' exposure to losses in its enforcement of securities market regulations. As a result, investors experienced losses amounting to billions of Jamaican Dollars. These losses impacted countries within the region as well as the USA.

Subsequently, in December 2013, there were amendments to the Jamaican securities laws, to introduce a broad range of civil and administrative remedies to be imposed on securities market participants engaging in illicit behaviour in the securities markets. But, why was the FSC enforcement programme not effective in investor protection? Was it the lack of sufficient remedies that caused losses to investors? To address these questions, this paper examines the FSC's enforcement practices to determine the factors that impacted investor protection.

Using a series of elite interviews complemented by desk based research and case studies the paper reports on the FSC's enforcement practices prior to the amendments and distils the factors inhibiting investor protection. I find that civil remedies can be effective for investor protection. However, I also find that investors receive the greatest protection when there are (1) clear policies and guideline for enforcement action (2) an effective monitoring framework (3) decisive management and (4) active enforcement of applicable laws to violations.

Key words: Securities regulation; enforcement; civil remedies; Jamaica; Financial Services Commission (FSC)

ACKNOWLEDGEMENTS

I would like to acknowledge the support of my supervisor, Professor Lajos Bokros, in undertaking research for this paper. I am grateful to the staff of the Financial Services Commission (FSC), Jamaica, who provided candid testimonies of work processes and enforcement practices at the FSC. I also express gratitude to my family for lost time that saw the completion of this paper and the fulfilment of the requirements for the Master of Arts in Public Policy. Finally, my gratitude goes to God for his continued blessings.

CONTENTS

INTRODUCTION

Background

In the aftermath of the 2008 financial crisis ("the crisis"), policymakers all over the world renewed their focus on enforcement in the markets for financial services. As such, it is an issue that is hotly debated in scholastic as well as policy circles. For example, in a report reacting to the crisis, the G-20 emphasized that effective enforcement is necessary to achieve "the objectives of the regulatory framework" (cited in Carvajal and Elliott, 2009). Largely, these discussions place focus on the normative responses for the banking industry. But, as research evidence suggests, securities market participants played an active role in "creating and transmitting systemic risk" (Technical Committee of the International Organization of Securities Commissions 2011) during the crisis. As a result, although limited in scope, a natural spinoff from the crisis is the focus on enforcement of securities market regulation.

The International Organization of Securities Commissions ("IOSCO") sets global standards for securities regulators and "promotes adherence to internationally recognized standards for securities regulation" (Ryder 2014). As IOSCO posits, "active enforcement of…rules is…necessary, as this clearly influences market participants' behaviour and can limit the development of risks" (Technical Committee of the International Organization of Securities Commissions 2011). In view of its role in the international financial markets, IOSCO identifies three objectives on which securities market regulation hinges. These include ensuring that markets are fair, efficient and transparent; the reduction of systemic risk; and **investor protection** (International Organization of Securities Commissions 2010, 3).

Since 2006, the Jamaican securities regulator, the Financial Services Commission ("FSC"), has experienced significant challenges in achieving the objective of investor protection. A series of illicit activities in the securities market caused investors in registered as well as unregistered

financial organizations ("UFOs") to lose billions from investments in Jamaican Dollars ("JMD"). This situation caused investors and other market participants to question the FSC's capability to fulfil the objective of investor protection and more generally, to doubt the FSC's regulatory authority in safeguarding the securities markets from these risks (See for example, Henry 2012). As a securities regulator and a member of IOSCO, the FSC operates on the principles and objectives developed and promulgated by IOSCO. Consequently, investor protection remains one of its primary objectives. For this paper, we adopt elements of the definition of investor protection cited in Castro, Clementi and MacDonald (2004): "the extent to which the… law and its enforcement protect investors from expropriation by company insiders." In other words, minimizing the loss of investors' funds.

Inter alia, in pursuit of its objective to protect investors, the FSC administers and enforces the provisions of the FSC Act and the Securities Act. With losses to investors and the backlash the FSC received, policymakers determined that these consequences arose because the FSC lacked sufficient enforcement powers to allow it to undertake its responsibilities to investors. This perception of the local reality finds support in Carvajal and Elliott's (2009) conclusion that a shared weakness across countries is the "lack of broad sanctioning powers" of securities regulators. Specifically, the paper cites Jamaica as only being able to impose a limited set of civil remedies (20). Furthermore, in a concept paper regarding the rise of UFOs in the Jamaican securities market, the authors note that there was a general "over-reliance on criminal proceedings to effect remedial actions for breaches of financial sector legislation…[as well as]…the absence of sufficient administrative and/or civil options…" (Financial Services Commission; Bank of Jamaica 2011).

In light of these circumstances and the FSC's observable failure to significantly minimize investors' exposure to losses, in December 2013, the Government of Jamaica embarked on initiatives to broaden the powers of the FSC by strengthening the legislative framework, particularly relating to the securities market. There have been amendments to the Securities Act to allow "the

FSC to investigate and impose administrative and civil remedies on unlawful financial organizations that engage in fraudulent and otherwise unlawful activities" (Ministry of Finance & Planning 2014). With the introduction of the amendments to the Securities law, the range of remedies and sanctions applicable to securities market violations are now more extensive. While the reforms are primarily aimed at UFOs, which permeated the Jamaican market for several years, the reach of sanctions also covers registered entities.

Before these legislative reforms, almost all breaches of the Securities Act were criminal and thus attracted criminal penalties. However, at present, the FSC may use civil remedies to address almost all violations. The changes in the legislative framework is meant to rectify apparent deficiencies in the law, which failed to provide restoration of losses to investors. While the implementation of these remedies is still in its embryonic stage and has not had an opportunity to be tested, the FSC is still making efforts to increase the protection offered to investors in the securities market. As such, it has undertaken other legislative reforms with specific focus on its enforcement framework, including amendments to the FSC Act.

Prior to December 2013, the sanctions applicable to breaches of the Securities law were provided under section 69 (1B) of the Securities Act as well as the third and fourth schedules of the FSC Act and included the execution of search warrants; undertakings; directions; written warnings; cease and desist orders; temporary management; winding-up; referral of matters to the Office of the Director of Public Prosecution ("DPP"); requiring the removal of directors; suspension of licenses; termination of licenses; cancellation of registrations; offering fixed penalties and; instituting civil proceedings in its own name or on behalf of another person. Of these tools, those applicable to UFOs were only the execution of search warrants and CDOs. Now, with the amendments to the Securities Act by section 68(A), the penalties now include the FSC taking action on behalf of investors, including seeking restitution or compensation; civil monetary penalties; restraint orders; settlement (an alternative to prosecution); disgorgement (where profits from illegal

acts are paid to the persons affected); restraint orders to freeze assets; barring professionals from practicing before the FSC and; making public statements.

A major problem arising from the collapse of the UFOs and the failure of registered companies were the enormous losses suffered by investors. According to estimates, the UFOs cost Jamaica between 15 and 25 percent of its GDP (Luton 2013) while losses to investors in a single registered entity were in billions of JMD (Henry 2012). As a result, there are high aspirations for the potential uses of civil remedies in addressing the securities market problems and in enhancing investor protection. So, there will be heavy reliance on the possible deterrent and combative effect of civil remedies for potential and actual perpetrators of securities market crimes.

While legislative reforms may be crucial in resolving the issues surrounding investor protection in Jamaica, there is limited literature on enforcement of securities regulation in the Jamaican market. There is even less related to the use of civil remedies in developing countries. Research in this area tends to focus on the more developed markets such as Australia, the USA or other more sophisticated securities markets (Welsh 2009; IP33 2012; Savarese and Carlin 2014). Civil remedies are in its infancy in Jamaica, but as Savarese and Carlin (2014) notes, there is a growing trend in the use of civil enforcement powers. The article indicated that prosecutors had "aggresively expanded" the use of civil enforcement powers in relation to financial services firms even when firms culpable of misconduct had made amends in other ways. Furthermore, the authors suggest that utilizing remedies available through civil enforcement has proven advantageous to prosecutors because of the broad powers and settlement leverages it offers. Firstly, the cases are easier to win because there is a lower burden of proof on the state; and secondly, it affords flexibility because a civil action can be converted into a criminal enforcement matter, if desirable.

Securities market crimes from developing countries easily export into other markets. As we will see later, Jamaica is a prominent case. In spite of this, research on the enforcement

programmes of securities regulators in developing countries is sparse. Yet, developing countries primarily suffer from weak institutions (Malcolm, et al. 2009, 66) and regulatory framework to tackle securities market problems. With risks of market contagion - the inter-jurisdictional impacts from financial crimes that infiltrate markets beyond its originating borders - as well as the international trend to converge regulatory practices, the area provides a fertile field for study. Moreover, research in this area is especially significant in light of the fact that remedies that may be suitable in one jurisdiction may not necessarily find ease of transplantation into another, especially when the destination jurisdiction is one classified as less developed. In that, institutions, culture and judicial frameworks differ.

Contribution

As Chen, et al. (2011) argues, in comparison with the more advanced countries, [developing] countries' regulators possess "relatively limited powers of punishment" for market violations (12). For example, many developed countries are empowered to impose civil sanctions as a securities enforcement remedy while developing countries securities regulators may not necessarily be empowered to do so. Given this differential in powers, the efficacy of enforcement remedies in securities regulation is of current relevance to public policy debates. The Caribbean region, which includes Jamaica suffers from the reputation of having poor regulation and enforcement in the securities markets (Luton 2013). This provides good reason to explore this topic with specific reference to a country in the region.

In the last seven years, the FSC experienced several failures despite its attempts to minimize investors' losses. One explanation is the lack of available remedies to combat securities market crimes. Given the lack of confidence in the Jamaican securities markets and the recent expansion of civil remedies in the FSC's quiver of tools, it is both useful and timely to assess whether or not the expected benefits can be materialized.

By honing in on civil remedies as a measure of effectiveness for enforcement programs, this paper will serve as a practical input for regulatory policy in respect to enforcement, especially for developing countries with similar problems and characteristics as Jamaica. Therefore, this thesis will contribute to the literature relating to the efficacy of civil remedies in realizing the objective of investor protection with a specific focus on their suitability in developing countries with weak institutions. Enforcement of financial regulation is a mainstay in protecting the global marketplace. So, the thesis is expected to have broad application. My research will provide invaluable insights for improved policies to counter the negative realities in the sphere of enforcement within a developing country as well as the adequacy of civil remedies in improving investor protection.

Research Aims and Objectives

With the anticipated benefits of civil remedies for the FSC, the research aims to describe the FSC's enforcement practices and explain the underlying factors that impeded investor protection. It thus aims to ventilate the areas that policymakers should focus on and to ultimately provide inputs into regulatory policy in Jamaica and the region. In so doing, policymakers may have greater insights into building the reputation of the region as a safe place for investing.

The researcher is interested in finding out whether or not civil remedies in the enforcement of securities regulation can lead to enhanced investor protection in Jamaica. In other words, it explores and provide answers to the questions: Why was the FSC enforcement programme not the most effective for investor protection? Was it the lack of sufficient remedies that caused investors to suffer losses? More specifically, it teases out those factors within the FSC enforcement program that impacts investor protection.

Therefore, the objectives of the thesis are to examine how the FSC carries out enforcement action against breaches of securities regulations and to determine the key factors preventing the FSC from achieving greater investor protection. In iteration, the paper identifies and examines the factors within the FSC's enforcement program that affected investor protection in order to

determine if civil remedies is a worthwhile solution. The paper will critically assess whether or not civil remedies can help to mitigate the perceived gaps.

Summary of Chapters

The thesis relates to the FSC's enforcement practices in the securities market before the legislative amendments. I zero in on the FSC's response to non-compliance and the resultant effects of those activities. I show that while civil remedies may be useful in Jamaica, several other factors are also important in achieving maximum investor protection, including quick and decisive action in enforcement of regulations.

The paper is organized in the following way. Chapter 1 outlines the research design and describes the methodology applied, applicable frameworks and the case selection. Next, to situate this research and set the stage for the rest of the paper chapter 2 provides a literature review summarising and assessing existing debates in the scholarship relevant to the study. It reviews studies on enforcement, investor protection, and civil remedies. Chapter 3 presents specific problems in the Jamaican securities markets and the pre-reform results of enforcement action. It establishes the basis for the introduction of civil remedies in the FSC's enforcement programme, by giving an overview of the rise of UFOs as well as licensee failures in the securities markets with an indication of investors' losses. I also provide the empirical results of the FSC's enforcement practices, with a discussion of the factors that affects the FSC's objective of investor protection. The chapter documents the results of interviews with FSC personnel, outlining any factors that inhibited enforcement activity and or any perceived obstacles to investor protection. I synthesise the empirical results with the secondary data gathered and provide explanations of the influences on investor protection specifically indicating the role of civil remedies.

The last section concludes with the finding that civil remedies, albeit useful, must be supplemented with other enforcement practices including (1) clear policies and guideline for

enforcement action (2) an effective monitoring framework (3) decisive management and (4) active enforcement of applicable laws to violations. It also explains why the consequence of civil remedies on investor protection is highly dependent on factors identified, a failure of which reduces the efficacy of civil remedies in protecting investors. The section will also explain that while civil remedies are useful and bolsters investor protection, it cannot be undertaken in a vacuum because it is only as good as the compliance monitoring programme that the securities regulator engages in, the speed at which the regulator takes action as well as how serious the regulator is perceived to be in the eyes of the regulated industry.

CHAPTER I

RESEARCH DESIGN & METHODOLOGY

Design and Theoretical Framework

To address the research questions posed in this paper, the writer undertakes a descriptive as well as an explanatory research using qualitative methodology. Where appropriate, the paper draws on IOSCO's principles for the enforcement of securities regulation, which, in part, gives effect to achieving the objective of investor protection. Globally, securities regulators are expected to abide by these (as well as other) principles in order to fulfil the overarching objectives of securities regulation so it helps to clarify our understanding of the most effective means of enforcing securities market regulation.

Case Selection, Methodology and Limitations

The rationale for selection of Jamaica lies in the exponential growth of UFOS in its securities market, the failure of registered entities and the spill-overs into neighbouring countries and into the USA, the largest and most significant financial market in the world (See for ex. Jackson 2012; Jamaica Gleaner 2008). In addition, in recent times, Jamaica is the first country in the Caribbean region to have introduced a wide range of civil remedies in the enforcement of securities market regulation. With the possibilities of the policy being diffused into neighbouring countries, it is an appropriate case for study.

The methodology for this thesis can be dissected into distinct parts. First, I engaged in desk-based research to survey existing literature relevant to the topic under study. Second, I conducted a research trip to Jamaica to conduct semi-structured interviews with staff of the FSC, including line managers and other senior staff members and to collect primary data included in the FSC's archives. From these, the researcher selected case studies of entities against which the FSC

has taken enforcement action in order to trace the process and to extract any weaknesses or practices that may have had an effect on investor protection.

In undertaking the study, I experienced certain limitations with respect to the chosen methodology. Literature on the use and effectiveness of civil remedies across jurisdiction and with specific reference to securities regulation was sparse. As a result, the research drew on the use of civil remedies in other areas of the social sciences related to criminal activity. However, the use of specific case studies were one means of which to overcome this problem. Using the case studies, I was able to determine from the enforcement practices, the applicability of civil remedies to investor protection.

I chose a single case study of a registered entity. Starting from when a breach is first identified, I trace the enforcement process in this case to determine at what stage the new remedies could be useful. Given the sensitive nature of information, I was cautious not to disclose the identity of the institution. The main challenge with this approach is that there were a limited number of cases from which to select. However, the selected study was useful because it included relevant actors and provided insights on the enforcement practices. I was able to assess the FSC practices leading up to enforcement action.

The empirical results of interviews were a useful source of primary data, which assisted the researcher to triangulate the results from the case study and make conclusions about enforcement decision-making and enforcement practices. Respondents came from a cross section of units engaged in the enforcement process[1]. While recommended by the Executive Director, to mitigate the issues associated with this type of selection, I reviewed the FSC's organizational chart to confirm that selected interviewees were the best candidates based on positions held.

[1] The results reflect the individual respondents' perception of the FSC's enforcement practices and is not an indication of the views of the FSC.

The interviewee selection was not completely random but the nature of the research and statutory requirement for confidentiality imposed on respondents precluded that type of randomness. Thus, selection was limited to more senior staff. The total number of interviews were four. These are General Counsel, Legal Services Research & Policy Division; Senior Director, Securities Division; Manager, Securities Division and; Senior Investigator Investigation & Enforcement Division.

CHAPTER II

LITERATURE REVIEW

In fulfilling the objective of investor protection, securities regulators experience a myriad of challenges. However, one of the key challenges lies in enforcement of securities regulation. As Carvajal and Elliott (2009) argues, not having certain enforcement capabilities may have dire consequences for an entire financial system. In that, "[s]ecurities are no longer secure when illicit behaviour is unchecked" (Marquis 2009). This deficiency in enforcement capabilities has had a severe impact on developing countries (Carvajal and Elliott 2009, 9) and one deficiency more pronounced in developing countries is the lack of civil remedies (Chen, et al. 2011).

The lack of civil remedies has resultant effects on the timeliness of enforcement action. Civil remedies allow securities regulator to bring standalone actions in its own right. Therefore, it makes the process more efficient. In addition, there is more flexibility for the regulator because civil enforcement requires a lower burden of proof. As a result, it strengthens deterrence efforts (White 2014). All together, these advantages enhance investor protection. However, while it may be useful to import policies utilized in developed jurisdictions as a means of bolstering their enforcement programme, are civil remedies the best mechanisms in developing country contexts? While acknowledging the insufficiency of powers in these countries, no one has examined the enforcement practices, with specific focus on the efficacy of civil remedies in the context of a developing country.

Carvajal and Elliott (2009) examined the challenges encountered by securities regulators in implementing an effective enforcement program. The paper reviews global enforcement practices of securities regulators and outlines ways in which different regulators handle the challenges that enforcement poses. Their findings suggest that the reliability of an enforcement program is proportionate to the probability of the consequences for non-compliance. Using illustrations from

several cases across jurisdictions, Carvajal and Elliott finds that enforcement is difficult because detection is slow in numerous instances, deterrence insufficient, and punishment delayed (11). In addition, "if enforcement is ineffective…the ability to achieve desired outcomes is undermined" (6). The study also advances the finding that the lack of enforcement powers is ubiquitous across the countries surveyed. However, the problem is even more prominent in developing countries.

Therefore, it would appear that developing countries are at the nadir of the framework of enforcement. To glean the efficacy of enforcement in a developed as opposed to a developing country, Malcolm, et al. (2009) assessed the differential impact of insider trading laws in developed countries relative to developing countries. The study found that enforcement has a greater impact in developing countries. In that, when enforcement is visible in the face of low credibility of laws, as is the case in developing countries, it makes a "measurable difference". The study found that the credibility of new laws can only be demonstrated through enforcement. In contrast, the study concluded that because developed countries already have a credible regime, enforcement has less of an impact in these countries. The study pointed to the fact that a failure to enforce securities laws may result in reduced credibility of the laws and hence an erosion of beneficial market outcomes.

A common response to enhancing enforcement capabilities is the introduction of civil remedies. Smith (1998) cites several studies (for example, Buerger and Mazerolle, 1998; Cheh, 199; Davis et al., 1991; Finn and Hylton, 1994…National Crime Prevention Council, 1996) that discusses the use of civil remedies to address criminal behaviour (67). Smith points to the fact that civil remedies are used as a means of changing a situation in which a crime is occurring rather than punishing a perpetrator when used in situational crime analysis (70).

In applying this concept to enforcement in securities regulation, civil remedies may be used by the regulator as a means of righting the wrong caused to persons aggrieved by market participants in the securities markets. Moreover, as Smith points out, civil remedies (ex. a

restraining order; cease and desist orders) is most useful when they are able to exert influence over behaviour in a way that criminal penalties (ex. a jail sentence) or non-coercive encouragement (voluntary submissions) may not be able to. Smith also delineates that the advantages civil penalties have over criminal include a lower burden of proof, it is speedier to apply, increased likelihood of application, can be imposed prior to the occurrence of serious harm, and may have threat of criminal penalties where, for example, an offender does not comply with the civil remedy.

This view is corroborated by White (2014), who notes that the U.S. Securities and Exchange Commission (USSEC), for example, has unique remedies in standalone cases to protect investors. She argues that in the civil proceedings, the USSEC is able to punish wrongdoing and send a stong message of deterrence against misconduct. Savarese and Carlin (2014) also finds that civil remedies in the US offers mutiple recoveries for the same harm and a pose a potentially large economic threat to institutions.

The enforcement remedies available to securities regulators varies widely across jurisdictions. In sum, it seems that integrating these broad remedial powers within the enforcement programme of a developing country's securities regulator can enhance the protection afforded to investors within these markets. However, it cannot be done in isolation as there are other mechanisms that must complement this initiative. As Marquis (2009, 6) argues, the objective of investor protection demands a "well-resourced, coherent and politically viable" enforcement regime. Furthermore, the findings from Carvajal and Elliott (2009) also demonstrate that in order for regulators to be a credible threat to securities market abusers, among other things, the probability of enforcement action must be real. As markets evolve, enforcement programs and policies must adapt to reflect changing circumstances because an effective securities regulator must be able to enforce the rules with which they are equipped (Marquis 2009). Developing markets face a significant challenge and literature in sparse in this area so this research aims to build that base.

CHAPTER III

FINDINGS AND DISCUSSION OF THE RESULTS

This chapter provides a summary of key information gathered as well as case studies from a compendium of internal documents that the researcher was allowed to access. It also documents and discusses the results of the elite interviews conducted. It summarises the salient points regarding the FSC's enforcement process as well as its weaknesses, and the outcomes from enforcement activity. The chapter culls out the issues arising from the manner in which the FSC carries out activities leading up to enforcement action, the obstacles to investor protection and any issues stemming from the lack of civil remedies.

Eventually, the chapter narrows into the areas of the enforcement process that require changes and thus increases understanding of any links between civil remedies and investor protection. Given the sensitive nature of the information and to preserve confidentiality, as appropriate, the researcher omitted specific names of companies that were the subject of enforcement action by the FSC.

Pre-Reform Results of FSC Enforcement Actions

From 2006, a number of self-styled investment clubs commenced operations and rose rapidly in the Jamaican securities market (Carvajal, Monroe, et al. 2009). From the perspective of the FSC, these were UFOs. The Caribbean Policy Institute estimated that there were 21 UFOs operating in Jamaica in 2008. But by 2010, the FSC's count was 63 (Luton 2013). Most UFOs offered unrealistically high returns on investments and operated "through a system of referrals by existing members" not dissimilar from a Ponzi scheme - a type of financial fraud which have the potential of wreaking havoc on the financial system (Carvajal, Monroe, et al. 2009).

According to research evidence, the negative effects of a UFO includes, among other things: (1) undermining confidence in financial markets; (2) causing socio-economic strife if a sufficiently large number of households are suddenly exposed to losses; and (4) undermining the reputation of political authorities, regulators, and law enforcers … (Carvajal, Monroe, et al. 2009). This research is mainly concerned with investors' exposure to losses.

Despite the fact that the UFOs and their principals acted in contravention of the Securities Act, the FSC failed to minimize investor exposure in the actions that it took against the unlawful entities. David Smith, principal of OLINT – a UFO promising unrealistically high returns to investors – was convicted in the United States. OLINT originated in Jamaica, and according to estimates, bilked more than US$220 million from over 6,000 investors. However, no criminal charges were proffered against him in Jamaica (The Gleaner 2013). Yet, he was convicted in the US and sentenced in the Turks and Caicos [a British colony]. Additionally, a case against Carlos Hill, principal of Cash Plus, another UFO, continues to drag out in the Jamaican Courts with no imminent action.

Around the same period, the FSC was also experiencing problems with several entities that were duly registered with the FSC. In that, they contravened securities laws. As will be explored in the following section, the records reflected the weak resolve of management in taking enforcement actions against the entities which continuously breached the Act. This also resulted in enormous losses to investors. In one company, claims submitted by investors were over JMD 3.6 billion (Thompson 2012).

Overview of the FSC's Enforcement Process

Before we can commence the analysis, an understanding of the enforcement process, as it is understood, is necessary.

Four functional units are primarily involved in the FSC's securities regulation enforcement machinery. The Securities Division ("Securities") is principally responsible for the monitoring and

supervision of licensed entities and undertakes technical analysis of data as required. This unit is customarily (though not always) the first source of information or identification of a breach. Once identified, the unit ought to refer the matter to the Investigation & Enforcement Division ("I&E"), which investigates alleged and/or suspected breaches and makes recommendations that leads to enforcement action. In a special audit or a temporary management, I&E also assists in the analysis of data.

It is expected that if Securities comes across an issue during the monitoring and supervision exercise, they should refer the problem to I&E for that unit to investigate and gather relevant documentation and evidence to prove or disprove an allegation and advance action, where necessary. The Legal Services Division ("Legal") provides advice and litigation support throughout the entire process. Legal reviews the information about a breach to determine whether, in actuality, there is a breach that falls under the Act based on the information in the FSC's possession. Legal interprets statutes to ensure that the actions taken by the FSC are within the confines of the FSC's empowerment.

Once analysis is completed and a breach determined then a report by I&E is submitted to the Board with recommendation for action. If the Board accepts I&E's recommendations, then action is taken. When a decision is arrived at, Legal drafts warrants, CDOs, and directions. Finally, the Executive Director executes or makes amendments to CDOs, Directions or other instruments requiring his/her signature and also makes other crucial final decisions emanating from enforcement actions. There is collaboration at all stages by the relevant units. Having now provided an overview of the process, we can proceed to examine the case study.

Case Study of a Registered Company

In 2003 and ensuing years, an FSC licensee violated sections of the Securities Act and its attendant Regulation by failing to submit mandatory filings including audited financial statements. On that basis, Securities convened a meeting with the company. Following the meeting, Securities'

examination team conducted a routine inspection of the affairs of the company which revealed among other things, weak internal controls relating to the documentation of requests and pay-out of client funds; inconsistencies with bank reconciliation items; and incomplete records. This further constituted a breach of the law governing the industry in which the entity operated. Thus, Securities issued Directions for the company to correct the deficiencies. In doing so, Securities failed to notify other key divisions of the breaches as well as the action it took.

Securities continued to communicate with the entity via email. Email content revealed that the entity lacked familiarity with the Act and as such, they were not conducting their business activities in accordance with the law. Additionally, the entity continued to operate in contravention of the Act by failing to submit mandatory filings. During that period, the non-compliant entity also requested an extension to submit their filings. Securities rejected their request and instructed them to comply within two weeks. Securities further outlined that failure to comply would result in enforcement actions against the entity. However, Securities [the FSC] did not seek statutory remedies nor did they take any enforcement action against the entity when it failed to submit filings within the stipulated timeframe. At times, the non-compliant entity exceeded deadlines for filings for more than a year and had several outstanding filings. Despite this, Securities did not act on their threat to apply the sanctions under the Act for the identified breaches. Additionally, Securities granted approval for other business activity that the company sought to engage in under the Act.

In the following two years, Securities requested a meeting with the company's principals. Approximately, one year after the meeting, the entity continued its breaches and failed to honour a financial undertaking to pay a client of theirs. At that time, Securities issued a notice to suspend its license. Still other key divisions that was required to be a part of the enforcement process was kept out of the loop. Subsequently, the company filed documents but still had several outstanding. Although Securities included the company on its internal list of problem institutions, again, the staff convened a meeting to discuss the concerns. The company promised to submit outstanding

documents and Securities decided to await receipt to determine the necessity of further action. Subsequently, Securities submitted a paper which "noted" the concerns to an oversight Committee.

Eventually, when Securities received the financials, the documents revealed that the company experienced huge losses. The company eventually failed, the principals fled and the FSC was unable to discern accurately the extent of investor exposure because the entity had misrepresented the total funds under management. However, losses were estimated in billions of JMD.

In this example, a registered company failed because of the lack of enforcement action, causing investors to suffer huge losses. The company benefitted from having the umbrella of registration by the FSC but in all instances slighted the FSC and avoided their statutory requirements which they needed to comply with to meet the requirements of their license and to safeguard assets of investors'assets. They undermined the FSC's regulatory authority by failing to act in accordance with their statutory requirements. This resulted in huge losses to investors. However, the losses are not isolated only to the failure of the FSC to take action but to numerous other factors.

For one, Securities failed on numerous occasions to advise other responsible units of the problems being experienced by the company. The timeframe between identifying an infraction and taking the relevant enforcement action was protracted. This allowed perpetrators adequate time to abscond the jurisdiction as well as expropriate funds placed with their institutions by investors. The practice of holding hands, sending numerous mails and engaging in talks of how to fix identified problems is long outdated. It seems this light touch system has not worked for Jamaica, which has a lot of rogue operators within its financial markets. In the instant case, "holding hands" has contributed to investors losses. In analysing the situation, one interviewee in I&E believes that if Securities had advised I&E of the issues they were undergoing in its supervision of this company in the early stages, the losses to investors could have been minimized. This

problem surfaces not due to the lack of available remedies but because there is no policy which gives an indication of when to elevate a matter. It is dependent on an officer's "perception of how egregious a breach is" (Interview). Uncertainty was also expressed about what violations the FSC should take action against. According to one respondent "I don't know that we have a procedure that dictates [a] particular approach to enforcement." The respondent continues by noting that the severity of an infraction may dictate that particular action. In criticising the current process, another interviewee indicated that a policy is required so that "once [a breach] happens [the FSC] takes a particular action." Without any procedure in place and outside of the inconsistencies in application of sanctions, this actions as described in the case study undermines the investor protection objective. If the FSC does not demonstrate that violators will be punished then its actions will not have meaningful impact. This provides rogues with the permit to violate laws and to abuse investors in the markets undeterred.

In no way did the FSC's actions minimize investor losses. At this stage of the process, it does not indicate that civil remedies would have been beneficial. There were tools that the FSC had at its disposal which were not used even when the agency threatened to levy sanctions. The resultant losses were due to internally generated weaknesses in the FSC enforcement programme rather than due to the lack of available remedies to institute action.

From the testimonies of the interviewees, I will now unpack the process and critically analyse its weaknesses

Identification of the Breach

All respondents indicated that there was no policy or procedure which guides enforcement action at the FSC. As a consequence, once Securities identifies a breach, the unit sometimes unilaterally makes enforcement decisions that are potentially detrimental to investors. As the General Counsel noted, while she was new to the desk, she was not aware of any written

policies or procedures guiding enforcement action. Outside of the Securities Act and the FSC Act, enforcement action was guided by unwritten practices or customs.

In some ways, the views differed with respect to what triggers enforcement action. From the perspective of the General Counsel, once there is a breach of law, the matter should be elevated for action. On the other hand, the response emanating from I&E is that it was a highly subjective process left to the discretion of officers within Securities. Respondents in Securities acknowledged the disparity between what ought to happen as opposed to what was practiced. For example, it was felt that:

> Once there is a violation or indication that a violation is about to occur, that is supposed to trigger enforcement action. CDOs for example, prevent the occurrence [of the breach] or if the breach started, stop[s] the action. **In practice, this happens only sometimes, not all the time**. It's a broader issue of the culture in the organization and how it views enforcement – is it an essential tool? Is the enforcement division as important as the [monitoring] division? The answer to this question may solve the problem. Currently, there seems to be some move away from the *traditional holding hands* [emphasis mine]. We have to view this change overtime but there are indications that things have taken a different direction.

Overtime, the process that has developed is for Securities to issue a reminder in the instance of a breach. One interviewee noted that it ought to be a single reminder but sometimes there are more. What follows afterwards are warning letters, convening meetings, issuing directions, and throughout the process, following up with companies and reporting their progress overtime. Most of these activities are undertaken by Securities without reference to I&E. The result of this is pointedly expressed by Senior Investigator, Tameka Samuels-Jones:

> The securities division is not trained to carry out enforcement action but they do so without communication with the Division which has that responsibility [I&E]. Sometimes the course of action taken is not one that is in the best interest of the consumers. In one example, the Securities Division issued a warning letter and had a series of meetings. However, the breach rose to far more consequences than what they did.

If none of the prior tools work, then, as appropriate the matter is escalated to the issuance of a CDO, revocation of fit and proper status, instituting temporary management, suspension, cancellation and ultimately, prosecution. But as one respondent noted:

> [The process is being undertaken in] the wrong way. Once there are issues requiring enforcement action, the enforcement division [I&E] should be the unit taking all enforcement action. This Division should take charge or take control [of the matter]…For example, at the USSEC, if one infraction is found, it is then the enforcement unit that does everything…Securities as the monitoring unit, monitors activities of various licensees and we take it as our responsibility to ensure that issues that may result in enforcement action is appropriately identified and reported. Capital risk, legal risk, fit and proper issue. Any type of activity passed on to enforcement. In practice, it does not happen at all times. Reputation risk is not just for the FSC but for the entire industry. Overseas investors may not want to use our capital markets because of no confidence in the regulatory process. Securities thus identify problem or potential problem and indicate the issues to I&E.

From these perspectives of the activities undertaken, I show significant weaknesses in the process. In my view, these practices may prove to be a significant deterrent to achieving the objective of investor protection. Having civil remedies available cannot correct the deficiencies manifested in an ad hoc process of enforcement, where staff members do not know what triggers action or when to elevate a matter for action. These are nuances that need to be addressed before the FSC can readily rely on civil remedies in boosting investor protection. Its utility will not be realized without the FSC streamlining the processes it relies on in enforcing securities regulation. One of the key principles of IOSCO is that the securities regulator should adopt clear and consistent regulatory processes (International Organization of Securities Commission 2010). Clearly, the FSC is not meeting this objective. If there are divergent views on the enforcement process, it will not be coherent in practice. Ultimately, this will impact investor protection. The goal of enforcement is to "detect and punish noncompliance" with laws (Carvajal and Elliott 2009). In other words, enforcement is the "apparatus [that] translate[s]…violations into regulatory sanctions or recovery for those harmed" (Millstein, et al. 2005). Based on the explanations of the process, this is not what happens. Rather, there is a protracted process of persuading an entity into

compliance with the laws. If the machinery through which enforcement is undertaken is defective, then it will not translate into any type of recovery for investors.

It also appears that there is no proper analysis of the risks associated with infractions. The only mitigating factor to investors' losses as conveyed by the respondents was where a licensee valued its business. In these cases, licensees respond to mere reminders. The poor enforcement practices would not have an impact in these cases. However, oftentimes, in the financial services market, regulators are not working with honest people and harsher methods are necessary to force compliance with the laws. In the author's opinion, even without the introduction of civil remedies, there were possible inhibitive sanctions under the FSC Act for failures to comply. Despite not covering a broad range of infractions, if utilized appropriately, the FSC would be able to establish itself as a no-nonsense regulator, which would, in effect, be a deterrent to market abusers. Ultimately, this strengthens the protection afforded to investors. In the words of an interviewee:

> If remedies are effectively used, they can protect investors. If you do not enforce the regulations, if you are not going to apply them then it does not make sense. Looking at the sum of things, the amount of nuances it creates for a dealer, these remedies are effective, it is just that they are not used to allow you to see the effects. *People have to get the message that we are serious about what we are doing so if they fail to comply, we will not fail to act. If they get the message then they will behave.* [Emphasis mine]

As contemplated by policymakers, the civil remedies are meant to address the gaps in the law to allow the FSC to engage in quicker action. However, in the same vein, if laws on the books are not enforced, they will not have the intended effects. It appears that there is significant reluctance to use the tools of enforcement that the FSC is empowered to apply.

Views regarding the significance of prudential as opposed to market conduct violations were also different. One interviewee expressed the view that "We believe prudential issues expose the clients to greater danger. Conduct issues can, however, be greater destruction [because these] expose behavioural patterns that the marketplace can do without". In contrast, another interviewee pointed out that:

> Over the years, it is my view that the FSC has experienced an "identity crisis" in distinguishing between the approach[es] to be taken for market conduct type activity versus prudential type supervision so they do not know when to apply what sanctions. Constantly failing prudential requirements can be a sign of conduct issues. Sometimes the FSC staff itself does not understand the statutory provisions. One example is where every activity is described as unsafe and unsafe business practice. This is purely a prudential issue.

And another:

> There are prudential as well as market conduct issues. For market conduct, you need to take swift and targeted action because clients' money is at stake so you have to act fast so that there is the possibility for restitution. There is no policy and procedures in place [which means there is no common standard for taking actions]. The regulator can try to work with [persons who are in breach of the law] but not in instances of market conduct because money moves and people also move quickly.

In order to minimize losses to investors, there needs to be some consensus on what violations should take priority. Presently, there does not appear to be consensus within the FSC regarding violations that are potentially more dangerous to investors. The factors examined here are solely internal factors which are significantly inhibitive in maximizing investor protection. In fact, these issues expose investors to greater dangers in the securities markets. Predominantly, the issues I unpacked here are embedded in a single failure – the lack of an enforcement policy and procedure. This one issue is significant because it gives rise to uncertainty of action, delays in the enforcement process, and inconsistencies in the application of sanctions, all of which compromise investor protection.

Second, there was a general breakdown in the way in which the FSC staff communicates. As explained, "Internally, the responsible units are not communicating and so, each person is unable to [comprehensively] determine the extent of a problem in a particular company." Furthermore, there no distinctive line separating the monitoring from the enforcement activities. Outside of complaints, I&E rely squarely on inputs from the Securities to advance enforcement action in any matter. Because of this, sometimes investigations are not advanced until Securities

takes the required action. This renders the enforcement process highly subjective and largely dependent on how a particular staff member perceives an issue.

In addition, there is no central information repository so I&E is unable to discern when a problem may be on the horizon. There was general consensus among the interviewees that the FSC relied a lot on memory. For example, there may be individuals who had in the past breached FSC administered laws. However, because this information is not stored, with staff turnover, the possibility exists for this person to re-enter the industry undetected. These creates additional risks to investors' funds and has an adverse impact on the FSC's deterrent efforts.

Consequently, the issues discussed are not ones that can be resolved with the new remedies in the FSC's toolkit. It is a problem that has to be resolved with some urgency through management decisions and the development of policies and procedures for undertaking and elevating matters for enforcement action.

Conducting the Investigation

In carrying out an investigation into a breach, very often other agencies are involved in the process, not least of which is the Financial Investigations Division ("FID"). Interviews with staff indicated that the role of the FID in the process is largely investigative. This is because the FID has massive powers under the statutes they administer, such as Proceeds of Crime Act ("POCA") and the FID Act. Namely, these powers include police powers, the execution of warrants, monitoring and production orders and stop orders for human flight.

Hence, to compound the tardiness by Securities in referring a matter, I&E had to rely on other agencies in carrying out certain actions required to secure investors funds. In that, at this already late stage and with the risk of human and capital flight, the FSC had to engage the FID for assistance in issuing stop orders, to subpoena bank records required to identify assets as well as to use its injunctive powers to freeze funds. An interviewee believes that the lack of these powers

were an inhibiting factor because of the reliance on other agencies to advance investigation and enforcement action. She noted that "Too many agencies have to be involved in a matter, and as a result the timeframe for action is protracted." However, the recent amendments will now allow the FSC to carry out independent investigation and to connect the paper trail.

The perception echoed that oftentimes, the investigations into breaches are protracted because the FSC has to rely on the powers available to the FID. Presently, with the legislative amendments, the FSC's reach in relation to UFOs has been expanded. For example, the FSC is now able to apply restraint orders, restitution and civil monetary penalties to secure investors' funds. This is significant in minimizing losses to investors.

Without prejudice to the factors already discussed, these sanctions renders a more expedient investigation and possible greater recovery of funds given the risk of capital flight.

An Analysis of the Use of Powers by the FSC

So far, I have argued that several aspects of the FSC's enforcement practices undermined rather than enhanced the protection that could be afforded to investors in the securities markets. Now, I will align the practices with the principle guiding enforcement of securities regulation. For this, IOSCO promulgates the principle that:

> The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.

The operations of the FSC in no way ensures a high level of compliance with the statutes. As such, it cannot be seen as effective and does not maximize investor protection. First, if the oversight mechanism in monitoring is inadequate, then this can increase risk exposures to investors. Elite testimonies indicate that of all the enforcement tools available to the FSC, those most often used to secure compliance with securities regulations and ultimately to protect the interests of investors are *Reminders, Warning Letters, Directions* and *Cease and Desist Orders (CDOs)*. So far,

continuous discourse, attempted persuasion, and the use of the least harsh methods such as reminders, warnings, and directions has not proven effective in enforcing the Jamaican securities laws. Instead, it has promoted disregard for the FSC. The FSC has placed too much reliance on the use of less harsh methods in the markets. In a market infiltrated with bad actors, a signal has to be sent that misconduct is untenable and will not be tolerated.

Directions is the least severe tool in the compendium of statutorily provided enforcement tools and is often used in the first instance of identification of a breach. One view held is that Directions do not necessarily protect individuals already invested in a company. However, it can be sufficiently mitigating for prospective investors, who become aware that a company is not financially healthy and therefore, would not invest. However, in some ways, this view is flawed because when directions are issued, they are not publicized. The FSC is now able to make public statement. Public censure may also be an effective measure. While it is yet to be seen, it is the author's view that threats of public reprimand can be a subtly coercive measure that deters market misconduct. Publicity has the potential of eroding reputation and economic potential of businesses so market participants may be more inclined to respond.

As for licensed entities, the approach is somewhat different because the FSC was able to demand certain actions if the entity wished to retain its license and the fit and proper status of its responsible officers. However, one interviewee held the view that the primary factor impeding investor protection, especially with reference to licensed entities at the FSC was "management indecisiveness". To clarify, he explained that it would be in the best interests for these entities to comply. If they did not the FSC had the option of, as an example, instituting temporary management. In these case, the FSC could ensure that problems within the company is remedied then return the company to its owner or apply to the courts for winding up. Even with this approach though it seems there was not sufficient protection for investors. Despite the latitude that the FSC had in relation to licensees, it failed to apply and execute sanctions.

It was noted in the experience of one respondent that there has never been a case where investors achieved any form of recompense as a result of enforcement action undertaken by the FSC. At the same time, if Directions, for example, are issued and appropriate monitoring and supervision takes place to ensure that the institution against which the Directions are issued abide by the directives, these instruments are able to provide a cushion against losses. In that, there may be instance when directives are given to remove a recalcitrant manager or inject capital into a business. Both these measures secure the protection of investors if actions are taken early out. In the former, there is the removal of an individual that is not fit and proper for continued performance in the industry. In the latter case, threats to solvency is eliminated and confidence in a company restored.

According to one response, contrastingly, there may be instances where Directions can be a deterrent to investor protection. The interviewee shared an example. A Direction was issued that precluded a company from making pay-outs. However, a bond obligation became due and payable by the company against which the Direction was issued. In this case, the company is faced with a dilemma. On the one hand, satisfying the obligation to the bondholder breaches the direction. On the other, complying with the direction puts the company in default of its debt.

According to the interviewee, circumstances giving rise to the issuance of a directive may change but because Directions are not reviewed on a continuous basis, they remain in place and lose their validity while putting a stranglehold on the company. The author's perspective is that this weakness in the FSC's programme may be potentially damaging even to investors. In that, failures by the FSC to review Directions may create possibilities for a rogue to use it as a means of saddling investors who require the use of their funds through ostensibly legitimate excuses of being constrained by Directions.

These issues are further compounded by lack of expertise in certain areas. As expressed:

> In the FSC, short of manpower, [the enforcement Division] may not have all the necessary skills for enforcement…we need…to have appropriate skills set to ensure that the objectives [of enforcement] are properly met. Part of what enforcement means is to interpret statutes and if an individual at the helm [of the enforcement division] does not know how to interpret [statutes] and…have to call someone for [assistance with] that, this makes the process inefficient and ineffective if that is done for every routine function.

One interviewee contends that another setback is with UFOs, "we know of [the] illegal activity, [but] we can't shut [it] down." In other words, despite the operations of these entities, the only instrument available were search warrants and CDOs. While the FSC was able to apply for and execute a search warrant, the General Counsel notes that a search warrant without a restraining order limited the actions the FSC could take. The author agrees with this sentiment because having the power to search without the authority to prohibit certain actions, for example, shredding of documents etc. may prove futile in the FSC's efforts. The new remedies will now allow the FSC, with a court order, to undertake these types of actions.

The complexities that arose with CDOs is that a failure to comply was punishable by fine, imprisonment, or both only through conviction. To exacerbate the situation, since all matters were criminal and without an alternative to prosecution, a failure to comply could only be addressed by referral to the DPP. This was an additional setback in the FSC's efforts. It not only impacts the timeliness of enforcement action, which are generally time-sensitive. It also proved ineffective at addressing financial market violations because it created further delays. Therefore, investor protection was undermined.

The DPP is constrained by limited human resources relative to the number of cases it handles. As expressed by one respondent, the DPP used its resources to address what it considers as more egregious crimes. In most cases, violent crimes take priority over financial crimes. As a result, the matters forwarded to the DPP by the FSC stays in abeyance and further adds to the time lags. Furthermore, "the FSC was sometimes reluctant for certain acts to be criminally prosecuted because it might have been too harsh" of a punishment for the violation that was committed.

Therefore, if all the FSC's sanctions were criminal and hence required referral to the DPP for prosecution, this aspect would affect how enforcement is carried out, the efficacy of enforcement in the markets and ultimately, the level of protection afforded to investors. That is, it was either time lags or lack of action, both detrimental to investor protection.

The introduction of the legislative amendments now include settlements as alternative to prosecutions and other civil actions that the FSC may take on investors' behalf. So, the FSC will no longer have to rely solely on the DPP. From the FSC's perspective, there was a general lack of enforceability of the CDOs because there was no action that the FSC could legitimately take to force compliance, save making a referral to the DPP. When all infractions were criminal, the FSC did not have an option but to involve the DPP in its actions. Ultimately, it was the investors who suffered due to matters being protracted. The new remedies now provide an alternative to prosecution. Currently, the FSC is able to eliminate that step in the process and bring proceedings independent of the DPP. From this we find support that there are advantages to the FSC having civil enforcement remedies that can potentially be applied to UFOs because of the advantages posited by Savarese and Carlin (2014).

That is, the FSC may undertake action in its own regard, which renders faster actions.

Despite the benefits to be achieved from the new remedies introduced, there are still issues that the FSC will have to contend with. As gleaned from the respondents, even after surpassing that hurdle, an additional challenge presents itself because an obstacle lies in the inefficiencies of the judiciary:

> The fact that [the FSC will] have to go to court could be challenging… [In] Jamaica, the court system is time consuming and this causes delays in enforcement actions. In spite of the delays, civil remedies may provide a quicker from of sanction as an alternative to prosecution in light of the fact that the DPP is overburdened. In addition, the burden of proof for civil sanctions is less.

As noted by La Porta, et al. (1999, 9), the quality of enforcement has several elements, which includes the efficiency of the judiciary. Further, judges are not necessarily expert in handling financial crimes. As one interviewee notes, a key element that may further inhibit enforcement activity is that the courts could find against the FSC. To illustrate, OLINT was a case of first instance in Jamaica. When the FSC issued a CDO against OLINT, it applied for and received from the court a stay of execution of the CDO. In handing down the judgement, the judge's unfamiliarity with these matters may be distilled from the statement that:

> The Claimants' operations is in relation to a club, and they **have not opened their doors to the public generally**. Whilst the fact that the operation is a club may not mean that the activities do not fall within the remit of the Commission, it does mean that **the apprehended danger is not of the same order as it would be in relation to an entity offering, for example, financial services to the general public at large**. [Emphasis mine] (Mangatal 2008)

In the author's view, this statement demonstrates one of the problems in the FSC's efforts aimed at protecting investors. First, as illustrated in the beginning of this chapter, investors' losses and the numbers who suffered when the scheme crashed was high.

The issue was not one to be relegated to the mere suggestion that the entity did not intend to provide freedom of access to the general public. In the broader analysis and as evidence shows, there were opportunities for the general public to participate - conduits through which investors in the Jamaican market could and did invest. The most vulnerable were the unsophisticated, who were more susceptible to the artifice. These persons suffered higher relative losses. With the rise of the UFOs, the FSC did a number of things to mitigate potential damages to investors. These included public education campaigns warning individuals about involvement in these schemes, the issuance of CDOs and the referral of matters to the DPP. However, investors were also a threat to themselves because a large number were unsophisticated. As specified by one interviewee, these investors believed that the formal sector was fleecing them out of interest so they saw value in the UFOs. The banks were offering 2% returns while these entities offered 10% or more. They had

a genuine belief that they were receiving the correct compensation from the UFOs. The courts did not share this opinion (See Mangatal 2008, 16).

Herein lied the erroneous view that it is unlike an entity offering services to the public at large. In fact, because the entity was unregulated, it was even more dangerous for investors in the Jamaican market because the entity would not have been subject to the due diligence that licensed entities are scrutinized by. One interviewee attributed the judge's unfamiliarity with the fact that the courts are for general jurisdiction.

Respondents were uniform in their responses relating to the manner in which the FSC undertakes enforcement action. The predominant perception is that because the oversight and monitoring mechanism seems to be broken, enforcement action against individuals and/or entities are often too late to afford investors any protection. One sentiment expressed was:

> The Securities team…conducts an inspection and recognizes a violation then…report[s]…a breach. However…decision takes forever. Management needs to be more proactive… [so] licensees flee with investors' money. All of these problems had more to do with management decision making rather than the ability to detect the problem. It was [never] an issue of knowledge of problem. I don't know if there is any justification not to act but in the early years of the FSC, we did not prosecute because we thought there was a learning process so in the event of a breach, there was a "slap on the wrist" as part of the learning process [of getting acquainted with the new Acts] to get in line with the Act but after 10/15 years, it is not a learning process anymore but time to act. *Indecisive Management* at the FSC allowed the industry to lose confidence and respect...

The interplay between all these crucial elements of the enforcement process affects the level of protection that can be afforded to investors at any crucial point. In the view of an interviewee, "enforcement action respond[ed] to a breach rather than consider investor protection."

The overriding disadvantage of the enforcement process as it is practiced at the FSC is that there was no policy guiding these actions. As a result, the probability for investors' harm was high due to the sometimes long time it takes before enforcement action is taken. A written policy would

incorporate a ladder of enforcement actions as well as specific timeframes to act and ensure protection and expeditiousness of action. Further, there needs to be some conscientiousness towards whether an infraction is serious enough to warrant enforcement action or it is just a matter requiring warning or just to highlight. As gleaned from the process and confirmed in interviews, in most cases, it is not that the FSC is unaware of a violation because the FSC "knows of problems long before it explodes."

Predominantly, the respondents did not believe that the enforcement machinery of the FSC, as it was utilized, brought about restitution to investors. From the interviews, it seems the usual approach was to highlight and persuade. Civil remedies can protect investors from the variety of forms in which market abuse manifests itself in. However, the enforcement program is only as effective as the precursor actions leading to enforcement. Another difficulty that may arise is the decision of whether to prosecute or when to use civil remedies because in the current culture of indecisiveness, determining whether a matter should be dealt with criminally or civilly raises another issue.

Relevant perceptions of the process are:

> no action so far has ever resulted in restitution. Not having power was a deterrence. Now you have the power, we have not [yet] been given the opportunity to use it [given the shot time since their introduction].

> There was [no protection] guaranteed [to investors when enforcement action was taken] because even if prosecuted a non-registrant, there was no requirement for the FSC to get back anything. The only guarantee is protection from rogue but nothing tangible

After Dec 2013, the law makes provisions for restitution but if the monitoring framework is not bolstered, miscreants may be allowed to expropriate funds and in the end, the remedy may not be effective because the rogue company may not have the necessary financial resources or assets to provide restitution to investors. However, with improvements in the enforcement process,

the remedy can enhance protection. In addition, and as an appropriate end to the examination of the FSC's enforcement practices, the most candid point by one interviewee is reflected below:

> With the FSC's practices, it leads to losses, [I] hardly see any benefit how we acted, our delays in taking action has resulted in more misery. The way we operate more benefit licensees who benefit from bad practices – make money by abusing people "with the FSC indirectly as an accomplice."

CONCLUSION

As this thesis demonstrates, civil remedies in the enforcement of securities regulation are an effective means of addressing market infractions in the context of Jamaica. However, there should be a supportive enforcement framework within the regulator. Foremost, infractions stemming from compliance monitoring should be addressed promptly and there should be clear policy guiding such action which precludes the subjective ad hoc process that currently exists. The results further demonstrate that achieving the objective of investor protection in Jamaica cannot be achieved by merely introducing a range of civil remedies to the enforcement toolkit. The statements from the cross section of staff involved in the enforcement process revealed that while civil remedies may prove useful in enhancing investor protection, there are several other factors which inhibited the FSC from achieving that objective. As a result, civil remedies as a standalone will not prove worthwhile in protecting investors.

Four attributes of the FSC's enforcement programme impede investor protection. One, the absence of clear policies and procedures to guide enforcement action. Two, an inadequate monitoring and supervision framework. Three, indecisive management. And four, failure to actively pursue enforcement action in incidences on non-compliance. Investor protection is a derivative of the improvement in and an integration of all these factor with the new remedies. Without a change, these factors will have direct impact on the FSC's efforts to enhance investor protection.

The testimonies indicate that products of a lack of clear policy to guide enforcement action include inconsistency in application of sanctions, uncertainty about the enforcement process and the complete failure to take action when there are incidences of non-compliance. As already noted in the literature review, to be a credible threat, the probability of enforcement action must be real (Carvajal and Elliott 2009). As one of the most basic prerequisites, it is a significant blight on the FSC.

The above analysis did not support a finding that it was due to the lack of remedies why the FSC has been unable to meet the objective of investor protection. Coglianese (2012) notes that the most appropriate indicators for measuring the extent to which a policy impacts an outcome are those that measures the ultimate problem that the policy intended to solve. Ultimately, civil remedies are meant to address the problem of the significant losses faced by investors. Therefore, while we find that civil remedies may be helpful, it cannot remedy the causes of the problem of the lack of investor protection. The causes are largely internal.

It seems that the FSC's enforcement efforts, albeit contradictory, was more geared towards the protection of the offending company as opposed to investors. In the first instance, the FSC's approach favoured business continuity rather than investor protection. Because of this, even in the most obvious cases of failure, the approach taken was one of persuasion rather than swift decisive enforcement action. This evaluation is reflected in the fact that when a company, for example, does not comply with Directions that the FSC issues, the FSC engages in several discussions, meetings and variation of directions in an attempt to put matters right. The experience with this approach has been that most companies involved in this type of light enforcement usually go belly-up with investors as the primary victims. As one interviewee puts it, "it is not that the FSC does not know of the problems, it is management's indecisiveness that is the problem." It is the authors view is that the FSC relies too much on persuasion to correct action in a market that is ostensibly unresponsive to that approach to enforcement.

There also seems to be the lack of an appropriate mechanism to weigh the cases that the FSC should take enforcement action against. If the FSC faces an "identity crisis" then investor protection will not be maximized. As it is, urgency may not be accorded to the most crucial matters that would give rise to high probabilities of investor losses. The enforcement machinery will not be effective unless and until Securities establishes its identity distinct from I&E and there are clear policies and procedures to distinguish between the end of the monitoring activity and the

commencement of the enforcement activity. Without these modifications, the objective of investor protection will not be realized.

As persuasively stated by a respondent, "a risk based approach is necessary…[the FSC] has to look at…the severity and frequency of the breaches" to determine what violations must take priority for enforcement action. The interviewee notes that the FSC [should] take action against serious breaches such as, *inter alia*, matters which compromise the interests of investors. As demonstrated in this paper, a significant obstacle to investor protection was the FSC own internal dynamics and attitude towards enforcement.

If the current enforcement practices remain – seldom enforced threats of sanction, exercising undue leniency – there is a low probability that the introduction of civil remedies will afford increased investor protection and as such, are not adequate in optimization of that objective and have much impact in the crucial role that they undertake in the securities market.

By raising awareness of the factors inhibiting the objective of investor protection, it is my hope that this research will provide useful insights into enforcement practices within the Caribbean region. There are external factors existing which the FSC has no control over, for example, the poor court system. As a result, it is incumbent on the FSC to look at the internal issues that have so far contributed to as well as given rise to losses suffered by investors in the securities markets. An understanding of these factors as well as implementation of tools designed to mitigate against the bad practices are crucial in fulfilling the objective promulgated by IOSCO. Over time, these may help to sustain an enforcement programme. However, the factors articulated only commences the discussion on enforcement practices in developing countries and thus, explains only in part, the weaknesses that should be overcome.

As persuasively argued by Das and Quintyn (2002, 20) in order for a regulatory agency to be well governed, there should be an "…effective legal and judicial system" as this is one of the

crucial factors for the agency to "perform its functions in a coherent, credible and consistent fashion." Otherwise, "regulatory forbearance" is easy to hide. As a result, before conclusive judgement can be made, future possibilities for research lies in the areas of (but are not limited to) the legal framework, judicial safeguards against inefficient enforcement practices and the best organization of the regulatory system.

APPENDICES

Interview List

The position of the respondent is as documented on the FSC's internal company directory and confirmed with the interviewee at the time of the interview.

Anonymous, May 22, 1014

Sonia Nicholson, Senior Director, Securities Division, May 15, 2014

Ingrid Pusey, General Counsel, May 16, 2014

Tameka Samuels-Jones, Senior Investigator, Investigation & Enforcement Division, April 30, 2014

REFERENCES

Carvajal, Ana, and Jennifer Elliott. "IMF Survey Magazine: IMF Research." *IMF Study Points to Gaps in Securities Market Regulation.* February 04, 2008.

Carvajal, Ana, and Jennifer Elliott. *The Challenge of Enforcement in Securities Markets: Mission Impossible?* Working Paper, Washington, DC: International Monetary Fund, 2009.

Carvajal, Ana, Hunter Monroe, Catherine Pattillo, and Brian Wynter. *Ponzi Schemes in the Caribbean.* Working Paper, Washington, DC: International Monetart Fund, 2009.

Castro, Rui, Gian Luca Clementi, and Glenn MacDonald. "Investor Protection, Optimal Incentives, and Economic Growth." *The Quarterly Journal of Economics*, 2004: 1131-1175.

Chen, Donghua, Dequan Jiang, Shangkun Liang, and Fangping Wang. "Selective enforcement of Regulation." *China Journal of Accounting Research*, 2011: 9-27.

Coglianese, Cary. *Measuring Regulatory Performance: EVALUATING THE IMPACT OF REGULATION AND REGULATORY POLICY.* Expert Paper, Paris: Organisation for Economic Co-operation and Development, 2012.

Das, Udaibir S, and Marc Quintyn. *Crisis Prevention and Crisis Management: The Role of Regulatory Governance.* Working Paper, Washington, DC: International Monetary Fund, 2002.

Financial Services Commission; Bank of Jamaica. "UFO Concept Paper." Concept Paper, 2011.

Henry, Paul. "Glimmer of hope as court winds up Intertrade Finance." *Jamaica Observer*, June 25, 2012.

International Organization of Securities Commission. *Objectives and Principles of Securities Regulation.* June 2010.

IP33, NZLC. "Publications: Law Relating to Civil Penalties - Civil Pecuniary Penalties (Issues Paper 33)." *The Law Commission.* 2012. www.lawcom.govt.nz (accessed February 10, 2014).

Jackson, Steven. "Goddard Takes J$420m Hit On Intertrade Investment." *The Gleaner Company Limited*, February 1, 2012.

Jamaica Gleaner. "Olint raided - Authorities shut down offices in Turks and Caicos, Miami." *Jamaica Gleaner*, July 16, 2008.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny. "INVESTOR PROTECTION: ORIGINS, CONSEQUENCES, REFORM." *NBER Working Paper Series* (NATIONAL BUREAU OF ECONOMIC RESEARCH), no. 7428 (December 1999).

Luton, Daraine. "Ponzi Squeeze - House Revises Security Act In Bid To Attract More Investors." *The Gleaner*, December 11, 2013.

Malcolm, Kyla, Mark Tilden, Scott Coope, and Charlie Xie. *Assessing the Effectiveness of Enforcement and Regulation.* Discussion Paper, London: The City of London, 2009.

Mangatal, J. *Claim No. 2006 HCV 01365.* Kingston, 2008.

Marquis, Keith. *"Responsive‟ Securities Regulation: An Assessment of the Enforcement Practices of the Ontario Securities Commission.* MA Thesis, Ontario: Regulatory Governance Initiative, Carleton University, 2009.

Millstein, Ira M, Shri G N Bajpai, Erik Berglof, and Stijn Claessens. "Enforcement and Corporate Governance: Three Views." *The Global Corporate Governance Forum Focus 3.* Washington, DC: The International Bank for Reconstruction and Development/The World BAnk, 2005.

Ministry of Finance & Planning. *International Monetary Fund Web site.* March 4, 2014. http://www.imf.org/External/NP/LOI/2014/JAM/030414.pdf (accessed April 10, 2014).

Ryder, Nicholas. *The Financial Crisis and White Collar Crime: The Perfect Storm?* Cheltenham: Edward Elgar Publishing Limited, 2014.

Savarese, John F, and Wayne M Carlin. "White Collar and Regulatory Enforcement Trends in 2014." *The Harvard Law School Forum on Corporate Governance and Financial Regulation.* Harvard Law School Program on Corporate Governance. January 28, 2014.

Smith, Martha J. "Regulating Opportunities: Multiple Roles for Civil Remedies in Situational Crime Prevention." *Crime Prevention Studies*, 1998: 67-88.

Technical Committee of the International Organization of Securities Commissions. "Mitigating Systemic Risk: A Role for Securities Regulators ." *Discussion Paper.* February 2011.

The Gleaner. "Ponzi Schemes And Party Financing." *The Gleaner*, December 23, 2013.

Thompson, McPherse. "InterTrade Creditors Owed J$3b." *The Gleaner*, January 8, 2012.

Welsh, Michelle. *Civil Penalties and Responsive Regulation: The Gap between Theory and Practice.* PhD Thesis, Melbourne: Monash University, 2009.

White, Mary Jo. "All-Encompassing Enforcement: The Robust Use of Civil and Criminal Actions to Police the Markets." *U.S. Securities and Exchange Commission.* March 31, 2014. http://www.sec.gov/News/Speech/Detail/Speech/1370541342996#.U5Suk_mwLK8 (accessed June 8, 2014).