The Legacy of RT Capital

When I was in Grade 6, my teacher sat the class down and asked us to present a debate on the pros and cons of that early 1980s hotbed of controversy, "Should the seal hunt be banned?" Even though none of the Grade 6's wanted to debate in favour of killing baby seals, the "pro" side won. They presented a well-researched case that examined the issue from different angles. The "cons," however, assumed public opinion would be on their side and didn't bother to do much preparation. They instead performed a hurried (albeit compelling) mime show in which the team leader, dressed in hunter garb, repeatedly struck a stuffed seal toy with a baseball bat until it exploded in a fuzzy cloud at the front of the room.

The teacher wasn't impressed. At the time, the lesson was that an informed and studied argument triumphs over high drama, taking the public vote with it. But, as I have since discovered, that isn't always the case in the real world.

In "High Closing—An Alternative Interpretation," Professor Joel Fried revisits the dramatic scandal surrounding the RT Capital high closing case settled in August 2000. At the time, RTC admitted that their actions were against the public interest—actions that consisted of 53 cases of causing the price of a security to end on an up-tick—a high close. Looking to the Ontario Securities Commission's (OSC) ruling for guidance on how pension plans should structure their valuation methods in future, Professor Fried finds a confusing maze of unavoidable contradictions. For one thing, the OSC provides no operational definition to differentiate a high close from other end-of-day purchases. Moreover, any trade in an illiquid stock could alter its price, if only within the bid/ask spread provided by the market maker. In terms of valuation, the case sets a worrying precedent and provides no clear answers. In future, how should managers deal with the valuation difficulties presented by illiquid assets? Just what distinguishes high closing from normal price discovery? In what way was the public harmed?

Now, of course, I know that the OSC is not that bat-wielding kid in my Grade 6 class—they are regulators and protectors, working for the good of fair markets and the public. And RTC was not a stuffed seal, being beaten repeatedly just to make a point.

All the same, Professor Fried's argument still reminds me of the old seal-hunt debate. One side of the debate is so much easier to argue than the other. It's the side of the public who entrust fiduciaries with their hard-earned money so that they don't have to spend their sunset years eating cat food out of a can. The other side is less warm and fuzzy—RTC has already admitted they broke the rules and willingly received their punishment.

In an effort to create a debate, we offered the OSC equal time and space to respond to Professor Fried. They gave us one sentence. Case closed. Or is this just the beginning? What exactly is the legacy of RT Capital? ∎

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