

May 8, 2003

**TO: The Canadian Capital Markets Community**

On March 4, 2003 Finance Minister Manley appointed the Committee I chair to make recommendations to resolve the long-standing debate on the structure of securities regulation in Canada. The Committee has been set up to take a fresh look at the issues free from the constraints that may be felt by government officials or regulators. Our task is to propose a securities regulatory structure that will be in the best interests of Canada.

My colleagues and I believe that it is important to Canada's economic future that we come to the best possible answer to this question. Without vibrant capital markets we cannot have a strong national economy. It follows that we need to have the best possible structure for securities regulation, in the interests of investors, issuers and intermediaries alike. The prosperity of our country depends upon it.

I am attaching a short consultation paper that solicits your input on the questions that are before us. I strongly encourage you to respond. We are interested in knowing your experiences, good or bad, with the present system. In addition, your views as to what will best serve the national economic interest will be important both to us and to the policy makers who are responsible to take decisions.

The paper outlines a series of questions – the basic question of course is simply “What would be the best securities regulatory system for Canada?”

We are also interested in any views you may have on the underlying issues:

- The key strengths and weaknesses of the current securities regulatory structure.
- Whether there is effective enforcement for serious market malfeasance in Canada and how the structure of regulation affects enforcement.
- How the securities regulatory structure affects the international competitiveness of Canada's capital markets and, in the long run, the success of the Canadian economy.
- Efficiency issues associated with the current structure, including cost and time consequences.
- Regional or local requirements that must be met by an optimal regulatory structure.
- The capacity of the current system to innovate and to adapt its policies effectively in a fast-changing market environment.
- The lessons to be learned from the experiences of other countries.

We do not intend these topics to be limiting. If you have views in respect of other matters relevant to the structure of capital markets regulation, we welcome them.

I urge you to participate in this discussion of national importance. As the attached paper indicates, we would like to have your submission by June 30, 2003.

Yours truly,

Michael Phelps  
Chair

Enclosure

May 8, 2003

## **QUESTIONS TO THE CANADIAN CAPITAL MARKETS COMMUNITY**

On March 4, 2003, the Minister of Finance of Canada appointed this Committee to make recommendations to resolve the long-standing debate on the structure of securities regulation in Canada. Our essential task is to provide policy makers and market participants with an independent assessment of what securities regulatory structure will best serve Canada's interests. Specifically, our mandate asks us to review and assess strengths and weaknesses of the current system and to recommend an appropriate regulatory structure, with a governance model and accountability framework.

Our work plan will include both research and consultation components, so as to ensure a rigorous, empirically supported analysis of the issues. We are prepared to consider any practical model for structural reform.

The Committee's recommendations will reflect our consideration of how well particular structural models achieve a number of key objectives of securities regulation identified in our terms of reference, including (a) sound investor protection and rigorously enforced high standards of regulation, (b) efficient capital markets for Canadian businesses of all sizes, regulated so as to avoid placing undue burdens on market participants, (c) dynamic and innovative capital markets throughout Canada, and (d) international confidence in Canada's securities regulatory system so as to encourage participation in Canadian markets by foreign issuers and investors and to assure optimal credibility for Canadian regulators in representing Canadian interests abroad.

The terms of reference of the Committee can be found in Annex A.

### **BACKGROUND**

A central challenge for Canadian governments is to establish and maintain a policy framework that is focused on the long-term determinants of growth. One such determinant is the presence of efficient and dynamic capital markets that make low-cost, innovative financing readily available to those who seek it. How well those markets are regulated will have a significant impact on their performance.

Canada's capital markets support a growing and diverse economy. Consider some of the attributes of Canada's capital markets: there are over 4000 publicly listed companies in Canada; the market capitalization of publicly listed stocks was \$1.06 trillion at the end of 2002; the TSX is the world's seventh largest equity exchange and the Montreal Exchange and Winnipeg Commodity Exchange both offer specialized products; Canada has well-developed government and corporate debt markets as well as markets in over-the-counter derivatives; for businesses, capital markets are an essential and a growing source of financing, providing over 30 per cent of short term financing and 80 per cent of long-term financing; almost half of Canadians own company shares, either directly or through mutual funds, and more still have pension or insurance assets invested in markets.

Capital markets in Canada compete globally for issuer and investor participation. Measured by market capitalization at the end 2002, Canada's markets made up less than 2 per cent of global market capitalization, a percentage that has been gradually trending downwards in recent years. Issuers and investors alike now have substantial choice in terms of the capital markets in which they participate. From an issuer perspective, about 14 per cent of net new equity issued by Canadian corporations over the five-year period 1998-2002 was placed abroad. The comparable figure for corporate bonds was about 50 per cent. This fact was not part of the debate during earlier reform attempts. Many Canadian businesses have also taken steps to list their shares on foreign stock exchanges, some exclusively so.

It will be a challenge for Canadian capital markets to remain robust against this background. The participation by investors outside Canada in Canadian capital markets will increasingly depend upon their perceptions of the liquidity and transparency of those markets. The sufficiency of Canadian capital market regulation is under scrutiny by international investors as never before.

Maintaining strong and vibrant capital markets is essential to meet the continuing financial needs of businesses and individual Canadians. This is particularly the case for small- and medium-sized companies that do not always have ready access to global capital markets. For them, active, liquid and sustainable Canadian markets are essential to long-term success and growth. Canada's economy as a whole will prosper only if we have a market environment that enables innovative growth companies to find the capital they need at home.

Recent corporate scandals in the United States have demonstrated that capital markets can be fragile; they can be effective engines of growth only if they consistently engender a strong sense of confidence among investors.

It is incumbent upon governments and market participants to continually question whether capital markets are performing at their best and whether the policy and regulatory frameworks that govern them foster long-term economic growth and national competitiveness as well as they should. At its best, sound regulation better

assures that markets will be both transparent and fair so as to inspire investor participation and that capital will be allocated efficiently to its most productive ends. Capital markets around the world continue to evolve rapidly in the face of a changing competitive landscape, new information and communications technologies, and globalization. These developments and the pressures and expectations that have resulted from capital markets malfeasance have placed new demands on securities regulators.

In response to these changes, many countries, such as Australia and the U.K., undertook significant reforms of their financial markets regulatory structures.

### CONSULTATIONS – OUR QUESTIONS TO YOU

The Committee is keenly interested in hearing from issuers, intermediaries, investors and other persons interested in capital markets.

With this in mind, we have developed the following questions, the answers to which will help us to recommend the optimal securities regulatory structure for Canada. We invite you to respond with your views and your own experiences on those questions that are relevant or of interest to you. Your participation is essential if improvements are to be made.

***What, in your view, are the key strengths and weaknesses of the current structure?***

The Committee has been asked to review the strengths and weakness of the current system. Many market participants and regulators have spoken in general terms about the shortcomings and strengths of Canada's securities regulatory system. We are interested in your assessment of the relative importance of any shortcomings that affect your business or participation in Canadian capital markets. At the same time, we will need to fully understand the positive aspects of the current system that should be retained if structural changes aimed at achieving improvements are made. Therefore, we are interested in your assessment of the strengths and weaknesses of the current structure and the basis, including relevant anecdotal or quantitative information, upon which you make that assessment.

***How well are enforcement activities related to capital markets carried out in Canada? Does the present securities regulatory structure enhance or diminish the effectiveness of enforcement? What are the key enforcement issues?***

In the wake of Enron, WorldCom and other corporate scandals, businesses and investors alike have expressed a strong interest in ensuring that Canada has an effective capital markets' enforcement capability. Presently, each regulator is responsible to enforce its own provincial or territorial laws and regulations, though issues can often cross provincial boundaries and require co-ordination among commissions. We are interested in your views on Canada's performance in respect of enforcement issues and whether and how enforcement strengths or weaknesses are affected by the current regulatory structure. Is there a difference between the

effectiveness of investigation and enforcement activities among small and large jurisdictions? How well do commissions handle multi-jurisdictional cases? Are investigation and enforcement activities undertaken in a manner which enhances investor confidence in market integrity?

***How does Canada's regulatory structure affect the international competitiveness of Canadian capital markets and the Canadian economy?***

The growing global competition for capital is an important consideration in any assessment of securities regulation in Canada. The quality of the Canadian securities regulatory system has a direct bearing on the competitiveness of Canadian capital markets and indirectly on that of the Canadian economy. Sound regulation seeks to create benefits by attracting investors, both domestic and international, to place funds in a transparent and efficient marketplace. It also seeks to minimise the costs of regulatory compliance that are associated with achieving those benefits. In your view and experience does the current system create a competitive advantage or disadvantage for Canada? How does the Canadian securities regulatory structure influence your decisions to access capital in the Canadian and foreign capital markets? How effectively do Canadian regulators coordinate their efforts with foreign regulators? How well are the interests of Canadian capital market participants represented, promoted and defended in foreign markets and with their regulators? What are the perceptions of foreign market participants of the Canadian regulatory system, and how does this affect our markets?

***How does the current regulatory structure affect your costs of complying with securities regulation? How have recent initiatives by the Canadian Securities Administrators affected these costs? Are there other significant efficiency issues?***

The costs of the current system are often cited as being excessive, particularly for small- and medium-sized firms wishing to raise capital or to comply with regulatory requirements in more than one jurisdiction. These excess costs are frequently attributed to the need for issuers and intermediaries to deal with many regulators and sometimes conflicting regulations, and to the lack of timeliness in regulatory decision-making. Others argue that excess costs are a consequence of overly prescriptive regulation and not of regulatory structure. Costs of regulation include levies paid to securities regulators, internal corporate costs of compliance, fees payable to external advisors and opportunity costs. In recent years, the CSA have proposed a number of initiatives in an effort to lower costs. How do you perceive the level and trend of the costs of regulation? How are they affected by the current regulatory structure? What impact do these compliance costs have on your ability to access capital markets efficiently and in a timely manner? What effect have recent or proposed CSA initiatives or commission self-funding practices had in this regard? Those who are able to contribute their own analyses of or data on regulatory costs actually experienced are urged to do so.

***Are there unique regional and local characteristics of capital markets across Canada that affect you? What regional and local requirements are met by the current structure and how? In particular, do small- and medium-sized growth companies have unique needs and how does the current regulatory structure accommodate these needs?***

The presence of a regulator in each province or territory is commonly cited as better assuring that there will be an effective response to regional and local interests. The existing framework allows each legislature and regulator, where required, to develop laws, regulations, rules and policies that are tailored to foster local or regional companies. Much debate has centred on whether there are regional and local capital markets or whether the reality is that capital markets, and the needs of issuers, are national in scope, but with special factors defined by sector (for example, the mining or oil and gas industries) or by business size (for example, emerging growth companies). In order to understand how any future regulatory structure can best address regional and local needs (or needs determined by sector or business size), the Committee would like to better understand the nature of those needs and how the current regulatory structure helps or hinders them. Therefore, we are interested in your identification and assessment of diverse capital markets interests (local, regional, sectoral or size-based) and how they should be served by a regulatory structure.

***How do you perceive the timeliness, responsiveness and flexibility of the current system in developing policies, rules and regulations and, where necessary, in revising or simplifying them to meet new circumstances?***

Policy and rule development is an ongoing, necessary process. Securities regulators are constantly adding, subtracting or modifying rules and provisions in response to changes in a fast-moving marketplace. The policy and rule-making process can be judged in two main respects. First, is the process timely, efficient, flexible and forward-looking so as to respond effectively to developments in the market? Second, does the process result in good policies, rules and regulations? We are interested in your views and experiences in respect of the present multi-jurisdictional approach to policy-making in which regulators strive to achieve consensus. How effectively does it provide regulatory responses to new investor or issuer needs? Does it provide innovation where that is needed? We would also like to have your opinion as to whether the content and complexity of rules is affected by the current regulatory structure, including whether there is a proper balance between resources devoted to regulatory coordination as compared to rule content.

***What is your assessment of regulatory structures in other countries? Are there lessons to be learned from other countries' experiences?***

As mentioned earlier, many countries have restructured, or are considering whether and how to restructure, their financial sector or capital markets regulatory systems. These countries argue that structural change is needed to obtain greater efficiency in regulation, in response to a changing financial sector landscape characterized by cross-border and cross-pillar service providers and new communications and information technologies. From your knowledge and experience of other countries' capital

markets, what comment do you have on their regulatory structures and the lessons that Canada might learn from their approaches? Are there approaches to enforcement issues in other countries that are instructive for Canada?

Finally, the most basic and important question upon which we solicit your views is simply “***What would be the best securities regulatory system for Canada?***” We invite you to provide us with your answer to this question in as much detail as you feel you can, including any comments you may have as to the governance structure, the accountability framework, and how to manage any transitional issues you may identify. We are particularly interested to know whether you would favour an enhanced version of the present system or a single commission model.

We ask that, where possible, you provide us with any analysis or objective data that support your assessment of the issues or your conclusions. Your experiences, good or bad, with the present system are especially relevant. The more complete your comments, the better you will assist us in making useful and convincing recommendations to policy makers.

Annex B contains details as to how you may provide us with your submission. We very much value and seek your contribution, and urge your continued participation in this important national policy discussion as our consultations proceed.



## ANNEX A

### Wise Persons' Committee on Securities Regulation Terms of Reference

Given:

- that a dynamic and efficient capital market in Canada will contribute to economic growth through the effective mobilization of savings and the provision of low-cost financing for new and existing businesses;
- that efficient, effective and responsive securities regulation is an important factor in ensuring a dynamic and efficient capital market;
- that securities regulation needs to provide high standards of investor protection—particularly in light of the Sarbanes-Oxley Act in response to Enron and other U.S. corporate scandals; and
- that a large number of Canadians believe that the present system of securities regulation in Canada can and should be improved;

a Wise Persons' Committee is established. The Committee will:

1. review and assess the strengths and weaknesses of the existing system of securities regulation in Canada;
2. recommend the appropriate regulatory structure that will best meet Canada's needs; and
3. recommend a governance model and describe an accountability framework.

The objectives of the regulatory structure proposed by the Committee should be to:

- provide sound protection for investors and confidence that Canada's capital markets are regulated with the highest standards and that those standards are rigorously and equally enforced throughout the country;
- provide efficient capital markets for Canadian businesses of all sizes, and not place an undue burden on firms seeking to raise capital or on firms seeking to offer capital market services;
- encourage dynamic and innovative capital markets throughout Canada; and
- present foreign investors, governments and regulators with a positive image of securities regulation in Canada.

In carrying out this mandate, the Committee will solicit the views of governments, regulators, market participants and the Canadian public on these issues and consider any other relevant issues raised in these discussions. The Committee should, where possible, work with provincial governments and regulators and take into account the work of complementary processes aimed at improving securities regulation in Canada.

The Committee will also give particular consideration to the respective merits of two specific models against the objectives described above, namely:

- (a) an enhanced version of the present system, with such practical and achievable improvements as the Committee might propose so that there is a greater sense of common purpose and more efficiency; and
- (b) a single commission model in which governments electing to participate would pool some or all of their authority in a single regulator administering one set of rules.

The Committee may also consider other models, including combinations of the above.

In elaborating its recommendations, the Committee will also:

- identify any difficult or challenging issues to be encountered in achieving the model it recommends and propose ways to resolve these issues; and
- address any significant implementation issues, including transition costs, should major institutional changes be proposed.

The Committee will supervise a dedicated staff to assist in its consultations and to undertake or organize research studies or prepare papers or discussion documents it considers necessary to complete its work, subject to budgetary limits.

The Wise Persons' Committee will report by November 30, 2003.

## ANNEX B

Please provide your submissions by June 30, 2003 to:

Mr. Michael Phelps (Chair)

WPC Committee to review the structure of securities regulation in Canada

P.O. Box 10026

700 West Georgia Street

Vancouver, B.C.

V7Y 1B3

e-mail: [wpc-cpa@farris.com](mailto:wpc-cpa@farris.com)

Facsimile No.: (604) 661-9349

### SUBMISSION GUIDELINES

The Committee proposes to post all submissions received on the Committee's website at <http://www.fin.gc.ca/wise-averties>, subject to "Confidentiality" below. Where possible, all submissions should be forwarded electronically to the Committee at [wpc-cpa@farris.com](mailto:wpc-cpa@farris.com). If a submission is provided by mail or delivery, a diskette of the submission should be provided, if possible. Any electronic submission or submission on diskette should be in Word 97 or WordPerfect 9.0 and should not be in pdf form. However, if an electronic copy cannot be provided, the Committee will endeavour to convert the submission into electronic form.

All submissions should indicate a contact person and contact details (ie. return address, telephone and fax numbers, e-mail address), who would be available to respond to inquiries from the Committee, its staff, or the public in connection with the submission. You should indicate by which method you would prefer to be contacted and also state whether any communication with you should be in French or English.

### CONFIDENTIALITY

The Committee believes that the discussion of how to best improve the structure of the securities regulatory system, will be enhanced by a transparent and vigorous debate on relevant issues. With that in mind, all submissions will be made available on the Committee's website except for material containing confidential or otherwise sensitive information. If a submission or portion thereof is made to the Committee on a confidential basis, the submission or such portion should expressly state that it be treated as confidential. In the absence of any such indication, the Committee will treat each submission as public information. The Committee prefers that confidentiality requests be minimized and limited to situations involving only highly confidential information.

## **CONSULTATION PROCESS**

Persons or entities making submissions may request meetings with the Committee, or may be approached by the Committee or its staff, to enable such persons to expand upon their submissions or to enable Committee members to make further inquiries.

Members of the Committee and its staff will meet with interested persons to elaborate on the issues or to present their points of view. Meetings for that purpose will be scheduled in certain cities across Canada. The Committee will provide public notice of any meetings to be held. Please check the Committee's website (<http://www.fin.gc.ca/wise-averties>) for details of scheduled meetings and the procedures for these meetings. In addition, the Committee will commission research projects and requests the co-operation of interested persons in working with our researchers.