June 27, 2003

Mr. Doug Hyndman
Chair
British Columbia Securities Commission
PO Box 10142, Pacific Centre
701 West Georgia Street
Vancouver, BC V7Y 1L2

Dear Mr. Hyndman:

The Ontario Securities Commission welcomes the opportunity to comment on the proposed BCSC model. We agree with your assessment that Canadian securities regulation is under intense scrutiny and there is need for reform.

As you point out in the *Commentary on Draft Legislation*, there are a number of processes underway to respond to the challenge for reform. These include:

- the federal Wise Persons' Committee which is seeking direction on what is the best securities regulatory system for Canada,
- the provincial ministers' process which is focusing on a passport system and harmonized securities regulation,
- the CSA Uniform Securities Legislation (USL) project which aims to streamline and harmonize securities legislation through a uniform securities act and rules,
- the report of the Ontario Five Year Review Committee which supports a national securities regulator among its recommendations for reform, and
- the Ontario Fair Dealing Model which proposes an innovative way to regulate financial services providers.

We are encouraged by the renewed interest and commitment on the part of governments and regulators to reform securities regulation. Over the past four decades, there have been attempts to reform our fragmented regulatory system to more adequately respond to the evolving and competitive challenges facing our small Canadian market. To be successful, we need to be innovative, timely, and we need to work together.

We applaud your Commission's immense effort and the extensive and transparent consultation process in developing a concept paper and draft legislation within a short period of time. As part of the dialogue on reform, your focus on the effectiveness, efficiency and complexity of the current system is an important component of the debate.

We share your objectives to streamline securities regulation, make the rules simple and clear, and reduce costs and inefficiency for market participants. We are supportive of the goal to establish a regulatory system that imposes minimum regulatory burden on industry as long as it does not compromise investor protection and market efficiency.

In reviewing your proposals, we assessed whether the BCSC model adequately ensures market efficiency and investor protection. We also measured your proposals against their compatibility with the initiatives of the CSA and other major jurisdictions.

Overall, we are concerned that the BCSC has chosen to pursue a significant shift in policy direction that will undermine the progress the CSA has achieved to harmonize securities regulation across Canada. If your proposals are implemented, it will further fragment securities regulation in Canada and open a significant gap in securities regulation between BC, the rest of Canada, the U.S. and other major world markets.

To be effective, reform needs to be accomplished on a harmonized and national basis. The BCSC proposals need to be considered in context with CSA initiatives aimed at regulatory harmonization and uniform securities legislation. In this regard, the BCSC proposals are not consistent with the direction of the Uniform Securities Legislation project to harmonize and streamline regulation across Canada. Your criticism of USL as a missed opportunity for regulatory reform undermines the importance of the project and the significant progress that has been achieved with the release of the concept paper, *Blueprint for Uniform Securities Laws for Canada*.

Although the primary focus of the USL project is to achieve harmonization of securities legislation, a complementary goal is to simplify and streamline the regulatory system. The resulting uniform Act, regulations and national rules will be simplified and less voluminous. Uniform registration, prospectus and exemption requirements, a streamlined registration system (passport) and delegation of powers are important components of the project. Given the aggressive time lines of the USL project, it has not been possible to achieve consensus in incorporating further policy changes. Where consensus can be achieved in a timely fashion, more reforms can be accommodated.

As you note in the *Commentary*, your proposals are driven by the BC government's agenda to reduce regulation across all government sectors by one third. To facilitate compliance with this direction, you have chosen to focus exclusively on the volume and complexity of rules. The analysis does not give sufficient weight to the more serious problems involving differences in regulatory requirements among jurisdictions and the multitude of decision-makers. A significant number of commentators on your proposals have identified the need for a national securities regulator as the most pressing issue that

needs to be addressed by regulators and governments.

Your objective is to reduce the volume of regulation by requiring market participants to adopt principles and codes of conduct. Compliance with the principles and codes will be encouraged through enhanced enforcement powers and new remedies for investors. We are concerned that the proposed shift in focus to enforcement and new civil remedies as the counterweight to relaxing requirements will not provide sufficient protection for investors.

We are concerned that you may have gone too far in removing prescriptive requirements and relaxing requirements on market participants. Commissions have a responsibility to proactively enforce clear standards to protect investors and foster a fair and efficient marketplace. Market participants also expect clear guidance on appropriate behaviour.

In reforming our securities regulatory system, we need to go beyond the debate on the relative merits of principles-based versus rules-based regulation. There is no question that we must have clearly articulated principles. The interpretive flexibility inherent in principles provides adaptability and allows our regulatory system to evolve.

The problem is that principles alone are rarely sufficient. They do not provide sufficient clarity for market participants or for regulators unless they are supplemented with rules. The application of principles could be open to widely differing interpretations unless they are supported by sufficient guidance to ensure that they will be applied consistently in similar circumstances. To force market participants to determine what is expected of them is to shift the regulatory burden down to those participants. To force investors to interpret a set of principles and to make a judgement as to whether their application by an issuer or registrant is adequate is neither efficient nor would it inspire confidence. We believe that rules are necessary to amplify and clarify clearly articulated principles.

The use of both principles and rules is necessary in the formulation of effective securities regulation.

Costs

We are concerned that your proposals will not reduce costs or increase efficiency for market participants. Your analysis is focused on a reduced role for the regulator, but overlooks the increased costs of compliance for market participants and the increased burden of enforcement that will be borne by investors. Your model does not take into account the duplication, inefficiency and increased costs for market participants complying with the requirements of different securities regulatory regimes.

A principles-based approach results in decision-making by the courts and administrative tribunals thereby adding to the complexity and costs for market participants. It also increases the uncertainty of future regulation by letting the courts, rather than the

securities commission, interpret the rules going forward, potentially changing the direction of regulation in ways not anticipated, nor possibly desired, by the BCSC.

Registration: Principles and Code of Conduct

Registrants are currently required to maintain high standards of integrity in all aspects of their dealings with investors. The current rules prescribing a registrant's qualifications, proficiency and ethical conduct are detailed and prescriptive. In place of the existing set of detailed regulatory requirements that determine who can participate in our markets, and govern the conduct of market participants, the BCSC model proposes the following changes:

- the substitution of eight broadly-worded principles for most of the existing detailed rules that must be satisfied in order to obtain registration and that govern the ongoing operation of registrants,

- new civil remedies which are intended to expand the ability of investors to sue market participants who break the rules as the counterweight to the relaxation of detailed requirements, and

- elimination of the existing requirements for representatives of registered dealers and advisers to be registered, and hence the current screening by regulators of these market participants for fitness or suitability (the "firm-only registration proposal").

We do not agree that Principles, a Code of Conduct and Guidelines should serve as a replacement for existing prescriptive legislative or SRO requirements. Our existing requirements have been developed over many years, based on the experience of industry and regulators. We disagree with the premise that replacing prescriptive requirements with general principles to be applied ad hoc by registered firms results in reduced regulatory burdens and more efficient capital markets. We believe that a combination of principles and clear prescriptive requirements reduces the regulatory burden for market participants and promotes efficiencies.

We are concerned that the ability of regulators and investors to take remedial action for breach of these requirements could be substantially impaired, due to the generalized language of the principles (and the recognition in the principles that firms can determine their own requirements). We believe that the substitution of a set of *subjective* principles for an existing comprehensive set of *objective* regulations will necessitate substantial costs – as the regulators, registrants, and their clients must determine, through costly administrative and civil litigation, what conduct constitutes compliance with the Code. This will inevitability add significantly to the regulatory burden and cost for market participants and investors.

Both investors and market participants expect clear guidance on the expected conduct of

market participants. Clear and unambiguous rules serve to promote investor protection and market efficiency as fewer resources need to be expended on interpretative issues and the pursuit of legal remedies.

The permissive language contained in the Code and the flexibility in the Code's direction that firms need only adopt policies and procedures that suit their situation will invite divergent standards of conduct that will place burdens on clients seeking redress.

Investor redress will be further compromised by your proposed elimination of specific minimum capital requirements for participating firms (although investment dealers and mutual fund dealers that are members of an SRO will be required to satisfy the SRO's capital requirements). Owners of adviser or restricted dealer firms may choose to address the risk of remedial action by maintaining minimal capital in the enterprise, thereby reducing the assets available to satisfy client claims.

Registration: Firm-Only Registration

The BCSC model proposes that only firms be required to obtain registration, and that the present requirement to register the individual representatives of the firms be eliminated. The firm, not the regulator, would have the responsibility of determining an individual's "fitness" or "suitability" to participate in the industry.

The effect of the BCSC proposals is to shift the regulatory burden onto the employer, raising the question whether firms have the same duty to protect investors as regulators do. The shift also raises concerns regarding increased costs for the employer. A significant number of industry participants have flagged the cost implications of this proposal.

You argue that the registration of individuals creates a large paper burden on firms because they have to submit detailed applications in each jurisdiction where they wish individuals to be registered. This argument is no longer relevant because, as you acknowledge, the National Registration Database (NRD) addresses these concerns. Redesigning NRD to accommodate firm-only registration would involve significant costs.

Investor protection is enhanced by the requirement for the individual representatives who trade and advise on behalf of a registered firm to also apply for registration (including a reinstatement, or transfer to another firm) and renewal of registration. In connection with the firm only registration model, an important issue that arises is the ability to appropriately deal with individual registrants who have been disciplined or terminated by their employers, but who resurface with another registered dealer. The process of individual registration assists in monitoring the movement of such individuals.

The *Commentary on the Draft Legislation* suggests that, while regulators would no longer be in a position to prevent an individual from trading or advising on behalf of a firm (by

the regulator satisfying itself on the suitability or fitness for registration of the individual representative), the regulator would still retain the power to suspend or prohibit inappropriate or unqualified individuals after the inappropriate activity has come to the regulator's attention. We believe that investor protection is better served by not permitting participation in the industry by undesirable individuals in the first place, rather than by trying to remove them after they have harmed investors.

The premises that underlie the BCSC model have not been tested nor have they been subjected to a cost-benefit analysis. While the proposed changes may stimulate a useful discussion of the objectives and efficacy of existing registration requirements, we are concerned that they will not produce the intended results with respect to market efficiency, investor protection and streamlining. Additional information is needed to better assess the merits of a Code of Conduct. We would like to see more discussion on the enforceability of principles, a cost-benefit analysis of the implications of this proposal and some discussion of how SROs fit into your proposals.

Continuous Market Access System

Your Continuous Market Access System (CMA) appears to be a refinement of the streamlined offering system outlined in the Integrated Disclosure System (IDS) proposal published by the CSA in January 2000.

As you know, the CSA has been actively working on the development of IDS in recognition that more efficient access to capital with minimum regulatory delays will benefit all market participants. IDS will permit faster and less costly access to capital markets by allowing eligible issuers to use their continuous disclosure and streamlined offering process and disclosure for new distributions.

In order to facilitate the implementation of IDS and given that the vast majority of trading takes place in the secondary markets, the CSA has been focussing its efforts on improving the quality of continuous disclosure in Canada**.** In developing National Instrument 51-102 *Continuous Disclosure Obligations,* important steps are being taken to harmonize continuous disclosure requirements and to introduce new requirements which will greatly enhance the quality of continuous disclosure provided to the marketplace by Canadian issuers. A strong system of continuous disclosure will pave the way for an eventual implementation of an integrated disclosure system.

The significant differences between the CMA and IDS and the areas where we have concerns are as follows:

<u>Prospectus remedies</u>

The CMA proposal eliminates the prospectus and the consequent requirement for issuers to be responsible to investors who buy shares from the issuer for the completeness and accuracy of the information that is provided. Under a prospectus regime, purchasers of

treasury securities have the right to get their money back if they have been misled. Even if the misrepresentation is an innocent one, the issuer cannot keep the money. The CSA's proposed IDS system preserves this right for investors by keeping in place a streamlined prospectus.

The BCSC approach eliminates this right, providing a more limited right to recover limited damages and only if the issuer failed to be properly diligent. We cannot agree with an approach that takes away a fundamental right for investors.

Other major jurisdictions such as the United States, the United Kingdom, Australia and the European Union have retained the prospectus-based system for the distribution of securities.

We note that the BCSC model contains a "harmonized interface" that would entitle BC purchasers to the prospectus remedies available in other jurisdictions if they purchase securities under a prospectus offering. Given that many issuers seek financing in BC and other Canadian jurisdictions at the same time, we expect that most issuers and BC investors would be subject to and benefit from existing prospectus rights regardless of your changes.

Timely disclosure - Material information standard vs. Material Fact and Material Change

The BCSC model proposes to change the trigger for timely disclosure to a material information standard. Under this approach, an issuer must ensure its continuous disclosure record contains all material information about the issuer and its securities all the time. Any new material information must be disclosed in a news release as soon as practicable.

Comments in the *Issuers Guide* indicate that the material information trigger used in the BCSC model results in the disclosure of the same information as would be disclosed under the current regime of "material fact" used in the prospectus context and "material change" used in the continuous disclosure context. We disagree with this assertion and would like more analysis to understand the basis for this proposal. The Ontario Five Year Review Committee considered whether the disclosure standard should be changed to a material information standard, but rejected the idea because of the difficulties that issuers would face in trying to comply with that standard.

While the concept of changing the timely disclosure trigger to material information has some appeal because more information would be available to the marketplace, we believe it would be onerous for issuers to comply with this standard. To address this concern, we note that you included in your draft legislation a safe harbour for issuers that are subject to timely disclosure obligations in another Canadian jurisdiction. So long as these issuers comply with the material change disclosure requirements, they will be exempt from the BCSC draft legislation news release requirement. The practical effect of the proposed safe harbour is no change from the current timely disclosure trigger for the majority of

issuers in Canada, thus raising the question whether it makes sense to make the change.

We question whether the merits of adopting a material information trigger outweigh the confusion that we believe will be created in the marketplace, both from the change itself as well as the existence of a safe harbour provision. As an alternative approach, Ontario's Five Year Legislative Review Committee reaffirmed the existing material change approach, but with a recommended modification to the definition to replace the market impact test with a reasonable investor standard. We suggest this would be a preferable approach.

Fewer requirements – increased "guidance"

While we understand the approach taken by the BCSC to reduce regulation, we disagree with the replacement of existing requirements with only general guidance. Again, we believe this to be an extreme approach. We believe that the approach taken by the BCSC pushes the cost of regulation onto issuers and investors because there is less certainty as to what is expected of issuers to be in full compliance with the law. By allowing companies the flexibility to determine what disclosure is relevant for the market, comparability between issuers will be reduced.

We also note the ability of the BCSC to issue a cease trade order against the issuer in circumstances where it is determined by the regulator that the issuer has failed to provide material information to the marketplace. We believe that it would be difficult to evaluate when information is missing from the market and that the use of the cease trade tool against an issuer in these circumstances inappropriately penalizes investors.

An additional concern with the substitution of guidance for specific requirements is how a regulator uses the guidance. We are particularly concerned where "requirements" are disguised as "guidance". It remains to be seen how the BCSC will view issuers that do not follow the guidance given. Again, this raises the issue of providing certainty for issuers to know they are doing what is expected of them to comply with the law.

We are concerned about the ability of regulators to enforce compliance under the CMA system, given the lack of specificity in requirements and the fact that disclosure decisions are largely left to the "reasonable business judgement" of issuers. We believe that it is critical to deal quickly with non-compliance matters to maintain the integrity of the system and the reputation of Canada's markets and to protect investors.

We are concerned about how our regulatory system will be regarded internationally if the prospectus and continuous disclosure regimes are perceived to be less onerous than they currently are and especially if they vary widely among our jurisdictions.

The cross-border and international implications of adopting a CMA system need to be carefully assessed. The implications of shifting to a CMA system while the U.S. and other jurisdictions and investors continue to rely on a prospectus disclosure regime must

be assessed.

Investor Remedies

The BCSC model proposes to provide investors with a right of action for damages for material contraventions of the Act or the Rules. This single right of action is intended to replace all of the existing rights of action under BC securities law and expand statutory remedies beyond where they are today. We are not aware of any deficiencies or gaps in existing common law remedies (other than in the context of secondary market investors who are injured by misleading disclosure) which would dictate such an expansion of the current statutory civil remedies regime. Your proposals are silent on this point. We believe that your proposed new civil remedies regime warrants a much more thorough review to better understand its impact on Canada's capital markets.

The balance of our comments relating to investor remedies focus on your proposed changes to the CSA's draft November 2000 statutory civil liability regime for secondary market investors. As you know, the Ontario Government recently passed amendments based on the CSA's draft legislation. We expect that these amendments will be proclaimed in force soon.

Ontario's Bill 198 civil remedies regime is a culmination of more than two decades of government and industry reports studying civil liability in the secondary market, including the report by the blue ribbon Allen Committee. Following the release of the Allen Committee's Final Report in March 1997, the CSA determined that it was a top priority to respond to the Committee's recommendations. The BCSC participated on the CSA Committee that developed the legislation and was supportive of the initiative. At the outset, the CSA decided to follow in principle the Allen Committee's recommendations as they pertained to the design of the proposed civil liability regime for continuous disclosure. We carefully considered and relied upon the Allen Committee's extensive research, analysis, and consultations with market participants and their advisers and engaged in extensive additional consultations and public comment processes.

We are concerned that the BCSC proposes significant changes from the CSA's statutory civil liability regime. For example, the BCSC is proposing to:

- impose a more rigorous liability standard on directors and officers for misrepresentations in public oral statements,

- impose a more rigorous liability standard on outside directors for misrepresentations in documents not required to be filed under securities law and for failure to make timely disclosure,

- shift the burden of proof onto potential defendants under all circumstances,

- eliminate several defences available to defendants including the "whistleblower" defence,

- eliminate the automatic intervenor status of a securities regulatory authority in any civil action launched under the legislation, and

- eliminate the damages calculation section which was intended to provide a roadmap for courts to ensure consistency among awards.

These changes are troubling. As you know, many commenters on the CSA's draft legislation were concerned about the potential for multiple class actions being initiated in different CSA jurisdictions based on the same disclosure violation. Indeed, multiple class actions could undermine the ceilings on liability envisioned under the CSA's draft legislation and ultimately Ontario's Bill 198. These issues may be addressed by the courts through the exercise of powers given to them to manage class actions and to stay or consolidate actions. The difficulties of coordinating class actions intraprovincially, however, will be exacerbated by differences in provincial liability regimes. Such differences with respect to standards of liability, defences or burden of proof may also result in forum shopping by plaintiffs. None of these results is desirable. It is for this reason that the CSA was and remains committed to creating a uniform statutory liability regime for disclosure violations.

The issues relevant to creating an effective deterrent civil liability regime for secondary market investors have been considered in Canada on numerous occasions. Most recently, the CSA engaged in a robust and comprehensive study of the Allen Committee proposals, developed draft legislation for public consultation and considered comments received on the legislation. We need to proceed with the CSA's proposals – not reopen them to a further round of debate. We hope that other jurisdictions including BC will follow the Ontario Government's lead in enacting this landmark legislation.

Conclusion

Staff is reviewing your proposals in detail to determine where there are opportunities for harmonization. We agree that more can be done to streamline securities regulation.

We are pleased that, in some areas, such as mutual funds and take-over and issuer bids, the BCSC has decided to work within the CSA to implement reform. In developing their proposals for mutual fund governance, for example, staff has tried to achieve a more balanced approach to regulation by avoiding unduly prescriptive and detailed provisions, while including prescriptive rules where a consistent industry standard is necessary to achieve a regulatory result.

Mutual fund governance is an example of how we can work together to achieve a better balance between principles and prescriptive rules.

Overall, we are concerned that your proposals:

- increase the regulatory burden and costs for market participants,
- raise significant investor protection concerns, and
- are not compatible with the direction of CSA and other major international jurisdictions.

We are concerned that, if your proposals are adopted unilaterally, securities regulation in Canada will be further fragmented and the efficiencies that we have accomplished to date through the CSA would be seriously undermined.

I welcome the opportunity to further discuss my comments with you and to engage in a meaningful dialogue on how we can work together within the CSA to achieve a harmonized, effective and efficient regulatory regime.

Sincerely,

David Brown
Chair