Expert Panel on Securities Regulation

Creating an Advantage in Global Capital Markets

FINAL REPORT AND RECOMMENDATIONS

January 2009

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Expert Panel on Securities Regulation
Groupe d'experts sur la réglementation des valeurs mobilières

January 12, 2009

The Honourable Jim Flaherty, P.C., M.P.
Minister of Finance
Ottawa, Ontario K1A 0G5

Dear Minister:

We are pleased to present to you the report of the Expert Panel on Securities Regulation in Canada. The broad conclusions and recommendations presented in the report are supported by all members of the Panel. The report is accompanied by a draft Securities Act, including a commentary.

To support our deliberations, we commissioned a series of research studies. The research process was managed by the Capital Markets Institute, a research institute affiliated with the University of Toronto's Rotman School of Management. The research studies and the draft Securities Act can be accessed at www.expertpanel.ca.

Our work effort has been enriched by the time and energy devoted by many individuals. Those that participated in our consultation process shared important insights on how to improve securities regulation in Canada. Our special advisors, Sir Howard Davies, David Green, and Peter Hogg, Q.C., as well as our Legal Advisory Committee, gave wise counsel. The business law firm, Stikeman Elliott LLP, provided excellent legal advice, and our secretariat, led by David Murchison, delivered able, professional support along the way. The Canadian Bar Association (Securities Law Committee) provided valuable input on the draft Securities Act.

We hope that the report and draft Securities Act will be of value to your government, and to the provincial and territorial governments, as improvements to Canadian securities regulation are considered.

Sincerely,

Tom Hockin

The Honourable Thomas Hockin, P.C. (Chair)

Ian D. Bruce

Ian D. Bruce, F.C.A.

L. Denis Desautels

Denis Desautels, O.C., F.C.A.

Hal Kvisle

Dawn A. Russell

Dawn Russell, Q.C.

Terry Salman

Heather Zordel

Heather Zordel

c. Provincial-Territorial Ministers responsible for Securities Regulation

Mandate

The Expert Panel on Securities Regulation in Canada will provide advice and recommendations to the Minister of Finance and the provincial and territorial Ministers responsible for securities regulation on the following:

1. The objectives, outcomes, and performance measures that will best anchor securities regulation and the pursuit of a Canadian advantage in global capital markets.
2. How Canada could best promote and advance proportionate, more principles-based securities regulation, starting from existing harmonized legislation and national and multilateral regulatory instruments, with a view to creating a Canadian advantage in global capital markets.
3. How proportionate, more principles-based regulation could facilitate and be reinforced by better and more coordinated enforcement, which could include a separate securities tribunal.
4. How this approach to regulation could be implemented under a passport system or under a common securities regulator.
5. A model common securities act and a transition path, including key steps and timelines, that participating provinces and territories could adopt to effect proposed changes to the content, structure, and enforcement of regulation.

The Expert Panel will draw on global best practices and build on the strengths of Canada's capital markets. It will also review efforts to date to harmonize and simplify Canada's regulatory system.

The proposals of the Expert Panel will be respectful of the jurisdictional framework for securities regulation in Canada and will allow willing participation of provinces and territories.

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Chair's Foreword

If there is one message that came through clearly during our deliberations, it is that global financial systems matter. They matter to Canadians and they matter to international investors. When organized properly and operating efficiently, financial systems deliver capital that spurs job creation, facilitates investment, and creates opportunities.

What is also clear is that in today's increasingly interconnected economy, how Canada organizes its own capital markets matters not only to Canadians—but to the world. As billions of dollars move around the globe at the click of a mouse, investors will not tolerate outdated, cumbersome, or duplicative systems. And investors will not tolerate poor enforcement of securities law. If Canada is to realize its potential in the global economy, the regulation of its financial markets must be among the world's best. At the moment, it is not.

Our mandate focuses on securities regulation, the subject of over 70 years of study and several large bodies of work in recent years alone. This work informed our discussions; however, over the course of 10 months, we also met with well over 100 stakeholders, consulted with experts, and reviewed the results of our commissioned research studies.

The result is our report, which begins with an examination of different approaches to sound regulation. We recommend Canadian securities regulators should focus less on process and more on outcomes; relying more on articulating principles than on multiplying rules. We believe that regulation should be grounded in guidance and rules on a bedrock of well-formulated principles. This will help reduce unnecessary compliance costs, improve regulatory outcomes, and give Canada a competitive advantage. And, by harnessing the flexibility of proportionate-based regulation, we believe that regulation could be better tailored to reflect the risk, size, and sector of public companies in Canada. Canada's preponderance of smaller public companies should be a particular focus of this effort.

We also recommend adopting a comprehensive performance-based system of measurement for securities regulation—as a few provincial securities regulators are today doing—which will both sharpen the focus on outcomes and improve accountability to Canadians. To promote fairness in the adjudication of regulatory matters, we propose the establishment of an independent adjudicative tribunal. In coming to this conclusion, we were heavily influenced by the success of Quebec's independent tribunal.

During our consultations with Canadians, we heard particular concerns about investor protection. My fellow panellists and I were troubled by the accounts of individuals who had not been well-served by the current regulatory system. Investors who have lost money because of fraud or inappropriate advice quite naturally want their money back. But the likelihood of successfully obtaining this basic form of redress varies across the country.

Investors also told us of the difficulty of commencing the complaint process and the challenge of navigating the complicated web of securities regulators and national self-regulatory organizations.

We also heard that the enforcement of securities law in Canada does not compare favourably relative to other jurisdictions. This is true whether it is administrative enforcement by securities regulators and self-regulatory organizations, criminal investigations by police, or prosecution in our courts. If a basic purpose of securities regulation is to protect investors, Canada's system is falling short.

Over the past number of years, significant progress has been made through the development of the current passport system. This has enhanced the levels of harmonization across jurisdictions and facilitated operations for companies carrying on business in different parts of the country.

Although the passport system is a major step forward, most stakeholders told us that its application is limited and it still falls short of what is required in today's global marketplace. We agree. The shortcomings of the present system are clear: it remains too slow, too cumbersome, and too expensive. At a time when speed counts, policy development is protracted, negatively affecting Canada's ability to respond in a timely manner to national and global developments.

The Panel heard repeated—and often passionate—concerns about the cost and confusion caused by our fragmented system of 13 separate securities regulators. In this, our work echoes that of our predecessors. While the terminology has differed over the years— single, common, Canadian, national, or federal—the conclusion of virtually every study has been the same: Canadians are ill-served by such a balkanized system. It is worth noting that Canada is the only developed country without a national securities regulator.

The lack of a national Canadian securities regulator also raises wider concerns about systemic risk as there is no national entity accountable for the stability of our national capital markets. Systemic risk is no longer confined to just banking institutions; it now increasingly presents itself in capital markets, as the current financial crisis has clearly demonstrated. Neither the Canadian Securities Administrators nor the provincial and territorial securities regulators can provide a counterpart to the Bank of Canada or the Office of the Superintendent of Financial Institutions—federal agencies that are accountable for their role in the stability of Canada's financial sector. We are convinced, therefore, that the federal government needs to have a strong presence in the regulation of Canada's capital markets. We are assured by our constitutional advisor that the federal Parliament has the constitutional authority to enact legislation that would provide for comprehensive capital markets regulation in Canada.

With a mandate to find common ground and propose a workable solution, our central recommendation is that Canadians need a single securities regulator, with a strong decentralized structure that recognizes Canada's unique makeup and regional and local expertise, provides clear national accountability, and offers more effective enforcement and redress for investors.

At the same time, we want to build on the best of the current system. Those features that have served Canadians well—and helped attract foreign capital to our markets—have been retained and strengthened in our recommended structure.

We believe there are compelling reasons—and substantial benefits—for provinces and territories to participate in the new regulatory regime. If, however, after a reasonable period of time, some provinces or territories remain outside of the new structure, market participants—issuers and registrants—in those non-participating jurisdictions should have the opportunity to opt-in and reap the benefits of a single, national securities regulator, administering one Act, applying one set of rules, and collecting one set of fees.

Our report provides a clear and comprehensive roadmap to move Canada from where it is to where it must be. To facilitate the transition to the new structure, we have included a draft Securities Act. The steps we are proposing are both overdue and essential. They will finally provide Canadians with true national accountability across the full spectrum of financial regulation and align Canada with emerging trends in international financial markets. This will simplify the system, reduce costs, and attract investment.

Positioning Canada for success in today's interconnected markets is critical. The challenges are too great and the opportunities too numerous to muddle through as before. We must act—and we must act now.

Tom Hockin

The Honourable Thomas Hockin, P.C.

January 2009

Introduction

Financial markets are more international than ever before. While we do not live in a borderless world, capital flows easily across borders and can significantly impact economic welfare. This point has been borne out by the recent stresses experienced by financial institutions around the world, originating with the precipitous decline in the sub-prime mortgage market in the United States that is now impacting employment and retirement savings worldwide. Market innovation has led to much greater prominence for institutions such as hedge funds and private equity funds, which are not subject to the same market oversight as traditional institutions. New instruments such as collateralized debt obligations and credit default swaps have allowed the transfer of risk in ways that are testing the world's financial architecture. These developments, and the consequences of the growing global interdependencies, pose challenges for financial regulation.

As these observations indicate, the ambit of financial regulation is broad. The scope of the Expert Panel's mandate, however, is relatively narrow. Our focus is on those areas that enhance the content, structure, and enforcement of securities regulation in Canada. One of the early lessons we take from the current financial crisis is that regulators, legislators, and rule makers must be mindful of macro-prudential considerations when designing regulation. In this context, one key tenet of our work has been to consider how to facilitate better coordination and cooperation between the authorities with responsibilities for financial stability and the various parts of our financial sector—banking, insurance, pensions, and capital markets—both across geographic borders within Canada and internationally.

Canada's financial regulatory system is best described as a hybrid not common in the world.[1] In common with most other countries, oversight of banking in Canada is a national responsibility, discharged by the Office of the Superintendent of Financial Institutions. The Bank of Canada, like most central banks, has a mandate for overall financial stability. Canada's 13 securities regulators have provincial and territorial mandates. There is no securities regulator with a specific mandate for facilitating the reduction of systemic risk.

Following the terms of our mandate, this report begins by considering the objectives of securities regulation, examining the role of systemic risk, and discussing the often conflicting objectives of competition, innovation, and investor protection. This is followed by an examination of principles-based regulation as a possible response to a securities regulatory environment that many believe has become too reliant on rules. We also question whether securities regulators should make greater use of proportionate-based regulation given some of the unique characteristics of Canada's capital markets. We conclude by examining whether regulatory matters should be adjudicated by an independent tribunal in Canada.

Our report goes on to discuss a number of areas where we believe investors could be better served. Although not a core mandate item, we felt compelled to address a number of investor issues in light of our findings. We focus on the complaint-handling and financial redress mechanisms in Canada as well as the lack of representation of investors in the securities regulatory policy development process.

We then go on to address which structural model, a passport system or single securities regulator, would be best for Canada, and why. This is followed by a discussion of opportunities to strengthen enforcement as well as to improve the regulation of derivatives. In the final section of the report, we provide a transition plan that identifies key issues and steps to get us from where we are today to the implementation of our recommendations. A key component of this transition plan is a draft Securities Act.[2]

Securities regulation must protect investors and promote market integrity, while achieving effective regulatory outcomes without imposing unnecessary compliance burdens. Our report recommends how this can be achieved. Our conclusions and recommendations have been shaped by the submissions we received, by our deliberations, consultations, and research,[3] and by our experience.

CONSULTATIONS AND STAKEHOLDER INPUT

Between April 21st and July 15th, 2008, the Panel held meetings with over 100 stakeholders across the country, representing the diversity of participants in Canada's capital markets.

The Panel also met with certain regulators, policymakers, and market participants in the United Kingdom and United States in order to better understand the regulatory practices of these important jurisdictions and gain international perspectives of Canada's capital markets.

In response to our consultation paper, the Panel received over 70 written submissions from firms, regulators, investors, business associations, and others. Quotes from a number of these submissions are presented in captions throughout this report.

The Stakeholder Report, released in August 2008, provides a summary of the face-to-face consultation meetings. The written submissions can be accessed at www.expertpanel.ca.

ENDNOTES

[1] A schematic of Canada's securities regulatory system is provided in Appendix 4.

[2] The draft Securities Act, with a commentary and a table of concordance, is accessible at www.expertpanel.ca. The table of concordance relates the provisions in the draft Securities Act to the corresponding provisions in the applicable provincial securities acts, or if there are no corresponding provisions, to the relevant source(s).

[3] More information on the commissioned research studies is provided in Appendix 3.

Objectives, Outcomes, and Performance Measurement in Securities Regulation

I. OBJECTIVES OF SECURITIES REGULATION
II. PERFORMANCE MEASUREMENT IN SECURITIES REGULATION

Securities regulation requires clear objectives to achieve outcomes that are in the best interests of Canadians. In this section, we present the objectives that we believe will best anchor securities regulation in Canada. We also discuss approaches used by securities regulators in Canada, and in other key capital market jurisdictions, to measure the performance of securities regulation. We believe that clear, uniform objectives, combined with a strong system to measure performance against those objectives, will help to secure Canada's advantage in global capital markets.

I. OBJECTIVES OF SECURITIES REGULATION

Securities regulation plays an important role in helping to ensure that capital markets function effectively. The core objectives of securities regulation are to promote investor protection, enhance economic efficiency by allocating capital to its best uses, and foster confidence in capital markets. Securities regulators, in working to achieve these objectives, are often required to be mindful of other considerations, which are referred to as the guiding principles of regulatory conduct.

Our draft Securities Act prescribes core objectives and guiding principles that we believe will best position securities regulation in Canada (see Table 1). They reflect Canadian best practices and those supported by the International Organization of Securities Commissions.[4] We believe that having a uniform set of core objectives and guiding principles for Canada will foster a clearer understanding of what securities regulation is intended to achieve, and how securities regulators should conduct themselves.

We recommend a uniform set of core objectives of securities regulation and guiding principles of regulatory conduct for Canada.

During our deliberations on objectives and principles, we focused particular attention on two areas that we believe need to be assessed closely in light of the recent turmoil in global capital markets. We deliberated on whether the reduction of systemic risk in the larger financial system should be a core objective of securities regulation. We also discussed whether a guiding principle of regulatory conduct should be to enhance competition and innovation in Canada's capital markets, as had been recommended by previous expert bodies.[5] Our views on these matters are discussed below.

(TABLE 1)

RECOMMENDED CORE OBJECTIVES AND GUIDING PRINCIPLES

THE CORE OBJECTIVES OF SECURITIES REGULATION ARE TO:

- protect investors from unfair, improper, or fraudulent practices; and
- foster fair and efficient capital markets and confidence in those markets.

THE GUIDING PRINCIPLES OF REGULATORY CONDUCT INCLUDE:

- facilitating the reduction of systemic risk, including through monitoring of systemic events or developments and cooperation and coordination with other financial authorities;
- recognizing that the business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the benefits sought to be realized;
- maintaining the competitive position of Canada's capital markets, which is desirable as capital markets are international in character;
- facilitating innovation in Canada's capital markets;
- promoting the informed participation of investors in the capital markets to support effective and responsive securities regulation; and
- recognizing regional markets and sectors.

Note: This is an abridged list of the guiding principles prescribed in the draft Securities Act.

A) SYSTEMIC RISK

Securities regulators' focus on systemic risk has been primarily concerned with clearing and settlement issues, setting minimum capital requirements, and limiting the contagion from failing securities dealers. Globally, securities regulators have been much less involved in the more comprehensive financial stability mandates of prudential regulators and central banks. This approach was largely based on the conventional wisdom that systemic risk and the prospect of systemic failure are predominantly a banking phenomenon.

Recent developments in the global financial system have highlighted the need for securities regulators to be involved in the management of systemic risk through increased monitoring, coordination, and crisis management. Systemic failures, once largely confined to banking institutions, are increasingly manifesting themselves in capital markets. This transformation has largely been caused by the fact that it has become easier to access capital directly from the capital markets rather than through traditional banking institutions with systemic safeguards.

Along with this shift has come a corresponding concern that systemic risk in capital markets is growing. Financial innovation has led to the introduction of increasingly complex instruments. The impact of these complex instruments on capital markets is not well understood. Hedge funds and private equity funds are growing in importance, but are less-regulated and more opaque. Securities firms are becoming larger and more international, increasingly affiliated with commercial banks or insurance firms, and more involved in global trading activities, particularly in over-the-counter derivatives.

> *"We believe that effective securities regulation can contribute to the management and reduction of systemic risk and that this is a laudable objective, particularly given recent events in global financial markets."*
>
> ***Manulife Financial***

In our consultation process, stakeholders were generally in favour of addressing the role of a securities regulator in reducing systemic risk in the larger financial system. Stakeholders suggested that the changing nature of systemic risk requires the full attention and response capabilities of all financial sector regulators and their ability to act in a coordinated manner. They indicated that securities regulators should be actively engaged in the reduction of systemic risk.

After careful consideration, we have come to the conclusion that the role of a securities regulator in facilitating the reduction of systemic risk should be explicitly addressed in securities legislation and regulation. Although the prudential regulator and the monetary authority have a more direct role in mitigating systemic risks to the larger financial system, securities regulators should play a significant role in working to help reduce systemic risk. We believe that securities regulators should have the power to take interim measures to deal with market events that might pose systemic risks to Canada's capital markets. As a result, we have suggested language in the draft Securities Act for such a power.

We recommend that a guiding principle of regulatory conduct should be to facilitate the reduction of systemic risk. We also recommend that appropriate interim powers be prescribed in legislation to allow securities regulators to quickly respond to market events that might pose systemic risks to Canada's capitals markets.

B) COMPETITION AND INNOVATION

The integration of global capital markets has put regulators under increasing pressure to reduce regulatory burdens in order to make regulation more cost-effective relative to other jurisdictions. In light of this more global environment, commentators and expert bodies have advocated that securities regulators, as a guiding principle, should foster competition and innovation in Canada's capital markets. However, the recent turmoil in capital markets has called into question whether efforts in pursuing cost-effective regulation have gone too far. It is clear that, in some cases, financial innovation was allowed to proceed without having appropriate regulatory safeguards in place. It is also clear that certain financial institutions were allowed to take on excessive risk without having sufficient liquidity and capital in place to cover potential losses.

We believe that regulation of the capital markets and the financial sector more broadly, is fundamentally about maintaining public confidence in the integrity of the system and protecting investors. Like many other observers, we are deeply troubled by the apparent excesses in the financial system that are now having a devastating impact on all of us. Regulation will need to be reviewed and recalibrated to protect investors and restore confidence in global capital markets. However, over the long run, the competitive realities of the global economy will persist; the costs imposed by the regulation of capital market activities will continue to influence where capital is allocated and thus impact business investment, job growth, and living standards. Regulation simply cannot be developed without assessing the burden it will have on market participants.

We recommend that the guiding principles of regulatory conduct include the need for regulation to be cost-effective. We also recommend that they reflect the need to facilitate innovation and maintain the competitiveness of Canada's capital markets.

II. PERFORMANCE MEASUREMENT IN SECURITIES REGULATION

There is significant variation in the degree of performance measurement in securities regulation across Canada. Some securities regulators have made performance measurement a priority while others have not. This has implications for the ability of market participants and the public to hold securities regulators accountable. We believe that there should be a single, comprehensive system of performance measurement for securities regulation in Canada.

There are important efforts underway in many countries to develop systems that measure the performance of regulatory activity in capital markets. The efforts of the British Columbia Securities Commission and the Financial Services Authority (FSA) in the United Kingdom are particularly noteworthy.[6] We believe that they should inform the development of a comprehensive performance measurement system for securities regulation in Canada.

A) BRITISH COLUMBIA SECURITIES COMMISSION

The Commission has developed a performance measurement system that is one of the most advanced among its securities regulatory counterparts in Canada. The Commission actively manages its system and is committed to developing it further. It currently uses 13 performance measures. The results of its performance are presented in its annual report and in its forward-looking service plan, both of which are made available to the public.

The Commission evaluates performance in meeting its mission[7] by measuring its success in advancing the following goals: promoting a culture of compliance; acting decisively against misconduct; educating investors; and advancing smart rule-making and guidance. The advancement of each goal is supported by a specific policy strategy, which is linked to a number of performance measures. For example, the goal of acting decisively against misconduct is being advanced by three strategies: to disrupt abusive junior market practices in British Columbia; to disrupt and stop securities fraud; and to build stronger criminal investigation capability in British Columbia for financial crime. The evaluation of the Commission's performance in this area is based on the action taken in response to ongoing misconduct and the timeliness of the resolution of enforcement cases. The former is based on the percentage of new cases with active misconduct where the Commission has intervened, while the latter is based on the average life (in months) of cases resolved via settlement or decision. As Table 2 indicates, the Commission presents the current and previous years' results and targets, and provides a target for the upcoming year.

The Commission only uses performance measures that evaluate progress in achieving the four goals over several years. This provides the opportunity to properly assess performance over time and whether new regulatory approaches are having the desired effect. In addition, the Commission will only choose measures where it can collect accurate data and form baselines in a timely manner. It also seeks ongoing opportunities to benchmark its regulatory activity against other regulators.

(TABLE 2)

ACTING DECISIVELY AGAINST MISCONDUCT (BRITISH COLUMBIA SECURITIES COMMISSION)				
*Measure 1—Percentage of new cases with active misconduct where the Commission intervened**				
2006 (Actual)	2007 (Actual)	2008 (Target)	2008 (Actual)	2009 (Target)
50.0%	20.0%	55.0%	56.0%	58.0%
*Measure 2—Average life, in months, of cases resolved via settlement or decision***				
2006 (Baseline)	2007 (Actual)	2008 (Target)	2008 (Actual)	2009 (Target)
49.0	22.8	21.7	39.5	34.0

Source: British Columbia Securities Commission. Annual Report, 2007-08.

* *The Commission tracks the number of cases it accepts each fiscal year for enforcement action. It then calculates the percentage of the cases where it took formal action in the form of a freeze order, temporary order, or some other corrective action.*

** *The Commission measures the average number of months a case is open from when the Commission first learns of the conduct to the case's completion by settlement or decision.*

B) FINANCIAL SERVICES AUTHORITY

The FSA is required by law to report on its performance against its legislated mandate. It measures its performance against three strategic aims, which embody its statutory objectives as well as its principles for good regulation. The strategic aims are to help retail consumers achieve a fair deal; to promote efficient, orderly, and fair markets; and to improve business capability and effectiveness. The advancement of these strategic aims is articulated by desired outcomes. Performance is measured against achieving these desired outcomes, using a range of metrics, including high level indicators, activity measures, and process measures. The FSA has also put in place a significant number of measures to track the provision of service to regulated entities and publishes key statistics on compliance and enforcement. The FSA is working to develop better measures to assess the costs and benefits of regulation, an area that is particularly difficult to quantify in a meaningful way.

The performance assessment is reported to the Executive Committee and the Board of the FSA every six months, and it is presented to the public annually in a series of publications, including the Outcomes Performance Report, the Performance Account, and the FSA's annual report.

C) A PERFORMANCE MEASUREMENT SYSTEM FOR CANADA

> *"...any performance measurement system will only be effective if it is readily understandable and informative, and it is applied consistently to the securities regulatory regime across the country."*
>
> ***Royal Bank of Canada***

Based on these best practices, we believe that uniform performance measures should be developed for securities regulation in Canada and should include measures of performance against statutory objectives, service standards, enforcement outcomes, and measures to assess the costs and benefits of regulation.

We believe that it is important for the securities regulator to establish service efficiency targets in areas where there is significant interaction with regulated entities and the public. Performance against these targets should be measured on an ongoing basis and disclosed to the public. This disclosure will help to set service expectations and will likely promote a higher quality of service and a more client-focused regulator.

We suggest that performance should be reported to the public on an annual basis at a minimum. It should be presented in a manner that is clear and concise, and it should be possible for the public to understand how the regulator is faring in relation to the past and the milestones it has set for the future.

We recommend the development of a single, uniform performance measurement system for securities regulation in Canada that includes timely reporting to the public on the advancement of statutory objectives, service efficiency, enforcement outcomes, and the costs and benefits of regulation. We also recommend that a governance board provide oversight of the performance measurement system, in order to ensure that it is advanced in a transparent and effective manner.

ENDNOTES

[4] The International Organization of Securities Commissions, or IOSCO, is an international cooperative forum for securities regulatory agencies. IOSCO members regulate more than 90 percent of the world's securities market. IOSCO has developed a set of core objectives and principles to guide securities regulatory agencies. See the IOSCO publication entitled, "Methodology for Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation." (February 2008).

[5] The Task Force to Modernize Securities Legislation in Canada (2006); Crawford Panel on a Single Canadian Securities Regulator (2006); Five-Year Review Committee (Ontario, 2003).

[6] The FSA is an independent organization responsible for regulating financial services in the United Kingdom. It is an integrated financial sector regulator, covering most financial services markets, exchanges, and firms.

[7] The mission of the British Columbia Securities Commission is to protect and promote the public interest by fostering a securities market that is fair and warrants public confidence and by fostering a dynamic and competitive securities industry that provides investment opportunities and access to capital.

Advancing Proportionate, More Principles-Based Securities Regulation

I. PRINCIPLES-BASED SECURITIES REGULATION
II. PROPORTIONATE-BASED SECURITIES REGULATION

Both principles-based and proportionate-based approaches to regulation are to some extent already reflected in existing securities regulation in Canada. The focus of this section is to assess whether the use of these regulatory approaches should be expanded in Canada and, if so, under which securities regulatory structure, the passport system or the single securities regulator model.

I. PRINCIPLES-BASED SECURITIES REGULATION[8]

A) OVERVIEW

Moving towards a more principles-based approach to securities regulation has received considerable attention in recent years. Businesses are attracted to its promise of lowering unnecessary compliance costs. Regulators believe that it might improve regulatory outcomes and help to strengthen enforcement. Policymakers suggest that it could create a distinct competitive regulatory advantage relative to other jurisdictions. In general, a more principles-based approach is thought to be an appropriate response to the current securities regulatory environment that many believe has become too heavily reliant on rules, focused more on process than on achieving effective regulatory outcomes.

Principles-based regulation is not about replacing rules with principles or leaving businesses to their own devices, without regulatory guidance or oversight. It is a distinct, regulatory approach that contrasts with the rules-based approach. No regulatory system is entirely based on either the rules-based or principles-based approach; there is a continuum between the two extremes and regulatory systems fall somewhere in the middle. The key question is whether there is merit in moving the securities regulatory system toward a *more* principles-based approach.

Principles-based regulation establishes high-level principles for business conduct, which articulate desired regulatory outcomes. Businesses are given greater freedom to develop and manage internal compliance systems to achieve those outcomes. Regulators work more with businesses to provide guidance on appropriate regulatory practices.

Under the rules-based approach, businesses must adhere to a strict body of rules to achieve compliance. Businesses have less freedom to organize their regulatory affairs. Regulators are thereby focused on ensuring that businesses comply with the rules and are prone to a more adversarial role. The emphasis of regulatory efforts may be more on compliance with the rules and process rather than on the broader objectives and outcomes.

A number of regulators in Canada and internationally have been advancing principles-based regulation. The FSA in the United Kingdom is considered to be a leader in principles-based financial services regulation. The FSA has established 11 regulatory principles for business, which all regulated entities must meet. It provides significant guidance to businesses and works closely with stakeholders in the financial sector to find mutually beneficial solutions to regulatory issues.

The British Columbia Securities Commission has been developing an outcomes-based approach to securities regulation, a label that it believes more properly describes principles-based regulation. The Commission is committed to intervening less and working more with businesses by encouraging them to do the "right thing" in whatever manner they choose, in order to achieve desired regulatory outcomes.

The regulation of derivatives has also attracted the use of principles-based regulation, in large part because of the speed of innovation in this area of finance. For example, the Commodity Futures Trading Commission in the United States operates in a principles-based manner, and the new Quebec Derivatives Act is substantially principles-based and represents one of the first attempts internationally to regulate a full range of derivatives.

Some commentators are of the view that a more principles-based approach could improve securities regulation in a number of ways. First, capital markets are becoming increasingly more sophisticated and dynamic. In this environment, principles-based regulation might achieve better regulatory outcomes since it would give businesses greater flexibility to adapt compliance practices to the latest innovations in the capital markets. Second, under principles-based regulation, businesses, when confronted with an ambiguous situation, would no longer be bound by strict rules. They would be responsible for actively developing and managing compliance practices to achieve the desired regulatory outcomes. Market conduct, in turn, might improve because businesses would have to pay greater attention to achieve desired compliance outcomes rather than simply applying rules and procedures prescribed by regulators. Finally, principles-based regulation might facilitate better enforcement actions by being able to hold businesses accountable for rule infractions as well as actions that, although technically compliant, violate the public interest.

There are, however, possible risks to a more principles-based approach that must be carefully considered, balancing the need for some rules with the desire to build on principles. There is a general concern that the regulatory burden on businesses might actually increase due to the need to develop and monitor internal compliance controls to achieve the desired regulatory outcome. This burden could be particularly acute for smaller businesses, which generally have limited resources and expertise for these purposes. In addition, a principles-based approach could reduce the regulatory certainty for market participants, while allowing enforcement actions to be conducted without any violation of a guideline or rule.

B) CONSULTATIONS

> *"...securities regulation in Canada should be principles-based and, where possible, not come with a detailed set of interventionist rules. While we recognize that some prescription will always be necessary (and, indeed, desirable), the balance in Canada today is excessively tilted towards prescription."*
>
> ***Scotiabank***

The stakeholders in our consultation meetings were generally supportive of moving to a more principles-based approach to securities regulation. They thought that it might be an effective way to address the current overly prescriptive nature of securities regulation, and they suggested that its flexibility would help make regulation more responsive to the accelerating pace of financial innovation.

Some stakeholders did, however, express a number of caveats. They emphasized the need to provide sufficient guidance to market participants about compliance requirements in order to maintain certainty and confidence in regulatory practices. They also noted that principles-based regulation requires a strong but skilful approach to enforcement. Enforcement must provide credible deterrence against wrongdoing, but it must not be too aggressive so as to undermine the flexibility and innovation that is the bedrock of principles-based regulation. Some stakeholders also noted that a more principles-based approach would be difficult to properly implement in the absence of a single securities regulator. The idea of having a set of principles being interpreted in 13 different ways was described as unworkable.

C) IMPLEMENTATION CONSIDERATIONS

We understand that there are opportunities and risks in moving to a more principles-based approach to securities regulation. According to our study on this subject, risks may be mitigated and opportunities maximized if a number of factors are met in implementing a more principles-based system. A number of these critical success factors merit discussion.

i) Reducing Uncertainty

Principles-based securities regulation must be implemented and advanced in a manner that reduces uncertainty and enhances predictability. In this regard, the regulator must establish mechanisms to communicate its expectations to industry. The regulator can do so by providing official guidance, conducting specific enforcement actions, or commenting on industry standards. The regulator can also collaborate with businesses and work closely with industry to develop standards. The FSA, for example, routinely works with trade associations to find solutions to regulatory issues. The goal of these efforts is to create an "interpretive community" that understands regulatory expectations, and can effectively interpret regulatory pronouncements in different situations over time. It is imperative that the development of this community be nurtured under principles-based regulation to enhance certainty and predictability.

ii) Rethinking Enforcement

> *"The failure of the regulatory regime is due in part because the regulatory system is based upon rules rather than principles, and the regulatory system is based upon the administration of those rules."*
>
> ***Small Investor Protection Association***

A well-conceived and vigorous enforcement approach will encourage regulatory innovation and discourage activities that compromise the integrity of the regulatory system. Enforcement cannot be too aggressive, since it will cause businesses to quickly revert to the safety of rules and detailed guidance, and it cannot be too lax, since it will allow wrongdoers to take advantage of the freedoms afforded by principles. To work toward finding the right balance, there must be a measured, well-considered response to rule violations and other forms of alleged wrongdoing. The securities regulator must examine the situation and determine whether there is wrongdoing or simply an attempt to achieve compliance using an innovative, albeit misguided, approach. In the case of wrongdoing, the full force of the law should be applied; otherwise, the regulator should work with the business in question (perhaps in conjunction with industry) to bring its practices in line with a more accepted standard. The overriding goal should be to support, rather than suppress, innovative regulatory practices.

Enforcement actions must also be conducted with special care if based solely on a breach of one or more principles. This is an area that is particularly prone to concerns of overreaching. For example, there is a well-documented concept in this regard known as "hindsight risk." This can occur when the regulator, dissatisfied with a particular regulatory outcome, and without a clear rule violation, uses the benefit of hindsight to conduct enforcement actions based solely on a breach of principle. This can be unfair because it may only be in the presence of full information at the conclusion of an activity or transaction that the true extent of the risk becomes clear and the desired *ex ante* regulatory approach presents itself. Under these circumstances, businesses, which acted in the best interests of the market and investors, using the information available at the time, should likely not face enforcement actions. There are a number of ways to reduce hindsight risk, including using prior rules (i.e., quasi-safe-harbour rules) and the use of notice-and-comment mechanisms for rulemaking. In general, ways to reduce the risk of overreaching in this area must inform the approach to enforcement under principles-based regulation.

iii) Meeting the Distinct Needs of Small Public Companies

Small public companies (i.e., small reporting issuers) pose unique challenges under any regulatory approach, since many lack the expertise and resources necessary to foster the development of proper internal controls. The principles-based approach, however, has the potential to make these challenges more acute, since small public companies would lose the certainty of rules and be required to apply often limited resources to developing their own approaches to compliance.

There are a number of ways possible to minimize the risk of compliance burden imposed on small public companies. First, principles-based regulation should be complemented by proportionate-based regulation (discussed in the next section). Proportionate-based regulation will help to harness the regulatory flexibility of principles-based regulation to tailor regulation appropriately to small public companies. Second, the securities regulator should work closely with the management of these companies and their industry representatives to develop guidelines, best practices, and expedite the overall development of an interpretive community. Third, small public companies should be allowed to use pre-existing, quasi-safe-harbour rules as a baseline for a transitional period. Given the large number of small public companies in Canada, these methods should be part of a larger strategy that works to support their transition to a more principles-based approach.

iv) Engaging Investors

A benefit of principles-based regulation is that it is flexible and allows the content of regulation to evolve over time. A disadvantage of this flexibility is that larger, more sophisticated parties could come to have greater power to influence the development of regulatory content over time. These parties might be in a better position to persuade, or even pressure, regulators to advance their interests at the expense of others. This could, for example, cause investor protection to be eroded in order to enhance regulatory efficiency.

The nature of principles-based regulation is such that it must be informed properly by a broad range of stakeholders, but particularly investors that have traditionally been given less of a voice in informing regulatory content. For principles-based regulation to be a success, real opportunities must be afforded to all investors to contribute to the development of regulation. The securities regulator must actively seek input and develop relationships with organizations and individuals that operate on behalf of investors.[9] More must be done to promote investor education so that investors can effectively represent their views on securities regulation. Securities regulators must be transparent in decision-making, articulating how regulatory changes reflect the input and the overall interests of stakeholders in Canada's capital market.

We recommend a more principles-based approach to securities regulation. We are convinced of the merits of this approach and believe that it would improve securities regulation in Canada. The approach, however, must be implemented with care, particularly with due regard to reducing regulatory uncertainty, rethinking enforcement, addressing the distinct needs of small public companies, and properly engaging investors.

D) STRUCTURE AND ENFORCEMENT

We believe that a more principles-based approach would be best advanced under a single securities regulator. Although it could be developed within the current securities regulatory structure, we find that the degree of coordination required across the 13 securities regulators to consistently interpret principles, develop guidance, foster interpretive communities, as well as conduct principles-based enforcement actions, poses significant challenges, making its implementation more difficult and its success less likely over time. A single securities regulator would be best able to provide the consistency and degree of focus required to properly steward principles-based securities regulation in Canada.

We believe that this regulatory approach could strengthen enforcement by expanding the capacity of enforcement authorities to act against those that did not violate a regulation or rule but did not act in the public interest. However, we are not of the view that it would dramatically improve enforcement in Canada. Enforcement is a complex and multifaceted area whose improvement relies on many jurisdictions and organizations.

Securities regulatory structure and enforcement are discussed more fully later in the report.

II. PROPORTIONATE-BASED SECURITIES REGULATION

A) OVERVIEW[10]

Securities regulation is sometimes criticized for being applied in a manner that is insufficiently tailored to the economic characteristics of public companies.[11] Regulatory approaches may not always account for size, the diversity of sectors in which public companies operate, or the regulatory risk represented by public companies across sectors. As a result, small public companies might face undue compliance costs to meet regulations designed for large public companies. Securities regulators might impose too much regulatory scrutiny on large public companies. Disclosure might be insufficient to allow investors to make informed decisions. Securities regulators might devote too much time regulating entities that pose little risk to investors, and too few resources to higher risk companies.

Effective outcomes can be achieved if securities regulation is tailored to the economic characteristics of public companies. However, securities regulation that is overly tailored comes with its own set of inefficiencies. It could significantly increase administrative costs to the regulator, causing greater fees to be levied on market participants or taxpayers. Proportionate-based securities regulation could increase regulatory complexity and reduce the overall transparency of securities regulation to investors. The key challenge for securities regulators is to advance proportionate-based securities regulation in a manner that enhances economic efficiency and promotes investor protection.

Some elements of proportionate-based securities regulation already exist in Canada, predominately based on differentiating a public company by whether it is a venture issuer, listed on the TSX Venture Exchange (TSXV), or a non-venture issuer, listed on the Toronto Stock Exchange (TSX). Venture issuers, because of their smaller size and early-stage of development, are often subject to less onerous regulatory requirements, especially with respect to disclosure. Venture issuers are, however, subject to significant monitoring and oversight to guard against risks that are associated with early-stage companies that have less sophisticated compliance controls. In consultations, we heard that this approach has helped to support the development of venture issuers, while maintaining confidence in public capital markets.

Canada's securities regulators have also adopted proportionate-based securities regulation to specifically address barriers to early-stage financing. For example, securities regulators have an agreement with the TSXV to allow capital pool companies to list on the TSXV subject to specific conditions.[12] This agreement provides nascent companies with the opportunity to access public capital markets to fund investments in growth-oriented activities. An additional example, albeit on a smaller scale, is the effort of the Government of Nova Scotia to simplify reporting requirements to encourage the establishment of investment funds that are aimed at providing early-stage financing to businesses located in Nova Scotia.[13] The program provides streamlined regulatory requirements to facilitate the establishment of, and investment in, these investment funds, which in turn support economic development in the region.

According to our research study on proportionate-based securities regulation, provincial securities regulators have expressed varying degrees of interest in expanding the scope of proportionate-based securities regulation in Canada. The Alberta Securities Commission has noted some interest in developing a proportionate approach that would better regulate its mix of very large and very small public companies. The British Columbia Securities Commission is uncertain about its need for more proportionate-based securities regulation once it has fully implemented its outcomes-based approach, which would allow public companies to organize their own affairs to achieve the desired regulatory outcomes. Quebec's regulator, the *Autorité des marchés financiers* (AMF), has not taken a public position on proportionate regulation. The Canadian Securities Administrators has indicated that they are considering opportunities to expand the scope of proportionate regulation.[14] From this survey of regulators, it is unclear how quickly, at this point, proportionate-based securities regulation will be further advanced in Canada.

B) CONSULTATIONS

During our consultations, we heard broad support for a more proportionate-based approach to securities regulation. Some proposals were relatively modest, including the streamlining of certain prospectus and financial reporting requirements, while others were more ambitious, calling for public companies to be regulated according to market capitalization or sector. Many stakeholders, however, suggested, in the context of a discussion of a single securities regulator, that its first priority should be to adopt a rigorous risk-based approach, to the extent that it can achieve an improvement over the status quo in Canada. This initiative itself, it was suggested, would likely better allocate regulatory resources and improve regulatory outcomes. Once complete, efforts should be expanded to examine areas that could benefit from more tailored regulation.

C) OPPORTUNITIES

We believe there are opportunities to expand the use of proportionate-based securities regulation in Canada, in order to reduce regulatory burden and support the growth of Canada's capital markets. Our research shows that Canada's capital markets have a number of unique features that are well-positioned to benefit from a more tailored, innovative regulatory approach.[15]

> *"Small and medium-sized corporations are important in Canada and deserve more astute regulatory consideration, which the existing securities regulators have not satisfied."*
>
> ***Warren Grover, as an individual***

Small public companies are an important contributor to the growth of the Canadian economy. Securities regulation must be particularly cost-effective for these companies, as their growth and overall success can be needlessly undermined by overzealous regulation. We believe that action must be taken to review current regulatory practices and examine opportunities to develop innovative regulatory approaches that streamline reporting requirements and, overall, reduce undue regulatory burden for small public companies in Canada.

We recommend the establishment of an independent panel that would represent the views and interests of small reporting issuers in the formulation of securities regulation.

We were intrigued by the notion of differentiating the application of proportionate-based securities regulation to the size or to the sector of public companies. As suggested by a number of stakeholders, given the unique features of Canada's capital markets, there might be value in tailoring regulation to the size of public companies (e.g., by market capitalization) or by sector, particularly in respect of financial services, oil and gas, diversified industries, and mining. However, these proposals might increase the cost of administering securities regulation and the complexity of the regulatory system, possibly reducing the transparency of the system to market participants, particularly investors. The merits of these proposals must be carefully studied to better understand the risks and opportunities.

We recommend the further examination of opportunities to better regulate public companies through the use of more proportionate-based securities regulation.

D) RISK-BASED SECURITIES REGULATION

We believe that the resources of a securities regulator should be allocated to market participants, such as issuers and securities firms, and investment products that pose the greatest risk to the economy generally and the investor in particular. We understand that this risk-based approach to securities regulation is used by many securities regulators in Canada. For example, the Ontario Securities Commission and those of several other provinces use a risk-based approach to select prospectuses for more detailed review and to select reporting issuers for a continuous disclosure review. They also use this approach to determine the frequency of compliance reviews of advisors and fund managers as well as to determine which enforcement matters will be pursued through full investigations. The Ontario risk-based selective review system for prospectuses may result in a prospectus being subjected to a basic review, a full review, or an issue-oriented review. The risk factors used to determine the level of review have been published.[16] They relate to the issuer's corporate structure and underlying business, to its financial condition or results, to the nature of the offering, and to matters related to the issuer's advisors or corporate governance.

Risk-based regulation is also employed by self-regulatory organizations (SROs). For instance, IIROC and the MFDA[17] have each developed a sophisticated and well-conceived risk-based model to determine the frequency and depth of audits of its members. IIROC has also worked with the Canadian Investor Protection Fund to coordinate auditing activities with a view to eliminating duplication, targeting those members whose activities are more likely to give rise to problems, and ensuring that limited resources are effectively employed and that the regulatory burden is proportionate to the risk posed.

During our international consultations, we learned about the risk-based approach used by the FSA in the United Kingdom. The FSA prioritizes regulatory intensity based on risk, assessed in part through the use of a sophisticated model that calculates a risk score for all regulated entities. Risk is calculated as a function of the probability of failure and the impact of that failure. This risk calculation is then complemented by a qualitative analysis, conducted by experts in regulatory risk management. Risk scores and peer comparisons are shared by the FSA with all regulated entities. The FSA approach allocates resources to the most risky enterprises regardless of size, recognizing that it cannot prevent the failure of all companies. We believe that the FSA risk-based approach is a global best practice and should inform the further advancement of risk-based securities regulation in Canada.

We recommend a risk-based approach to securities regulation. We also recommend that consideration be given to expanding the existing use of the risk-based approach in the Canadian context.

E) STRUCTURE AND ENFORCEMENT

We believe that the advancement of proportionate-based securities regulation is not well-served by the current securities regulatory structure. The degree of proportionate securities regulation in use, and the priority for its advancement, significantly varies across the provinces.[18] We believe that the benefits of a proportionate approach should be consistently applied across Canada. Its potential benefits should not be limited to the market participants of a single province. There is no reason, for example, why the efforts of one jurisdiction to reduce the compliance burden for smaller public companies should not be provided to the rest of Canada. We believe that a single securities regulator would be better positioned to advance a comprehensive agenda of proportionate regulation for Canada.

The nature and design of proportionate-based securities regulation will determine its impact on enforcement in Canada. We note that risk-based regulation is well-positioned to strengthen enforcement. It allows resources to be focused on market participants that pose the greatest risks to investors. The impact, however, of other types of proportionate regulation, such as tailoring to size or sector, need to be carefully assessed within the context of compliance and enforcement. There is risk that a poorly conceived approach could reduce compliance burden while compromising disclosure. Proportionate regulation should not come at the expense of investor protection.

ENDNOTES

[8] This section draws on a research study commissioned by the Expert Panel. See Ford, Cristie. "Principles-Based Securities Regulation." Expert Panel on Securities Regulation (2009).

[9] The establishment of an investor panel could provide a greater voice for investors in informing the securities regulatory policy development process. The investor panel is discussed in greater detail in the section entitled "Better Serving Investors."

[10] This section draws on a research study commissioned by the Expert Panel. See Sarra, Janis. "Proportionate Securities Regulation: The Potential for Scaled Treatment of Junior Issuers." Expert Panel on Securities Regulation (2009).

[11] The discussion of proportionate-based securities regulation is limited to publicly-listed companies.

[12] Capital pool companies have no assets (other than cash) and have not commenced business activity.

[13] This initiative is known as the "Community Economic Development Investment Funds" (CEDIF).

[14] The Canadian Securities Administrators is a forum for the securities regulators of Canada to coordinate and harmonize the regulation of Canada's capital markets.

[15] Canada's capital markets embody a number of unique features. Canada has a large number of very small public companies and a small number of very large public companies. Many of Canada's largest companies are cross-listed on international stock exchanges, particularly in the United States. Canada's market capitalization is concentrated in Ontario, Alberta, Quebec, and British Columbia. In each of these provinces, the market capitalization is heavily concentrated in one sector: financial services in Ontario, oil and gas in Alberta, diversified industries in Quebec (e.g., forestry products, transportation), and mining in British Columbia.

[16] Ontario Securities Commission Staff Notice 11-719–A Risk-based Approach for More Effective Regulation, effective December 20, 2002, 25 O.S.C.B. 8410.

[17] IIROC is the Investment Industry Regulatory Organization of Canada, while the MFDA is the Mutual Fund Dealers Association of Canada.

[18] Unless stated otherwise, "provinces" shall refer to "provinces and territories."

Independent Adjudicative Tribunal

We have reviewed the merits of an independent adjudicative tribunal for Canada. We note that this issue is fundamentally about the perception of fairness in the adjudication of regulatory matters rather than strengthening enforcement.

Most securities commissions in Canada conduct regulatory, enforcement, and adjudicative functions. They develop policies and rules, investigate and prosecute alleged regulatory misconduct, and preside over adjudicative proceedings. The adjudication of regulatory matters is conducted by the commissioners of the securities commission who preside over hearings to review the facts of the case, to hear the arguments, and to render a decision. Numerous commentators suggest that this multifunctional commission structure fosters the perception that the adjudicative process is unfair, lacking independence and impartiality. They recommend that the responsibility for adjudication should be given to an independent adjudicative tribunal.[19]

To inform our deliberations, we commissioned a research study on Quebec's independent adjudicative tribunal, the *Bureau de décision et de révision en valeurs mobilières* (the "Bureau").[20] The Bureau is the only independent adjudicative tribunal in respect of securities regulatory matters in Canada. It was established in 2004 as part of a larger set of structural reforms that principally created the integrated financial sector regulator for Quebec, the AMF. The Bureau has broad powers under the Quebec Securities Act to enforce compliance, including the power to revoke licenses, freeze assets, and impose other administrative penalties. It can also review decisions rendered by the AMF and recognized SROs, such as IIROC. The Bureau has three full-time members, including a chair and deputy chair, as well as three part-time members, each with extensive experience in securities regulation and litigation. Members of the Bureau are appointed by the Government of Quebec for a period of five years. The decisions rendered by the Bureau can be appealed to the Quebec courts. The financial operations of the Bureau are overseen by Quebec's Minister of Finance and Auditor General.

> *"...it is clear that greater separation between adjudicative functions and other responsibilities can significantly enhance the credibility of institutions as well as the integrity of the legal system of which they are an extension."*
>
> ***Desjardins Group***

We believe that the experience of the Bureau lends further support to the merits of establishing an independent adjudicative tribunal. Our research study on the Bureau provides support for the establishment of an independent adjudicative tribunal. The experience to date mitigates concerns that have been expressed with regard to the separation of the adjudicative function, particularly with respect to the policymaking function and possible overproceduralization. However, as discussed later in the report in the section, "Our Recommended Structure for Canada," some Panel members would like to see oversight of the independent adjudicative tribunal in the context of promoting operational efficiency while others thought such a function might compromise the independence of the tribunal.

Many of the decisions made by the Bureau since 2004 have invoked the public interest. In defining the public interest, the Bureau has looked to the core objectives of securities regulation, specifically promoting investor protection and enhancing economic efficiency. This is consistent with the approach employed by other securities commissions in Canada as well as that followed by the Supreme Court of Canada. The Bureau appears to make decisions that are mindful of the policymaking and rulemaking activities of the AMF. Finally, the Bureau uses procedures that work to foster a fair hearing process. These procedures reflect the seriousness of the proceedings, but do not appear to be overly burdensome or a source of delay.

We recommend the establishment of an independent adjudicative tribunal. However, we believe that the securities regulator should retain jurisdiction over certain decisions, such as discretionary exemptions from securities regulations and rules, as well as matters regarding contested takeover bids. The securities regulator has the policy expertise and the quick response capability to properly address these matters in a more timely fashion, which in our opinion outweigh the benefits of referring these decisions to an independent tribunal.

We believe that an independent adjudicative tribunal should be established within a framework of a single securities act administered by a single securities regulator for Canada. A national tribunal, adjudicating matters based on the securities regulations and rules administered by a single securities regulator, would provide greater consistency in decisions and concentrate adjudicative expertise. The adjudicative tribunal would also better support a more principles-based approach to securities regulation, since it would likely provide greater consistency in the interpretation and application of principles in its decisions.

In the absence of a single securities regulator, action should be taken to examine proposals that respond to recent calls to create a pan-Canadian independent adjudicative tribunal within the current system.[21] Such a tribunal could be established unilaterally by the provinces, or in collaboration with the federal government, depending on the desired scope of adjudicative powers to be delegated to the tribunal.[22]

ENDNOTES

[19] See, for example, Osborne, C.A., D.J. Mullan, and B. Finlay. "Report of the Fairness Committee to the Ontario Securities Commission." (2004).

[20] Rousseau, Stéphane. "The Québec Experience with an Independent Administrative Tribunal Specialized in Securities." Expert Panel on Securities Regulation (2009).

[21] For example, see Jérôme-Forget, Monique. "The Passport Securities System." Speech to the Investment Funds Institute of Canada. Toronto (October 2007).

[22] See Rousseau, *supra* 20.

Better Serving Investors

I. IMPROVING COMPLAINT-HANDLING AND REDRESS MECHANISMS
II. GIVING A STRONGER VOICE TO INVESTORS

An important aspect of securities regulation is the protection of investors.[23] We believe that there are a number of areas where investors could be better served.

Investors whose money has been compromised by error or wrongdoing on the part of market participants expect the system of complaint-handling and redress to be accessible and responsive. The current system, however, requires significant knowledge, resources, and persistence to navigate properly. It all too often leaves investors frustrated and angry.

Our consultation process revealed that investors are not always adequately engaged and consulted in the development of securities regulatory policy. Securities commissions in Canada provide fewer opportunities for investor advocacy and engagement than other key capital markets jurisdictions. This is to the detriment of securities regulation in Canada and diminishes public confidence in regulatory accountability, integrity, and efficiency.

I. IMPROVING COMPLAINT-HANDLING AND REDRESS MECHANISMS

The complaint-handling and redress mechanisms in Canada are complex. Resolving an issue can involve securities commissions, SROs, arbitrators, and the courts. The redresses available to investors vary across Canada.

An investor may seek two types of redress.[24] The first involves a situation where an investor believes that a firm has failed to comply with securities law and is seeking a review of its conduct. In such circumstances, while the investor has the option to contact the SRO or the securities commission directly, where the complaint is against a member of a SRO (either IIROC or the MFDA), the recommended course of action in most provinces is to first exhaust all complaint processes internal to the firm in question. This would involve raising the issue with management and, if one is available, the firm's ombudsperson. If the issue remains unsatisfactorily resolved, the investor can then file a complaint with the appropriate SRO. Complaints against firms that are not members of SROs, or complaints that remain unsettled after the SRO review, can be made directly to the securities commission. Investigation by a securities commission can result in sanctions, including reprimands, fines, and suspensions.

The second type of redress involves a situation where an investor seeks financial compensation for a contravention of securities laws. As with the first type of redress, the investor is first expected to seek financial redress under the internal complaint process of the firm. If this is unsuccessful, the investor could then seek binding arbitration through IIROC or non-binding arbitration with the Ombudsman for Banking Services and Investments (OBSI). IIROC's arbitrator can order compensation of up to $100,000, while OBSI can recommend compensation of up to $350,000. These services, however, are only available if the firm in question is a member of these organizations.[25] Additionally, the investor might be able to seek financial redress through the securities commission in some provinces. Saskatchewan, Manitoba, and New Brunswick can order compensation of up to $100,000. To collect, the order must be registered in court. Quebec can immediately compensate investors, in an amount of up to $200,000. Finally, the investor can seek financial redress in the courts, by pursuing a civil action. Small claims court may also be an option if modest financial redress is sought.

> *"The journey to a successful complaint conclusion can be aggravating, time consuming, and add stress to an already stressful situation. Restitution claims require diligence, persistence, determination, and thick skin."*
>
> ***Kenmar Associates***

During our consultations, we heard accounts from investors who were compelled to navigate through the system to recoup funds lost as a result of error or wrongdoing. These accounts vividly described many of the shortcomings of the complaint-handling and redress mechanisms in Canada. We believe investors are not particularly well-served by the system. Although many mechanisms have been put in place to provide investors with simpler, more cost-effective alternatives to the courts, the numerous organizations, the multi-step processes, and the lack of uniformity across Canada pose challenges for investors to properly understand and achieve a proper conclusion in an expeditious manner. Based on some of the personal accounts, it appears that investors are often not provided with the information required to understand the full range of options available to seek redress.

We recommend the establishment of a dedicated service to address the lack of information, guidance, and support for investors in the domain of complaint-handling and redress. We envision that this service would disseminate comprehensive information about complaint-handling and redress in Canada. The service could be provided by a securities regulator or another existing regulatory entity.

We are concerned with the degree of variation in financial redress provided by securities commissions across Canada. The fact that some provinces provide financial redress that is binding while others do not is not comforting to investors who find themselves subject to wrongdoing in a province with weaker redress mechanisms. Seeking redress in the court system is an option, but it might not be a viable one, as the cost of engaging the court might exceed the compensation being sought. The lack of uniform financial redress in Canada is troubling and a direct result of Canada's fragmented securities regulatory structure.

We find that the process of financial redress established by the AMF in Quebec is a best practice in Canada. An investor, after receiving a ruling in his or her favour by Quebec's independent adjudicative tribunal, can submit a claim for compensation to the AMF for up to $200,000. The amounts paid in compensation are drawn from the financial services compensation fund, *Fonds d'indemnisation des services financiers*. Fees levied on regulated entities in Quebec are used to fund it. The AMF will, as required, undertake action to recoup the payment of compensation from those responsible. The benefit of this approach is that settlements are binding and investors are compensated expeditiously without having to wait for a court to enforce the ruling and collect compensation.

We recommend the following to improve investor complaint-handling and redress mechanisms:

- **a securities regulator with the power to order compensation in the case of a violation of securities law so that the investor would not be required to resort to the courts;**
- **establishment of an investor compensation fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law; and**
- **mandatory participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.**

We are concerned that in some provinces firms can avoid disciplinary action by a SRO or an exchange by simply leaving the securities industry. This allows wrongdoers to get away unpunished. We have suggested appropriate language in the draft Securities Act to ensure that the SROs and exchanges continue to exercise jurisdiction over former members.

II. GIVING A STRONGER VOICE TO INVESTORS

We believe that securities commissions across Canada could do more to engage and advance the interests of investors. This point became clear to us during our consultation process. We heard from concerned investors. We also learned of the practices used by regulators in other countries that have made investor engagement a priority.

In the United States, the Securities and Exchange Commission (SEC) has an office mandated to ensure that the SEC is truly the "Investor's Advocate." The Office is responsible for reviewing all actions taken by the SEC from the perspective of the investor. It plays a leading role in the SEC's efforts to make disclosure documents more readable and understandable to investors. It consults with investors to develop investor education programs, conducting focus groups and investor surveys. Finally, the office acts as a single point of contact for the intake of tips, complaints, and suggestions.

In the United Kingdom, the FSA has established a consumer section that is situated within the organization so that it has influence across all regulatory policy groups.[26] The group is known as a cross-sector leader. The objective is to put consumer interests at the core of regulatory policymaking at the FSA. To properly inform the regulatory process, the group works with consumers, organizations, think-tanks, and others that represent consumers. It identifies risks that could potentially disadvantage current, or potential, consumers. It stewards the FSA's overall approach to consumers, ensuring that it is coherent and being properly implemented.

> *"England has given investors considerably more clout by creating a core funded Financial Services Consumer Panel with resources to do research and the authority to review key decisions in the industry."*
>
> ***The Consumers Council of Canada***

The FSA also has an independent financial services consumer panel, which is statutorily mandated. The panel provides advice to the FSA on the interests and concerns of consumers, and it assesses the FSA's effectiveness in meeting its statutory objectives that pertain to consumers. The FSA consults the panel on its policy proposals and the panel raises its own concerns and initiates its own research. It is prescribed in statute that the FSA must consider any representation made by the panel. If the FSA disagrees with a view expressed or proposal made in a representation, it must give the panel a statement in writing of its reasons for disagreeing. The panel currently has 11 members (including the chair), with diverse backgrounds. The panel is funded by the FSA and is supported by a dedicated secretariat.

We understand that the vast majority of the provincial securities regulators do not have an advisory panel on investor issues. We also understand that they generally do not have a group exclusively devoted to advocating the interests of investors in securities regulation.

We recommend the establishment of an independent investor panel. We also recommend that securities regulators establish a dedicated investor issues group.

ENDNOTES

[23] As noted previously, we have prescribed in the draft Securities Act that a core objective of securities regulation is to protect investors from unfair, improper, or fraudulent practices (see Table 1 in the section "Objectives of Securities Regulation").

[24] A more detailed description of the complaint-handling system and redress mechanisms in Canada is provided in Appendix 6.

[25] Most firms are members of these organizations.

[26] As an integrated financial sector regulator, the FSA regulates areas that affect investors as well as non-investors (e.g., depositors). The FSA uses the term "consumer" to capture both investors and non-investors.

Recommended Regulatory Structure for Canada

I. CONCERNS WITH THE CURRENT STRUCTURE
II. OUR RECOMMENDED STRUCTURE FOR CANADA
III. WHY OUR RECOMMENDED STRUCTURE IS BETTER FOR CANADA
IV. FUTURE DIRECTIONS TO MODERNIZE FINANCIAL SECTOR REGULATION

Each province has its own securities regulator, which is either a self-funded commission or an entity funded within a larger government department. The securities regulator administers the province's securities act and, correspondingly, promulgates its own set of rules and regulations. The securities regulator delegates certain regulatory responsibilities to national SROs, such as IIROC and the MFDA. Accountability for securities regulation extends from the securities regulator to the Minister responsible for securities regulation and, ultimately, the legislature, in each province.

The concerns about duplication and overlap expressed by market participants and SROs that largely operate nationally have motivated efforts by the provinces to better harmonize and coordinate securities regulation in Canada. The most important effort is the implementation of the passport system. Under the passport system, compliance with the rules and decisions of the principal regulator is intended to constitute deemed compliance with the requirements of all other participating jurisdictions, in essence providing a passport to undertake capital markets activity across Canada. The passport system is currently limited to prospectus filings and certain types of discretionary exemptions. Efforts are underway to expand it to include registration requirements, currently expected to be implemented by the end of 2009. Ontario supports the harmonization and improved coordination of securities regulation in Canada; however, it does not wish to participate in the passport system.[27]

We have spent considerable time debating the appropriate structure of securities regulation in Canada, reviewing the work of previous bodies, consulting with stakeholders and expert commentators, and listening carefully to our international counterparts. We believe that the passport system is a positive development. It will reduce compliance costs and the complexity of securities regulation for regulated entities operating in more than one jurisdiction. We have, however, a number of significant concerns that arise from the fragmented securities regulatory structure that the passport system is unable to address, even when fully implemented. Many of these concerns have been informed by how securities regulators have performed under the recent turmoil that continues to unfold in global capital markets.[28]

I. CONCERNS WITH THE CURRENT STRUCTURE

We believe that the fragmented structure, requiring decisions to be coordinated across up to 13 jurisdictions, makes it difficult for Canadian securities regulators to react quickly and decisively to capital market events. One illustration of this difficulty is the adoption in September 2008 by our international counterparts, including the United States and United Kingdom, of restrictions of short-selling of certain stock as a temporary stability measure. The Canadian response lagged behind the coordinated efforts of the United States and the United Kingdom, and was not uniform across the provinces. A second illustration is the delay between the freezing of the non-bank Asset Backed Commercial Paper (ABCP) market in August 2007 and the release of a consultation paper by the Canadian Securities Administrators to seek input on a number of proposals that aim to prevent similar capital market failures in the future.[29] We find that the fragmented securities regulatory structure is prone to foster slow securities regulatory responses, which makes Canada vulnerable to market and reputational risks.

Second, we are concerned that our system of provincial mandates is incongruent with the national response required to address developments in capital markets that are increasingly national and international in scope. One of the important lessons from the recent capital markets crisis is that systemic risk is increasingly presenting itself in capital markets rather than being solely confined to banking institutions. We believe that effectively addressing systemic risk requires the coordination and collaboration of all financial sector regulators in Canada. It also requires working effectively with our international counterparts. We do not believe that multiple securities regulators will be able to work effectively as part of a national systemic risk management team, as structural challenges will likely compromise its ability to be proactive, collaborative, and generally effective in helping to address larger capital market issues on a timely basis. A delayed response, which is poorly managed by any one of the securities regulators, could have a detrimental impact on the integrity of Canada's capital markets as a whole.

> *"Under the current system, the reality is that all local rules still have to be complied with, whether they are rules of the principal regulator's jurisdiction or rules of the other non-principal jurisdictions."*
>
> ***Canadian Bankers Association***

Finally, we believe that the current structure fundamentally misallocates resources, causing securities regulation to be less efficient and effective. Resources must be devoted to keep 13 separate securities regulators operating in Canada. This is inefficient since each jurisdiction dedicates a different level of resources to securities regulation, which causes the intensity of policy development, supervision, and enforcement activities to vary across Canada. In addition, most efforts are duplicative, which results in unnecessary costs, overstaffing, and delays.

Canadians, in turn, are afforded different levels of investor protection depending on the jurisdiction in which they reside or invest. Second, market participants will continue to be burdened with undue compliance costs, even with the full implementation of the passport system. Market participants will still have to pay fees in up to 13 jurisdictions. They will still have to deal with the general inefficiencies associated with differences between provincial statutes and regulations, the ongoing use of local rules, and variations in the interpretation of national rules.

We think important progress has been made to date to make securities regulation more efficient. The fragmented structure, however, does not allow Canada to be as responsive and effective as it should be, especially when capital markets are under stress. It also imposes undue costs on market participants. Further changes will invariably be undermined by the inefficient structure. We believe that 13 securities regulators must be consolidated into one. Canada needs a single securities regulator. This echoes the views expressed by the vast majority of market participants that we consulted. It also reflects the vast majority of assessments by third-party international bodies, including, most recently, the International Monetary Fund and the Organisation for Economic Co-operation and Development (see Box 1).

(BOX 1)

ASSESSMENTS BY THIRD-PARTY INTERNATIONAL BODIES

"There would be advantages in moving towards a single securities regulator. Significant improvements to the regulatory system have been made as a result of the creation of the Canadian Securities Administrators, including those that will be brought about by the implementation of the passport system. Even so, moving further to a single regulator would allow policy development to be streamlined, reduce compliance costs, and improve enforcement."

International Monetary Fund, *Canada: Financial System Stability Assessment—Update,* 2008

"The current diversity of regulations – for example, each province has its own securities regulator – makes it difficult to maximise efficiency, and increases the risk that firms will choose to issue securities in other countries [i.e., other than Canada]. A single regulator would eliminate the inefficiencies created by the limited enforcement authority of individual provincial agencies."

OECD, *Policy Brief: Economic Survey of Canada,* 2008

II. OUR RECOMMENDED STRUCTURE FOR CANADA

Our recommended structure preserves and builds on the strengths of the current system while addressing its shortcomings. We need a single securities regulator that provides clear national accountability, reduces compliance burden, and strengthens enforcement. It must also better serve the needs of investors. However, we need the single securities regulator to maintain the high level of local service currently being provided, and to continue to advance the distinct needs of the regionally-based market participants and industry sectors across Canada.

We recommend the establishment of the Canadian Securities Commission to administer a single securities act for Canada. We recommend the adoption of the structure prescribed below.

A) CANADIAN SECURITIES COMMISSION

The Canadian Securities Commission would be responsible for policymaking and rulemaking activities as well as the investigation and prosecution of regulatory offences. The Commission would work to meet the core objectives of securities regulation by following our guiding principles of regulatory conduct, including facilitating the reduction of systemic risk in the larger financial system.[30] The Commission would provide a high level of service to investors and market participants across Canada, operating in a manner that is efficient, including in the administration of rules and in the processing of disclosure documents and other filings.

Based on our earlier discussions, we believe that the Commission should focus particular attention in advancing a number of areas. The Commission should:

- implement and actively manage a comprehensive performance measurement system;
- develop a more principles-based and risk-based approach, and it should examine opportunities to better tailor regulation to the size of public companies in Canada and the sector they operate in;
- work with and respond to representations made by the small reporting issuer panel and the investor panel (described below);
- establish the power and means to compensate investors in the case of a violation of securities law; and
- foster the development of a strong international division, which would represent Canada in multilateral forums and in bilateral relations with other national securities regulators.

The Commission's Executive Management Team would consist of the Chair (Chief Executive Officer), a number of Vice-Chairs, other members of the Commission, and an Executive Director. The members of the Commission, including the Chair and Vice-Chairs, would be appointed based upon the recommendations of the Nominating Committee described below. The Executive Director would be appointed by the Chair and would be responsible for managing the day-to-day operations of the Commission.

We note that the experience and reputation of the inaugural Executive Management Team, especially the Chair, will be critical to the success of the Commission. Ideal candidates would have a proven track record of managing large organizational changes, be highly regarded within the securities law and regulatory fields in Canada, and have strong leadership abilities. To attract the right people, staff compensation needs to be competitive, reflective of the compensation provided in the private sector for equivalent skills and experience.

We recommend that the Chair of the Commission become a member of the Financial Institutions Supervisory Committee (FISC) and the Senior Advisory Committee (SAC). These Committees are comprised of the heads of the federal departments and agencies that support the regulation of the financial sector and the financial stability of Canada.[31] FISC is statutorily-mandated to review the health of regulated financial institutions and reports to the federal Minister of Finance. The SAC reviews financial sector policy issues, including legislation and regulation. With the addition of the Commission Chair, the Committees would bring together all key players involved in financial regulation and stability in Canada, promoting a more integrated view of emerging issues that will help to support improved responses to them.

We believe that the Commission's head office should be located in one of the four largest provinces: British Columbia, Alberta, Ontario, or Quebec (assuming these provinces participate). The final decision will likely reflect negotiations with the participating jurisdictions. We strongly encourage the Commission to establish regional offices in major financial centres, each headed by a Vice-Chair in the largest provinces, to be responsive to the distinct needs of regionally-based sectors and local market participants. Smaller local offices will be maintained to properly service local market participants and support local enforcement actions. Regional offices in certain areas of Canada could specialize in the regulation of specific sectors or types of financial instruments. For example, British Columbia could specialize in the mining sector; Alberta in the oil and gas sector; Ontario in the financial services sector; and Quebec in derivatives. The regional and local offices should initially consist largely of staff from existing provincial securities regulators to ensure the continuity of regulatory expertise and to provide uninterrupted regional and local service.

The Commission should be self-funding with fees set on a cost-recovery basis, to reflect the cost of administering regulation. We recognize that the fees collected by some provincial securities regulators represent revenues that fund government expenditures. We encourage the federal government to negotiate a direct compensation arrangement to ensure that these revenue shortfalls are not provided through fees levied by the Commission.

The Commission would be accountable to federal Parliament through the federal Minister of Finance. The Minister would have the right to veto rules proposed by the Commission.

B) SPECIAL INDEPENDENT PANELS

We recommend the establishment of two independent panels; one would represent the views of investors and the other would represent small reporting issuers to the Canadian Securities Commission. The Commission would be required to consider and respond to any views expressed or proposal made in a representation by either panel, with a written statement publicly released by the Commission if it disagrees with a representation. Both panels would be supported by a dedicated secretariat and funded separately. Each Panel would prepare an annual report that reflects on its activities and discusses the actions taken by the Commission to address its concerns.

i) Investor Panel

The investor panel would work to ensure that the views of investors are captured as the Canadian Securities Commission develops securities regulatory policy. It might contribute to support the development of a more principles-based approach. It would help to steward the development of more effective investor education programs. The panel should be comprised of individuals that have a broad knowledge of, and a keen interest in, investor issues. Candidates could include investor advocates, journalists, academics, lawyers, and retired civil servants.

ii) Small Reporting Issuer Panel

The small reporting issuer panel would advise the Canadian Securities Commission of the impact of its regulatory and policy initiatives on small reporting issuers. The panel would identify regulatory issues that have a disproportionate adverse effect on small issuers. It is anticipated that it might support the implementation of more principles-based regulation and, in particular, advance proportionate regulation for small issuers. The panel should be made up of individuals that understand the compliance obligations of small reporting issuers, including lawyers, accountants, and managers.

C) GOVERNANCE BOARD

A Governance Board would oversee the Canadian Securities Commission. Certain Panel members wanted the role of the Board to be focused on the operational effectiveness of the Commission in areas that include financial resources, services, property, personnel, and contracts. The Board would provide strategic perspective on the Commission's financial and other non-regulatory affairs, supporting sound management practices and effective service delivery. Other Panel members wanted the role of the Board to be expanded to include providing strategic perspective on regulatory affairs and providing an oversight role in policy and rule changes proposed by the Commission for consideration by the federal Minister of Finance. There are arguments to support either view of the role of the Board in the oversight of the Commission. Both should be carefully considered by the architects of the Commission.

All members of the Board would be independent of the management of the Commission. The Chair of the Commission would, however, be an *ex-officio* member of the Board. The Board would be required to periodically report the findings of its oversight activities to the federal Minister of Finance.

D) FEDERAL-PROVINCIAL NOMINATING COMMITTEE

The federal Minister of Finance and the participating provincial jurisdictions would each be given the opportunity to appoint a member to the Nominating Committee. The Nominating Committee would be responsible for recommending candidates to the federal Minister of Finance for the members of the Canadian Securities Commission, including the Commissioners (i.e., Chair, Vice-Chairs, and other Commissioners), the members of the Governance Board, and the adjudicators of the independent adjudicative tribunal (discussed below). The federal Minister of Finance would only be able to consider appointments based on the candidates proposed by the Nominating Committee. This would support the promotion of regional balance in the appointment process.

E) COUNCIL OF MINISTERS

A Council of Ministers should be established comprising the federal Minister of Finance and a Minister designated by each participating jurisdiction. The Council would discuss the development of securities policy and the ongoing administration of the system. It would serve as a forum to discuss emerging issues in Canada's capital markets and work to ensure that securities regulation supports the distinct needs of regions and industrial sectors across Canada. The Council would consider proposed legislative amendments to the Securities Act. The provinces would have the power to veto any proposed legislative amendments.[32]

F) INDEPENDENT ADJUDICATIVE TRIBUNAL

We support the creation of an independent adjudicative tribunal. Under our recommended structure, the tribunal would assume adjudicative functions that would otherwise be exercised by the Canadian Securities Commission. The Commission, however, would retain jurisdiction over certain decisions, such as discretionary exemptions from the securities regulations and rules as well as matters regarding contested takeover bids. Cases involving quasi-criminal or criminal matters would continue to be referred to the appropriate authorities and tried in the court system. [33] The adjudicators would be appointed based on the recommendations of the Nominating Committee. The federal Minister of Finance would order the Commission to allocate a certain amount of funds each year to fund the tribunal.There were differences of opinion among the panel members as to the role of the Governance Board in the oversight of the tribunal. Some suggested that the Governance Board should oversee the tribunal to promote operational efficiency while others thought that the Governance Board should not have such a function as it might compromise the independence of the tribunal.

The tribunal should be designed in a manner that would maximize its effectiveness. First, adjudicators should have expertise in securities regulation, capital markets, and adjudication. This could include retired judges and former commissioners of provincial securities commissions. Appointments should be up to a maximum term of five years. Second, the tribunal should be designed to ensure regional presence. Strong consideration should be given to establishing tribunal offices across Canada in order to conduct hearings locally and foster the development of local expertise. Finally, the tribunal should have a Chief Adjudicator to oversee the operations of the tribunal.

G) SELF-REGULATORY ORGANIZATIONS

The SROs, such as IIROC and the MFDA, and other regulatory organizations, such as the TSX, should continue to play a critical role in the regulation of Canada's capital markets. In our recommended structure, SROs would only be overseen by the Canadian Securities Commission. This would reduce the compliance costs of the SROs, and it would likely result in more consistent regulation, as the Commission could ensure greater consistency between its policy and those of the SROs.

While the Panel believes that self-regulation is an important feature of our regulatory system that should be preserved, the Panel heard numerous complaints about the lack of independence of the SROs from the industry, the contractual relationships with the regulator (rather than a legislative one), and the concerns from investors about the process of complaint-handling and redress. A full review of SROs was beyond the scope of our mandate. The Commission, once formed, should take stock of the performance and responsibilities of the SROs.

H) CAPITAL MARKETS OVERSIGHT OFFICE

The establishment of the Canadian Securities Commission will take some time to negotiate and implement. We believe, however, that immediate action should be taken to establish a strong national presence in securities regulation.

We recommend the immediate establishment of a Capital Markets Oversight Office reporting to the federal Minister of Finance.

The Office will be responsible for providing leadership in the regulation of securities, both domestically and internationally. It will collaborate with regulators to develop policies that reflect the best interests of Canada rather than those of a single jurisdiction. It will closely monitor global financial markets. We envision that the role and function of the Office will be absorbed by the Commission when the latter becomes operational.

III. WHY OUR RECOMMENDED STRUCTURE IS BETTER FOR CANADA

The proposed structure provides clear national accountability to market participants and to the public. The federal Minister of Finance and, ultimately, the federal Parliament would be accountable for securities regulation in Canada. Decisions would be made by a single entity, rather than 13, facilitating quicker, more decisive action. The regulation of capital markets would have a national mandate that would complement the national character of Canada's capital markets. The Canadian Securities Commission would support improved coordination with domestic and international financial sector regulators. Canada, overall, would be able to respond from a position of greater strength to financial instability.

The decentralized structure, with regional offices in major financial centres and a network of smaller local offices, would work to ensure that provincial and regional interests are thoroughly represented at all levels of decision-making while benefiting from coordination, both in terms of internal management, and relationships with other domestic and international financial sector regulators. The regional and local offices would support local enforcement actions, serve as a first point of contact for complaints of regulatory misconduct, and generally provide a high level of service to meet the needs of local market participants and the public.

The structure would consolidate all policymaking and rulemaking activities for Canada into the Canadian Securities Commission. This would provide for more cohesive and responsive securities regulation. As discussed earlier in the report, it would support greater regulatory innovation, including more proportionate, principles-based regulation, and it would allow for the advancement of a comprehensive system of performance measurement in securities regulation for Canada. Regulated entities would also no longer have to comply with and pay fees in up to 13 jurisdictions. They would only be subject to a single fee and comply with a single set of rules and regulations. This would reduce compliance burden and allow resources to be put to more productive uses.

The enforcement of securities law would no longer be fragmented across 13 different jurisdictions. It would fall under the sole responsibility of the Canadian Securities Commission. This would facilitate the better use of enforcement resources and concentrate expertise. It would provide for uniform enforcement priorities and investor protection across Canada. Enforcement would be improved by advancing a more principles-based approach and building on the risk-based approach currently employed in Canada. The establishment of an independent adjudicative tribunal would help to ensure that market participants across Canada would benefit from a fair hearing.

Investors would be better represented by the recommended structure. The independent investor panel would work to ensure that securities regulatory policy is developed in a manner that is more mindful of the considerations of investors. It would provide an independent voice on investor issues to the Canadian Securities Commission. Basic investor education could be provided by the Commission or through another regulatory entity. Investors across Canada would also benefit from having the option of seeking financial redress at the Commission without having to engage the court system. Investors that have been subject to wrongdoing would be compensated expeditiously through the use of the Commission's investor compensation fund.

The structure would strengthen the reputation of Canadian capital markets regulation internationally. The Canadian Securities Commission would be able to better represent Canada at international meetings and negotiate with a strong, single voice. The Commission would, for example, be able to work more effectively with other countries in addressing many pressing global regulatory issues, including the development and oversight of international accounting and auditing standards, the oversight of credit rating agencies, and the regulation of derivatives. In addition, a single, streamlined regulatory approach would make Canada's capital markets more attractive to foreign issuers and investors.

> *"The status quo is not acceptable and the pace of reform toward an efficiently operating capital market is painfully slow. The federal and provincial governments must lead the bold reform that industry and all market participants have been calling for."*
>
> ***Advocis***

The fragmented structure of securities regulation weakens Canada's financial sector regulatory framework that otherwise exhibits strong federal leadership. Our consolidated structure should be implemented as soon as possible so that Canada can position itself to better respond to financial instability and attain better securities regulatory outcomes.

IV. FUTURE DIRECTIONS TO MODERNIZE FINANCIAL SECTOR REGULATION

We believe that once the path to the Canadian Securities Commission has been established, a larger assessment should be undertaken to examine whether Canada should reform the regulation of its financial sector. Many of Canada's financial institutions engage in activities that cut across banking, insurance, and securities. Yet, the regulation of these financial institutions is often undertaken by separate regulators looking at separate parts, rather than examining the activities as a whole. This has had implications for the safety and soundness of the financial system and the general efficiency of regulation. There may be an opportunity, therefore, to reform the structure of financial sector regulation to better reflect the realities of the modern financial services industry. In this regard, we are intrigued by the recommendations of our research study on this topic that Canada should consider implementing an objectives-based regulatory approach, under either a single, consolidated financial sector regulator, or under a twin peaks model that would create separate agencies for prudential regulation and business conduct.[34]

ENDNOTES

[27] The reasons why Ontario does not wish to participate in the passport system are explained in Ontario Securities Commission Notice 11–904, "Request for Comment regarding the Proposed Passport System."

[28] Other concerns about Canada's securities regulatory structure have been described by previous expert bodies and commentators. See, for example, the Crawford Panel on a Single Canadian Securities Regulator (2006), the Wise Persons' Committee to Review the Structure of Securities Regulation in Canada (2003), or Harris, Douglas A. "White Paper: A Symposium on Canadian Securities Regulation: Harmonization or Nationalization?" Capital Markets Institute (October 2002).

[29] For information on the non-bank ABCP crisis in Canada, see Chant, John. "The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets." Expert Panel on Securities Regulation (2009).

[30] See the section in the report entitled "Objectives of Securities Regulation."

[31] FISC is chaired by the Superintendent of OSFI and includes the federal Deputy Minister of Finance, the Governor of the Bank of Canada, the Chair of the Canadian Deposit Insurance Corporation, and the Commissioner of the Financial Consumer Agency of Canada. SAC is comprised of the same senior officials, but it is chaired by the federal Deputy Minister of Finance.

[32] An amendment may be vetoed by provincial ministers representing at least a majority of participating provinces having in total not less than a majority of the population of all participating provinces.

[33] Most provincial securities acts contain provisions creating quasi-criminal offences for breaches of securities law. Quasi-criminal offences can lead to punitive penalties, including imprisonment. Quasi-criminal offences are currently prescribed in provincial securities acts while criminal offences are prescribed in the federal Criminal Code.

[34] Pan, Eric J. "Structural Reform of Financial Regulation in Canada." Expert Panel on Securities Regulation (2009).

Opportunities to Further Strengthen Securities Enforcement

Timely, consistent, and visible enforcement of securities laws and rules is critical for deterring wrongdoing, protecting investors, fostering investor confidence, and encouraging participation in capital markets.

We are troubled by the concerns expressed during our consultations regarding securities enforcement in Canada. Stakeholders suggested that the scope of enforcement activities is not sufficiently broad or sophisticated to credibly deter wrongdoing. When action is taken, they noted, it is often ineffective at prosecuting those who have imposed significant losses on Canadians. To illustrate this point, stakeholders indicated that law enforcement bodies in the United States appear to have greater success in prosecuting Canadians that commit capital markets crime than Canadian authorities. One manager of a large Canadian pension fund stated that the fund has a policy of purchasing Canadian stock on U.S. stock exchanges in order to have the benefit of U.S. enforcement and redress.

We are also concerned that the lack of strong enforcement might be imposing undue reputational and economic costs on Canada. A number of recent economic studies have shown empirically that the cost of equity is higher in countries where investors are afforded less protection against the risk of losses due to wrongdoing.[35] It follows that investors want to be compensated for the additional risk and generally weaker enforcement regimes.

We do not have a mandate to broadly review the system of enforcement in Canada. Many expert groups and commentators have opined on enforcement issues in recent years.[36] However, in light of the concerns expressed by stakeholders, and the importance to the economy in getting it right, we felt compelled to provide some direction.

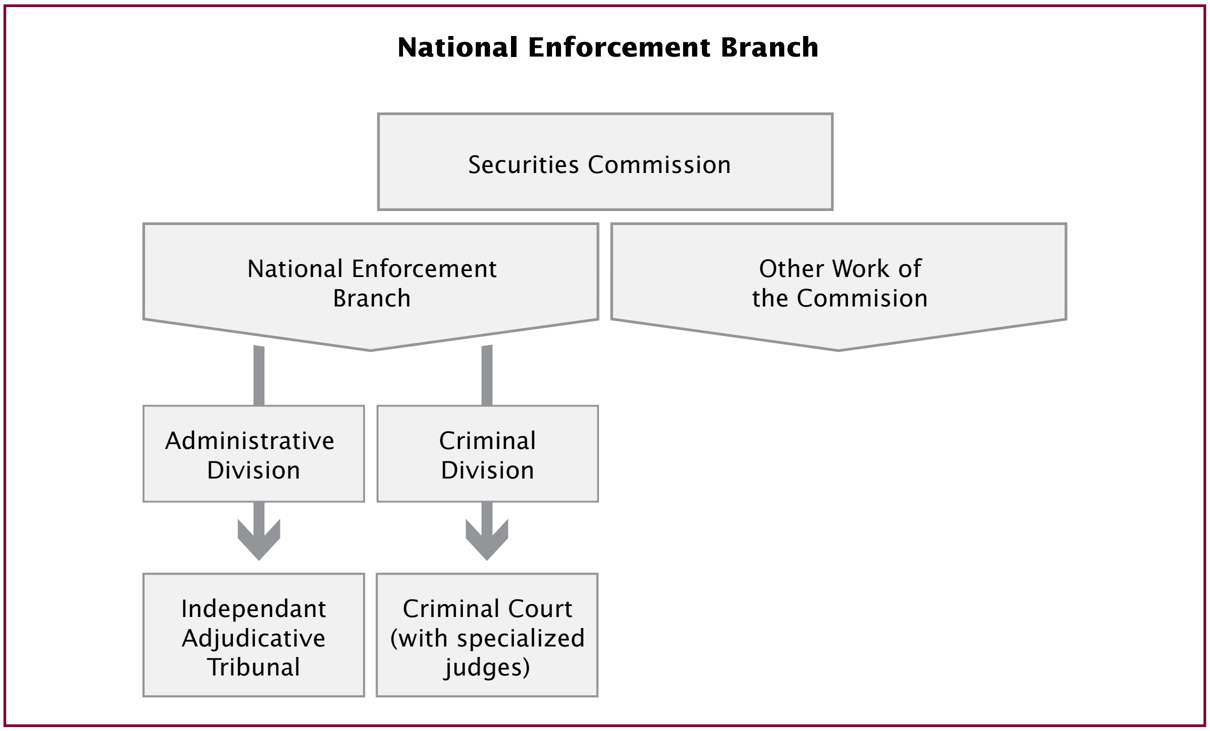
> *"…a continuation of this fragmented approach to enforcement will continue to erode investor confidence and discourage investment by Canadian and international investors."*
>
> ***TELUS***

We believe that the establishment of the Canadian Securities Commission, accountable to the federal Parliament, would be a significant step forward in supporting improvements to administrative enforcement. As previously discussed, the consolidation of administrative enforcement activities from 13 commissions into one would concentrate resources, eliminate unnecessary duplication and overlap, and support greater consistency in investor protection across Canada. We also note that the Commission, conducting administrative enforcement, might better align, and lead to improved cooperation, with federal and international criminal enforcement authorities. The latter is particularly at issue since most countries, including Canada, reserve treaty-making authority for federal governments.

We recognize that there are currently important efforts underway to improve criminal enforcement. For example, the RCMP-led Integrated Market Enforcement Team (IMET) program, which investigates the majority of capital markets criminal infractions in Canada, is in the process of implementing the recommendations identified in the Le Pan report.[37] We are encouraged by the recent criminal charges laid in a number of high-profile cases.[38] Sufficient time must be provided to allow reforms to take their course. That said, we do note that criminal enforcement appears to be hampered by the same fragmented structure that is undermining securities regulation. Each province has varying degrees of investigative, prosecutorial, and adjudicative expertise and resources to handle criminal matters, which appears to impede Canada's ability to have a strong national system of criminal enforcement.

In addition to the establishment of the Canadian Securities Commission, we recommend there be an examination of larger structural reforms to strengthen enforcement in Canada. We believe that the structural reform proposal submitted by the Canadian Coalition for Good Governance during our consultation process should warrant particular attention.[39] The proposal would establish a National Enforcement Branch under the auspices of a single securities commission (see Figure 1). The Branch would have two distinct and independent Divisions; one Division would investigate and prosecute matters regarding administrative enforcement, while the other Division would conduct corresponding activities for criminal enforcement. Administrative matters would continue to be adjudicated by the independent adjudicative tribunal. Criminal matters would be brought before criminal courts presided over by judges that have the necessary expertise to properly adjudicate capital markets criminal cases.

(FIGURE 1)



In addition to the establishment of the Canadian Securities Commission, we recommend there be a full examination of larger structural reforms to strengthen enforcement in Canada, including a complete assessment of the merits of a National Enforcement Branch that consolidates administrative and criminal enforcement functions.

As our research study on an equivalent structural proposal indicates, the consolidation of administrative and criminal enforcement functions may help to strengthen enforcement in Canada.[40] First, expertise in administrative and criminal enforcement (i.e., investigative and prosecutorial) is currently diffused across Canada. The Branch would concentrate this expertise, which might lead to improved enforcement outcomes. Second, the interaction between administrative and criminal enforcement authorities is often slow and uncoordinated. The Branch would allow for a quicker and clearer choice between pursuing investigations and prosecutions that are administrative or criminal. Finally, the coordination of cross-border investigations and enforcement actions is sometimes difficult given the fragmented structure of enforcement. The Branch would provide a single point of contact for all enforcement matters and, therefore, facilitate improved coordination with foreign regulatory and criminal authorities.

Some have argued that this structural reform should be pursued in the absence of a single securities commission. Our view is that the significant structural benefits would be diluted in a multi-jurisdictional framework. We also note that, even with a single securities commission, such a structural reform, although appealing in many ways and conceptually simple, would be a significant undertaking and could likely not be implemented quickly. The reform would require the support and cooperation of multiple jurisdictions and organizations in Canada.

ENDNOTES

[35] See, for example, Witmer, Jonathan. "The Cost of Equity in Canada: An International Comparison." Bank of Canada Working Paper (21-2008); or Hail, Luzi and Christian Leuz, "International Differences in the Cost of Equity Capital: Do Legal Institutions and Securities Regulation Matter?" (2006) Journal of Accounting Research, 44:3 485.

[36] See, for example, Cory, Peter and Marilyn Pilkington. "Critical Issues in Enforcement." The Task Force to Modernize Securities Legislation in Canada (2006).

[37] Le Pan, Nick (Special Advisor to the Commissioner of the RCMP). "Enhancing Integrated Market Enforcement Teams: Achieving Results in Fighting Capital Markets Crime" (October 2007).

[38] For example, in June 2008, IMET charged six individuals with defrauding Royal Group Technologies Limited. It also arrested six former employees of Norbourg Financial Group, laying 922 criminal charges.

[39] The submission by the Canadian Coalition for Good Governance to the Expert Panel on Securities Regulation is accessible at www.expertpanel.ca.

[40] Puri, Poonam. "A Model for Common Enforcement in Canada: The Canadian Capital Markets Enforcement Agency and the Canadian Securities Hearing Tribunal." Expert Panel on Securities Regulation (2009).

Improving the Regulation of Derivatives in Canada

The derivatives markets globally have been among the most dynamic of all financial markets for more than a generation. Derivatives are generally defined as instruments or contracts whose value depend on, or are derived from, something else, such as a commodity, reference rate, or index. Derivatives can be traded on stock exchanges, called exchange-traded derivatives, or over-the-counter, called over-the-counter (OTC) derivatives.[41] Derivatives markets have shown exceptional growth and innovation. In 2008, OTC derivatives globally accounted for notional positions totalling in excess of US$680 trillion, representing much more than the underlying value of the corresponding assets.[42]

> *"It is generally recognized that, in many countries, regulation of derivatives markets has failed for some time to take into account new types of products and trading practices."*
>
> ***Bank of Canada***

Highly leveraged, lightly regulated entities (e.g., hedge funds), competing in largely unregulated OTC derivatives markets, are an important factor behind the current global financial crisis. This has underscored that the regulation of derivatives markets in many countries needs to be modernized to better address the new types of products, trading practices, and the interrelationship between the derivatives markets and the cash markets.

I. EXCHANGE-TRADED DERIVATIVES

Exchange-traded derivatives are traded through the Montreal Exchange in Montreal, ICE Futures Canada in Winnipeg, and the Natural Gas Exchange in Calgary. These exchanges act as intermediaries, servicing standardized exchange contracts with the intermediary being a counterparty to the contract. The exchanges also fulfill a regulatory role with respect to their markets.

Exchange-traded derivatives are regulated in Canada through securities regulatory authorities only in the provinces of British Columbia, Alberta, Manitoba, Ontario, and Quebec. Regulation in this area has suffered from a lack of attention and coordinated effort. Manitoba and Ontario have specific, though outdated, legislation focused on commodities and futures contracts; British Columbia and Alberta address exchange-traded derivatives through their securities acts; and Quebec has recently passed a new Derivatives Act and is working on a draft of the corresponding regulation. The inconsistency in treatment of exchange-traded derivatives arises from a historical difference of views as to whether or not derivatives are "securities" or should be treated as such. It is also compounded by the demands of a quickly evolving market for new derivative products. Consequently, Canada has three different regulatory approaches among five provinces.

We believe that there needs to be a strong interrelationship between the derivatives markets and the cash markets in securities legislation.

We recommend that the regulation of exchange-traded derivatives be prescribed in securities legislation.

We conclude that the Canadian Securities Commission would bring significant improvement to the current fragmented approach to the derivatives market for exchange-traded contracts by providing a common regulatory base.

II. OVER-THE-COUNTER DERIVATIVES

OTC derivatives markets are largely unregulated in Canada. Provincial authorities have however spent considerable time attempting to develop regulation in this area, including the new Quebec Derivatives Act. The various efforts to regulate have been met with significant opposition from a range of industry participants, arguing regulation would impede the growth of the Canadian market and make it potentially uncompetitive with the much larger derivatives market in the United States.

As noted in our introduction above, and explained in a commissioned research study that examines the recent non-bank ABCP crisis in Canada,[43] the approach of allowing market participants trading in OTC derivatives to regulate themselves has proven to be unsatisfactory. More broadly, the Panel is concerned that the lack of sound settlement, legal, and operational infrastructure in the OTC derivatives markets is a potential source of weakness for Canada's financial system. While we advocate more regulatory oversight be applied to the OTC derivatives market, we are conscious that the United States and others are also considering regulatory responses. Until these are clearer, it would be premature for the Panel to recommend a regulatory approach that risks being out of step with much larger markets than our own. We are, however, of the view that the Canadian Securities Commission would be in a much better position than the current provincial securities regulators to participate in international discussions and to direct the development of corresponding regulation in Canada.

For OTC derivatives, we recommend that the Canadian Securities Commission have sufficient policy depth and resources to determine the best path for the regulation of OTC derivatives in the future.

It is important to note that the regulation of the OTC derivatives markets is not a substitute for regulating the institutions that trade in them. Canada's first line of regulation needs to be focused on these institutions, monitoring their risk and leverage.

ENDNOTES

[41] A briefing note in Appendix 5 describes in greater detail the different approaches used by provincial securities regulators to regulate derivatives in Canada.

[42] Bank for International Settlements. "OTC derivatives market activity in the first half of 2008." Monetary and Economic Department (November 2008).

[43] Chant, John. "The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets." Expert Panel on Securities Regulation (2009).

Transition Path

I. STAGE ONE: ESTABLISHING THE FOUNDATION
II. STAGE TWO: TRANSITION TO THE NEW REGIME

> *"We do not believe that moving to a single securities regulator would be disruptive to the marketplace if clear transitional provisions were adopted and the majority of provincial securities regulatory staff is initially transferred to the new single regulator."*
>
> ***Ontario Bar Association***

Under the terms of our mandate, we are called upon to provide, in addition to a securities act, a transition path including key steps and timelines for the implementation of the legislation, and changes to the structure of the regulatory system. We are recommending the adoption of a comprehensive national securities act (the "Act") with the willing participation of provinces. With a key consideration being the minimization of market disruption, we contemplate a staged transition to this new legislation and administration.

I. STAGE ONE: ESTABLISHING THE FOUNDATION

Following the announcement of the federal government's intention to move forward, negotiations would commence with the provinces with a view to their participation in a national regulatory system (including discussions as to compensation for foregone revenue). Coincident with such announcement, a transition and planning team (the "Team") would be created and its budgetary allocation authorized. The Team would support the intergovernmental negotiations, overseeing the transition to a federal regulatory system, as well as planning for the Canadian Securities Commission (the "Commission") and the independent adjudicative tribunal (the "Tribunal").

The Team would be expected to negotiate a memorandum of understanding (an "MOU") with those provinces willing to participate (the "participating jurisdictions") for the purposes of coordinating implementation of the national regime, given the expected need for a staged transition from the existing provincial regimes. Appendix 7 provides an indication of the potential subject matters which might be covered in such an MOU.

The Team would also, working with the federal government and participating provinces, oversee the preparation of the Act for introduction in Parliament. The Expert Panel has developed the draft Securities Act (see Box 2) to provide a basis for developing a national securities act; however it leaves open a number of issues that would require further consideration. These include determination of the appropriate transition provisions as well as certain institutional structural issues.

Assuming agreement with a sufficient number of jurisdictions, the federal government would introduce the Act. The aim of the federal initiative would ultimately be to move to a comprehensive national regime. In the absence of unanimity on the part of the provinces, the Act would contemplate provisions providing for voluntary provincial participation and limiting the application of the Act to participating jurisdictions during the transition to a comprehensive national regime.

(BOX 2)

ABOUT THE DRAFT SECURITIES ACT

The draft Securities Act, which is meant to provide a basis for legislation, together with the accompanying commentary and table of concordance, can be accessed at www.expertpanel.ca.

In considering the approaches available for drafting a securities act, the Panel chose to build on existing provincial securities regulation by seeking to harmonize existing legislation in the form of a single statute. This choice reflected two key criteria for assessing the available alternatives: first, a desire to simplify transition issues and, second, a desire to mitigate any potential capital market disruption.

The general legislative drafting approach reflected in the draft Securities Act, consistent with many existing provincial statutes, is to include core fundamental provisions in the statute while allowing for more detailed and technical requirements to be implemented through rules. This approach is believed to be more conducive to the development of more principles-based regulation, which, as noted earlier, the Panel recommends.

In the event that a sufficient number of provinces do not participate, we are also recommending that the federal government consider including a market participant opt-in feature in the transition provisions of the Act. Each market participant that is not based in a participating province would be granted the right to opt-in in respect of itself and its related entities and their respective activities. In this way, it would be governed by federal securities legislation to the exclusion of provincial legislation. As a result, market participants based in a participating province would now also have the ability to comply exclusively with the Act and related federal rules for all of their activities, not just in the particular jurisdiction itself but across Canada since these market participants need to be afforded equal treatment with their electing counterparts in non-participating jurisdictions. We expect that this opt-in feature would lose much of its significance when most of the provinces willingly participate. Appendix 8 provides a description of the market participant opt-in feature. Certain members of the Expert Panel noted their strong preference for a cooperative approach to moving forward towards the single securities regulator on a willing participation basis and their corresponding concerns about the market participant opt-in feature.

We would expect that this first stage from inception to Royal Assent would be approximately one year in length.

II. STAGE TWO: TRANSITION TO THE NEW REGIME

Following the passage of the Act, there would be a transition period expected to be approximately two years in duration, during which:

i) The Nominating Committee and the Council of Ministers would be established and the Commissioners of the Commission, the members of the Governance Board, and some of the initial group of adjudicators on the Tribunal, would be appointed;

ii) The initial Chair of the Commission and the Governance Board would be appointed;

iii) Existing rules and regulations of the participating jurisdictions (as well as any additional rules needed in order to fill any gaps between the Act and existing rules) would be adopted as rules or regulations under the Act or redrafted into federal rules or regulations;

iv) The Commission and Tribunal would hire staff, substantially all of whom would initially be drawn from existing employees of participating jurisdiction regulators, and who would share their time upon an agreed basis between the existing participating jurisdiction regulators and the Commission and Tribunal;

v) The Commission and Tribunal would secure appropriate office space and other assets in the various participating jurisdictions, and as necessary, in any of the non-participating jurisdictions;

vi) The Commission would address interaction with any non-participating jurisdictions in the absence of full participation by all provinces. Although participation would be encouraged, the Commission might also negotiate one or more MOUs with any non-participating jurisdictions for the purpose of coordinating securities regulation by the Commission and Tribunal and the non-participating jurisdictions in a manner analogous with the current passport system as well as for the purpose of mutual recognition in respect of those subject matters not currently part of the passport system; and

vii) The legislation of participating jurisdictions would be repealed effective at the time that the Act and federal rules and regulations became effective, except to the extent necessary to deal with any transitional issues.

Notwithstanding the receipt of Royal Assent, the Act and the ancillary federal rules and regulations would come into force only after a period of time adequate to permit the planning and establishment of the Commission and the Tribunal as well as the preparation, review, and finalization of all ancillary legislation.

Commencing when the Commission was in place, a detailed review would be undertaken of all local laws, regulations, rules, policies, notices, and orders of participating jurisdictions ("local laws and rules"), and all national and multilateral instruments, rules, policies, and notices applicable to participating jurisdictions ("CSA rules"), as well as other subject matters not dealt with in the Act or existing rules.

The Commission would need to be operational for the purposes of undertaking the federal rule-making process for a period estimated to be at least 12 months before the Effective Date. The extent and timing of the repeal and phasing out of local laws and rules and CSA rules in participating jurisdictions would likely need to take into consideration appropriate grandfathering and the survival of such rules to the extent necessary to avoid any unintended consequences for ongoing investigations, proceedings, activities, and orders subject to reasonable "sunset" provisions.

In the event that the transition mechanisms and plans described above not lead to the implementation of a single comprehensive national securities regime in Canada, we suggest that the federal government consider unilateral action to implement such a regime. The advice provided by our special advisor on constitutional law, Peter W. Hogg, Q.C., has confirmed that the federal government has the constitutional authority to do so. This opinion is widely held by constitutional lawyers.

Appendix 1: Members of the Expert Panel on Securities Regulation

PANEL CHAIR

The Honourable Thomas Hockin, P.C.

Former Minister of State (Finance) and former President, Investment Funds Institute of Canada (IFIC)

Mr. Hockin led the IFIC and the Canadian Institute of Financial Planning from 1994 to 2006. He is a former director of the Institute of Corporate Directors, the Mutual Fund Dealers Association, the Canadian Capital Markets Association and other voluntary boards. As a Member of Parliament and a Minister of State (Finance), he was responsible for the Blue Paper *New Directions for the Financial Sector* in 1986 and the Hockin-Kwinter Accord, which deals with the regulation of the securities-related activities of federally regulated financial institutions. As Minister of International Trade, he carried out the negotiations on the side accords to the North American Free Trade Agreement in 1993. As a former professor, he is the author of several scholarly articles and four books. He was awarded an Honorary Doctor of Commerce by Ryerson University in 2006 for his contribution to public and academic life and for his volunteer work. Mr. Hockin has a business degree from the University of Western Ontario, a master's degree in public administration, and a Ph.D. in political science from Harvard University.

PANEL MEMBERS

Ian D. Bruce, F.C.A.

Chief Executive Officer, Peters & Co Limited

Mr. Bruce spent six years with a major Canadian chartered accountancy firm before starting in the investment business in 1983. He joined Peters & Co Limited in 1998, following senior roles with RBC Dominion Securities and Scotia Capital Markets. Mr. Bruce is a director of Hardy Oil and Gas plc, a director and member of the Executive Committee of the Investment Industry Association of Canada, and is a member of the Patrons' Council of the Alberta Children's Hospital Foundation. He is a former member of the National Round Table on the Environment and the Economy, a former director of Taylor NGL LP, and a former director and Executive Committee member of the Investment Dealers Association of Canada. He was elected Fellow of the Chartered Accountants in 2004. He holds an undergraduate degree from Queen's University, an MBA from the Richard Ivey School of Business at the University of Western Ontario, and the designations of Chartered Accountant and Chartered Business Valuator.

Denis Desautels, O.C., F.C.A.
Corporate Director

Mr. Desautels served as Auditor General of Canada from 1991 to 2001. Prior to that appointment, he had a 27-year career with Ernst and Young, where he latterly was a senior partner in the Montreal Office and Regional Director of Consulting Services for the Province of Quebec and the National Capital Region. Mr. Desautels currently serves as Vice-Chair of the Accounting Standards Oversight Council of the Canadian Institute of Chartered Accountants and, until recently, was an Executive-in-Residence at the Telfer School of Management of the University of Ottawa. A graduate of McGill University, Mr. Desautels is Chairman of the Board of the Laurentian Bank of Canada and serves as a Board member of Bombardier Inc., Le Groupe Jean Coutu (PJC) Inc., CARE Canada, and the International Development Research Centre.

Hal Kvisle
President and Chief Executive Officer, TransCanada Corporation

Mr. Kvisle was appointed in 2001 to his current post with TransCanada Corporation, a leading North American energy company focused on natural gas transmission and power generation. He joined TransCanada in 1999 as Executive Vice-President, Trading and Business Development. Mr. Kvisle is on the Board of Directors of TransCanada Corporation, the Bank of Montreal, and the Nature Conservancy of Canada, and is past Chair of the Board of Governors of Mount Royal College. Mr. Kvisle holds an MBA from the University of Calgary and a B.Sc. (Eng.) from the University of Alberta. Prior to joining TransCanada, he was employed by Fletcher Challenge Energy and Dome Petroleum.

Dawn Russell, Q.C.
Purdy Crawford Chair in Business Law, former Dean of Law, Dalhousie University

Professor Russell practised corporate and securities law for five years with the Halifax firm of Stewart McKelvey Stirling Scales before beginning a career as a law professor. After nearly a decade as Dean of Dalhousie Law School, she is currently an Associate Professor at Dalhousie and has taught corporate law and securities law for many years. She served as co-chair of the Nova Scotia Law Reform Commission between 1995 and 2002, has co-authored two books and written numerous publications, and sits as a director of several corporations. Professor Russell served as a public governor of the Canadian Investor Protection Fund between 2000 and 2006. Professor Russell also served as a member on the Crawford Panel on a Single Securities Regulator, appointed by the Ontario government to develop a model for a common securities regulator. Professor Russell has a B.A. from St. Thomas University, an LL.B. from Dalhousie Law School, and an LL.M. from Cambridge University.

Terry Salman

Chairman, President and CEO, Salman Partners Inc.

Salman Partners Inc. is a full-service, institutional-based investment firm with offices in Vancouver, Calgary and Toronto. Prior to its founding in 1994, Mr. Salman was instrumental in expanding Nesbitt Thomson's operations into western Canada, the United States and Pacific Rim. He spent 21 years with Nesbitt Thomson, reaching the post of Executive Vice-President and Director. Mr. Salman is a member of the Advisory Committee for the Investment Industry Association of Canada, former Chair of the Investment Dealers Association of Canada, and former Governor of the Vancouver Stock Exchange. He serves on the boards of many charitable organizations. Mr. Salman has an MBA from the University of Hartford.

Heather Zordel

Partner, Cassels Brock & Blackwell LLP

Ms. Zordel works in the Securities Group at Cassels, focusing on corporate finance and securities regulatory compliance. She brings structured products to market and works with investment funds. She lists companies on the TSX and TSXV and assists public companies in complying with stock exchange and securities commission requirements. In addition to her law practice, Ms. Zordel is the Associate Program Director and a Course Director for the Osgoode LL.M. program in securities law and also teaches in legal professional development programs. Her career has included several years working for the TSX. She was a contributing author in a recent book on corporate finance. Ms. Zordel has served on the board of a crown corporation and currently serves on the boards of several private corporations. She has a B.Comm. from the University of Saskatchewan and an LL.B. and LL.M. from Osgoode Hall Law School.

SPECIAL ADVISORS

Howard Davies

Director of the London School of Economics (LSE)

Mr. Davies, who became Director of the LSE in 2003, is the former chairman of the U.K.'s Financial Services Authority (FSA). In his work as founding chairman of the FSA, Mr. Davies is regarded as one of the key leaders in bringing regulation of the financial sector in the U.K. from nine separate regulatory agencies to a single regulatory regime. His career has also seen him serve as a Deputy Governor of the Bank of England, Special Advisor to the Chancellor of the Exchequer and Director General of the Confederation of British Industry. Mr. Davies holds a MA in history and modern languages from Merton College, Oxford, and an MSc in management sciences from the Stanford Graduate School of Business.

David Green

Advisor on International Affairs, Financial Reporting Council (FRC)

Mr. Green was Head of International Policy Co-ordination and EU affairs in the Office of the Chairman at the Financial Services Authority from 1998 to 2004, after a 30-year career with the Bank of England. He now advises the FRC, the U.K.'s independent regulator responsible for promoting confidence in corporate reporting and governance, and has been closely associated with the development of the European regulatory system. Mr. Green is also Secretary of the International Forum of Independent Audit Regulators. He is a graduate of Corpus Christi College, Cambridge, and holds an MSc in Financial Economics from the University College of North Wales.

Peter W. Hogg, Q.C.

Professor Emeritus, Osgoode Hall Law School, York University

Mr. Hogg is the author of Canada's leading textbook on constitutional law and is currently the Scholar in Residence at Blake, Cassels & Graydon LLP. Educated at the University of New Zealand and Harvard Law School, he taught in New Zealand and Australia. He became a professor at Osgoode Hall Law School in 1970 and later served as Dean of the Law School from 1998 to 2003. Mr. Hogg has advised the Government of Canada, the Government of Ontario, other provincial governments, legislative committees, various public bodies, aboriginal organizations, and private law firms. He has appeared as counsel in a number of constitutional cases, including 13 cases in the Supreme Court of Canada.

SECRETARIAT

David Murchison

Executive Director

Mr. Murchison was Canada's Department of Finance representative in New York City from 2002 to 2007, where he managed relationships with the financial community and provided policy advice largely focused on the financial sector. As a management consultant from 1994 to 2002, he provided advice to the Department of Finance in the area of financial markets and helped manage the Government's retail debt program. Before that, he operated a mid-sized business based in Toronto and immediately prior to that, he served in a number of progressively senior management positions with Imperial Oil Ltd. He has an MA in Economics from Queen's University.

OTHER STAFF OF THE SECRETARIAT

George Bentley, Communications and Consultations Manager
Margit Herrmann, Executive Assistant
Joan Monahan, Special Counsel
Rodger Scott, Research Coordinator

Appendix 2: Members of the Legal Advisory Committee[44]

Dr. Philip Anisman
Barrister and Solicitor, Toronto

Philip Anisman, B.A., LL.B. (Toronto), LL.M., J.S.D. (U.C. Berkeley), is one of Canada's leading securities lawyers and commentators. Before entering law practice, he was a professor of law at Osgoode Hall Law School and the Director of the Corporate Research Branch in the Department of Consumer and Corporate Affairs (Canada). He was the principal author of *Proposals for a Securities Market Law for Canada* (1979), which contained a draft *Canada Securities Market Act* and an explanatory *Commentary*, has advised securities commissions, stock exchanges and self-regulatory organizations in and outside of Canada, has chaired Investment Dealers Association of Canada disciplinary panels and has written extensively on takeovers and mergers, insider trading, protection of minority shareholders, corporate governance, civil liability for securities violations, securities law enforcement, the jurisdiction and accountability of securities commissions, the rulemaking process, bifurcation of the adjudicative and regulatory functions of securities commissions, and corporate, constitutional and administrative law.

Richard J. Balfour
Partner, Torys LLP, Toronto

Richard J. Balfour practises corporate and securities law. He has substantial experience as lead counsel in mergers and acquisitions and corporate finance for both public and private companies. Recent transactions include representing The Thomson Corporation in 2007-08 in its acquisition of Reuters Group PLC, which formed Thomson Reuters under Canada's first dual listed company structure. His securities regulatory experience includes acting in 1994 as lead counsel for the Daniels Task Force on Securities Regulation, which recommended rule-making powers for the Ontario Securities Commission, and the Ministry of Finance of Ontario on the legislation implementing that recommendation, and the OSC in 1986-87 on the opening of the Canadian securities industry. He is a graduate of Princeton, Oxford, and Harvard universities and a former Assistant Professor of Law at Osgoode Hall Law School of York University.

Patrick Finnerty

Partner, Blakes, Cassels, and Graydon LLP, Calgary

Mr. Finnerty's practice focuses on commercial and corporate transactions, with an emphasis on public offerings, private placements, joint ventures, and public company mergers and acquisitions (M&A). A graduate of the University of Toronto Law School and with an MBA from the University of Chicago, he has been a member of the Securities Advisory Committee to the Ontario Securities Commission and the Alberta Securities Commission Oil & Gas Securities Task Force, and is a founding member of the Legal Advisory Committee to the Alberta Securities Commission.

Mitchell H. Gropper, Q.C.

Partner, Farris, Vaughn, Wills, and Murphy LLP, Vancouver

Mr. Gropper is a senior corporate and securities partner with an emphasis on corporate finance, reorganizations, M&A, and commercial real estate. He joined Farris in 1998 after spending the majority of the previous 28 years with the Vancouver office of McCarthy Tétrault LLP. Prior to joining that firm, he spent three years as a professor in the Faculty of Law at the University of Western Ontario in London, Ontario. Mr. Gropper is involved in various professional and community organizations including the Securities Law Advisory Committee of the British Columbia Securities Commission and the Solicitors Committee on Legal Opinions in British Columbia, and the Jewish Federation of Greater Vancouver. Mr. Gropper is a member and former chair of the Vancouver Board of Trade Task Force on the Federal Budget. He has an LL.M. from the London School of Economics and Political Science and a law degree from the University of Saskatchewan.

Francis Legault

Partner, Ogilvy Renault LLP, Montreal

Mr. Legault is a senior member of Ogilvy Renault's Business Law Group and Chair of its Securities practice. He focuses on corporate finance, both private placements and public financings, international financings, mergers and acquisitions, privatizations, and corporate governance. In the area of corporate finance, he has conducted numerous cross-border and international financings for both issuers and underwriters. His extensive experience with mergers and acquisitions involves many large transactions for major North American enterprises. He also has expertise in public income fund vehicles and their privatization. Mr. Legault was a member of the legal advisory committee to the Autorité des marchés financiers (Québec) from 2000 to 2008. He has an LL.B. from Université de Montréal.

Glorianne Stromberg

Securities Lawyer, Toronto

Ms. Stromberg is a securities lawyer and author of three reports on regulatory strategies relating to the provision of financial services and the protection of investors. She is a former Commissioner of the Ontario Securities Commission, serving from 1991 to 1998. Prior to her OSC appointment, she was a partner in the law firm of Cassels, Brock & Blackwell where her practice was primarily in the field of corporate and securities law. She is a frequent speaker and commentator on matters relating to the investment funds industry, the financial services sector, and the protection of investors.

ENDNOTE

[44] The legal advisory committee provided legal advice to the Expert Panel on a number of select issues as to which the committee members were consulted. The legal advisory committee was not otherwise involved in the formulation of the recommendations in the Final Report, or the preparation of the Final Report or the draft Securities Act and accompanying General Commentary.

Appendix 3: Research Commissioned by the Expert Panel on Securities Regulation

***The following research studies can be accessed at* www.expertpanel.ca.**

1. **The ABCP Crisis in Canada: The Implications for the Regulation of Financial Markets**
   By John Chant, Professor Emeritus of Economics, Simon Fraser University

2. **Principles-Based Securities Regulation**
   By Cristie Ford, Assistant Professor of Law, University of British Columbia

3. **Structural Reform of Financial Regulation in Canada**
   By Eric J. Pan, Associate Professor of Law, Benjamin N. Cardozo School of Law, New York, NY

4. **A Model for Common Enforcement in Canada: The Canadian Capital Markets Enforcement Agency and the Canadian Securities Hearing Tribunal**
   By Poonam Puri, Associate Professor of Law, Osgoode Hall Law School

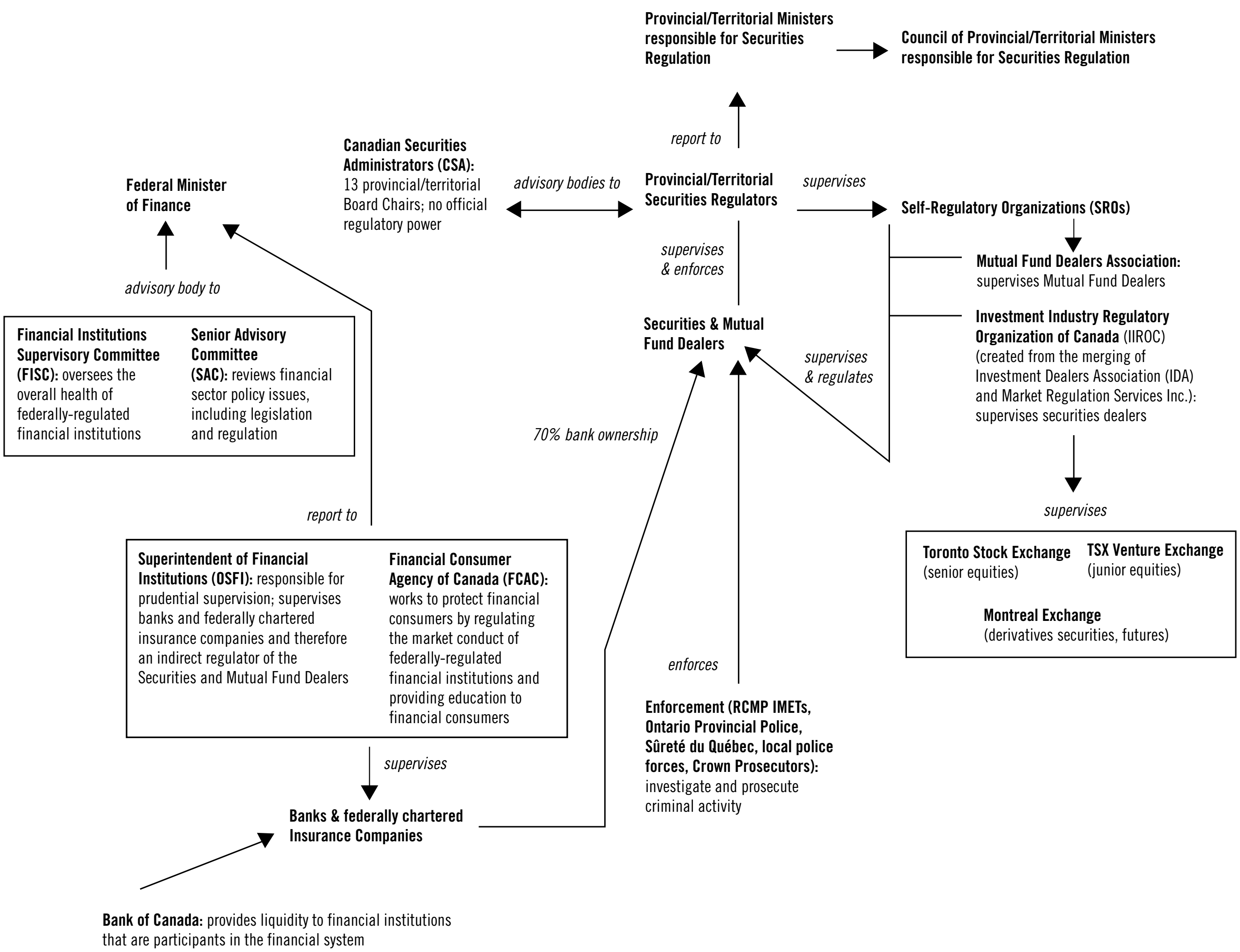
5. **The Québec Experience with an Independent Administrative Tribunal Specialized in Securities: A Study of the *Bureau de décision et de révision en valeurs mobilières***
   By Stéphane Rousseau, Associate Professor of Law, Université de Montréal

6. **Proportionate Securities Regulation: The Potential for Scaled Treatment of Junior Issuers**
   By Janis Sarra, Professor of Law, University of British Columbia

7. **Objectives, Outcomes, and Performance Measures in Securities Regulation**
   By Larry Schwartz, Independent Economic Consultant

Appendix 4: Schematic of Canada's Securities Regulatory System

Canada's Securities Regulatory System



Appendix 5: The Regulation of Derivatives in Canada

A financial derivative can generally be described as an instrument or contract whose value depends on, or is derived from, something else, such as a commodity or a reference rate or index. Derivatives can be broadly classified into two categories: exchange-traded derivatives and over-the-counter (OTC) derivatives.

Exchange-traded derivatives are traded through intermediaries, such as exchanges, based on standardized exchange contracts with the intermediary as the counterparty to the contract.

OTC derivatives are privately negotiated bilateral contracts entered into between the contracting parties directly (typically based on standardized agreements and contractual terms, such as those developed by the International Swaps and Derivatives Association, Inc.). OTC derivatives are largely entered into between sophisticated parties (such as financial institutions or similar entities) for the purposes of hedging financial or portfolio risks or for diversifying portfolios of assets.

Historically, the treatment of exchange-traded derivatives under securities legislation has been inconsistent, in part, because of a difference of views as to whether or not they are "securities" or should be treated as such. Derivatives are regulated in Canada through securities regulatory authorities only in the provinces of Alberta, British Columbia, Manitoba, Ontario, and Quebec. Alberta and British Columbia can be grouped together as they take a similar approach. The approach taken by Ontario and Manitoba is also similar, but differs from that taken in British Columbia and Alberta. Lastly, Quebec has recently passed a new Derivatives Act that has introduced yet a third approach to derivatives regulation in Canada. These approaches are summarized below along with other developments that have been undertaken in the past with respect to the regulation of derivatives.

Alberta and British Columbia regulate derivatives directly through their securities legislation. The legislation regulates exchange-traded derivatives based on the concept of "exchange contracts". Exchange contracts are not included in the definition of "security", but are regulated through securities legislation by the imposition of registration requirements for dealers and advisors and the regulation of those exchanges on which exchange contracts are traded (pursuant to recognition requirements for such exchanges). Unlike exchange-traded derivatives, while OTC derivatives are generally included in the definition of "security", the application of most aspects of securities legislation to OTC derivatives is clawed back through broadly applicable blanket exemptions. This approach is often described critically as one which attempts to blanket the entire field of OTC derivatives and then carves it back through exemptions to leave only those areas that are intended to be regulated (namely, the retail market as such). Shortcomings commonly cited with this approach include the difficulty in determining whether a particular type of derivative is or is not regulated as a security, particularly on account of the evolving nature of the derivatives industry versus the comparatively static approach to how they are attempted to be captured under securities regulation.

In Ontario and Manitoba the approach is quite different. Exchange-traded derivatives are not regulated under securities legislation and are governed by separate commodity futures legislation that applies to commodity futures contracts and options. Commodity futures legislation in these provinces generally governs commodity futures by imposing registration or recognition requirements on exchanges operating in the province and by imposing dealer and advisor registration requirements with respect to trading or advising on commodity futures contracts traded on recognized exchanges. A commodity futures contract that is not traded on a recognized exchange constitutes a "security" for the purposes of securities legislation. With respect to OTC derivatives, the application of securities regulation is not clear. While the definition of "security" is not as broad as it is in Alberta and British Columbia, so as to clearly capture OTC derivatives, there is a lack of consensus as to whether particular types of OTC derivatives, such as those that involve the physical settlement of equities or debt securities, are "securities" for securities law purposes. Despite such uncertainty in the law, however, the better view is that cash-settled OTC derivatives would not likely be characterized as securities, whereas OTC derivative transactions that will or may require the physical delivery of an underlying security could be regulated as an act in furtherance of a trade. With respect to a physically-settled OTC derivative, however, it is unlikely it would be characterized as a security separate from the underlying interest to which it relates. To the extent that an exchange-traded derivative (that is not traded on a recognized exchange) or an OTC derivative do fall within the scope of "securities", they are generally exempt from prospectus and registration requirements as they typically will qualify for available private placement exemptions. Other than the extent to which they may fall under the definition of "securities" in this manner, OTC derivatives are not otherwise directly regulated in Ontario although the Ontario Securities Commission does have rule-making power to regulate them to the extent they involve securities markets.

Quebec has recently passed a new Derivatives Act that applies to both exchange-traded and OTC derivatives. This Act imposes recognition and registration requirements on intermediaries as well as registration requirements on dealers and advisors. Notably, however, OTC derivatives and transactions involving "accredited counterparties" are carved-out from the application of most of the substantive provisions of the legislation. The legislation has been passed but is not yet in force and the specific rules required to implement it (and that will determine the breadth of its scope) have yet to be published.

In addition to the work undertaken in Quebec in developing the Derivatives Act, the regulation of derivatives was studied in Ontario most recently by an advisory committee charged with reviewing the Commodity Futures Act. In its final report, dated January 2007, the Advisory Committee concluded that the Commodity Futures Act was outdated and in immediate need of reform. With respect to exchange-traded derivatives, the Advisory Committee also made a number of other recommendations, including the repeal and replacement of the existing commodity futures legislation with new legislation that would include clearer and more precise definitions of commodity futures contracts and would regulate exchanges, clearing corporations, and self-regulatory organizations through a core principles approach. Specifically, the Advisory Committee recommended imposing a recognition requirement on exchanges and clearing organizations (or allowing for appropriate recognition exemptions) and allowing for self-certification of rules by these entities. Mandatory recognition of self-regulatory organizations was also recommended with self-certification being left open to further study. Notably, as well, the Advisory Committee also recommended that while this regulation should be achieved through separate legislation applying to commodity futures contracts, the next best alternative would be to include such regulation in a self-contained part of the Securities Act (Ontario). With respect to OTC derivatives, the Advisory Committee came to the conclusion that, while there was a role for securities regulatory oversight in the retail OTC market, such regulation should define the regulated activity precisely and not be overbroad. In this respect, further study and consultation was recommended.

The work of the Advisory Committee followed from earlier efforts made by the Ontario Securities Commission to impose regulation on OTC derivatives through proposed Rule 91-504. The proposed rule was returned to the Ontario Securities Commission by the then Provincial Minister of Finance in December 2000 for reconsideration. In particular, the Minister had asked the Ontario Securities Commission to reconsider whether the approach taken was appropriate in that it attempted to regulate OTC derivatives in a broad fashion under the Securities Act and then provide significant carve-outs through exemptions (as is currently the case in Alberta and British Columbia). Given the uncertainty with respect to the extension of the concept of a "security" to OTC derivatives under the Securities Act (Ontario) (as discussed above), under proposed Rule 91-504 the Ontario Securities Commission was endeavouring to include OTC derivatives as "securities" by way of interpretation guidance, and then would have provided broad-based exemptions similar to the approach taken in Alberta and British Columbia.

Under the Uniform Securities Act proposal, the CSA had originally proposed to adopt the approach taken by Alberta and British Columbia and to regulate exchange contracts. However, under the original proposal the uniform legislation was also to include carve-outs in Manitoba and Ontario to allow their separate regulation under commodity futures legislation to continue. The original proposal with respect to OTC derivatives was to include them in the concept of "security", but to allow for broad exemptions from prospectus and registration requirements for trades between qualified parties.[45] The proposal to regulate OTC derivatives was met with significant opposition by a range of industry participants. They discouraged such regulation noting that the approach was similar to that previously rejected by the Ontario Minister of Finance and raised concerns that it would impede derivatives markets.[46] In the end, it appears the compromise reached was to maintain the *status quo* in Ontario by allowing for Ontario specific carve-outs. In this respect, it was proposed that the definition of derivative would not be included in the Uniform Securities Act, but that the Act would instead allow for rule-making authority to enable the Ontario Securities Commission to define the term. As well, it was proposed that derivatives would not be included under the definition of "security" and that in Ontario the definition of "trade" would not include entering into a derivative.[47]

What is clear from a review of past attempts to change the manner in which OTC derivatives are regulated is that it is an area that requires significant further study and industry consultation. Any extension in the application of securities regulation to OTC derivatives would arguably represent a significant substantive departure to how they are currently regulated in most provinces. The concern from an investor protection point-of-view with respect to OTC derivatives lies mainly in the retail OTC market, which is an area that has yet to be clearly defined or identified. If such identification is possible, it is still questionable whether the protection sought to be provided to retail OTC participants is properly achieved by regulating them in the same manner as securities. On this account, while further consideration and discussion is clearly warranted, the approach currently suggested for the draft Securities Act is to preserve the status quo in each province to the extent possible. This can be achieved by including the concept of "exchange contract" and imposing regulation with respect to exchange contracts that would replicate the approach taken in British Columbia and Alberta under securities legislation and in Ontario and Manitoba through commodity futures legislation. The draft Securities Act would arguably result in duplication of commodity futures legislation. The provincial legislatures in Manitoba and Ontario would then have the option of repealing such legislation (which, as discussed above, has already been cited as being outdated and in need of reform). With respect to provinces that do not currently regulate either OTC or exchange-traded derivatives, this approach represents little change in that regulation of exchange contracts would extend primarily to exchanges, clearers, and other intermediaries operating in a particular jurisdiction in the derivatives area. Thus, the regulation would only be relevant to the extent that such operations exist in a particular jurisdiction. Further consideration of the Quebec approach is needed recognizing that Quebec has proceeded in a somewhat different direction.

ENDNOTES

[45] See CSA Uniform Securities Legislation Project Blueprint For Uniform Securities Laws For Canada (the "Concept Proposal") ((2003) 26 OSCB 943 at 960).

[46] See the Summary of Comments Received on CSA Notice 11-304 Responses to Comments Received on the Concept Proposal ((2003) 26 OSCB 5887 at 5929).

[47] See the Uniform Securities Legislation Project, Commentary on Consultation Drafts dated December 16, 2003 ((2004) 27 OSCB (Supp-1) at 15).

Appendix 6: Consumer Complaint and Redress Mechanisms in Canada

I. COMPLAINTS AGAINST CAPITAL MARKETS PARTICIPANTS
II. COMPLAINTS AGAINST FEDERALLY REGULATED FINANCIAL INSTITUTIONS

The purpose of this note is to provide an overview of the complaint mechanisms currently available to investors who have complaints relating to capital markets participants. By way of comparison, following this overview is a summary of the complaint and redress mechanisms available in respect of certain federally regulated financial institutions.

I. COMPLAINTS AGAINST CAPITAL MARKETS PARTICIPANTS

There are a number of mechanisms currently in place for investors who have complaints against capital markets participants. Depending on the purpose of the complaint (i.e., what the complainant is seeking), the complaint process can be classified into two separate streams: complaints for regulatory review and complaints seeking redress through financial compensation.

A) COMPLAINTS FOR REGULATORY REVIEW

If an investor believes that an individual or firm has violated securities laws and is seeking a review of their conduct, the complainant may contact the applicable self-regulatory organization or securities regulatory authority directly.[48] While their powers differ, these bodies are generally vested with the authority to investigate and deal with alleged violations of relevant laws or rules, and have the power to impose reprimands, administrative fines, penalties, or other sanctions, such as suspensions and/or expulsions.

If the complaint is against a dealer or advisor that is a member of either the Investment Industry Regulatory Organization of Canada (IIROC) or the Mutual Fund Dealers Association of Canada (MFDA), the first avenue for redress is to make a complaint in accordance with the internal complaint process of the member itself.[49] If the complainant is not satisfied with the outcome under the member firm's internal complaint-handling process, he or she may also complain directly to IIROC or the MFDA.[50]

Complaints of wrongdoing pertaining to mutual fund dealers are to be directed to the MFDA. The MFDA is responsible for regulating all sales of mutual funds by its members, as well as the business conduct of its members. As such, the MFDA has the authority to investigate complaints against member organizations and take disciplinary action where required. Alternatively, IIROC oversees its member investment dealers and trading activity with respect to debt and equity exchanges in Canada. IIROC sets and enforces its own rules regarding the conduct of investment dealer firms and their employees, as well as market integrity rules pertaining to trading activity in the marketplace. Similar to the MFDA, IIROC also has the ability to investigate complaints and take disciplinary action.

Complaints against individuals or companies who are not members of IIROC or the MFDA may be made directly to the applicable securities regulatory authority. The Ontario Securities Commission, for example, has the power to investigate breaches of Ontario securities law, complaints involving public companies, complaints involving dealers and advisors that are not members of IIROC or the MFDA, as well as conduct against the public interest. These investigations can result in sanctions, including reprimands, fines, and suspensions, as well as restrictions from participation in the securities industry.[51] Other provincial and territorial securities regulatory authorities have also instituted complaints processes similar to the process available in Ontario. These are summarized in Schedule A to this note.

B) COMPLAINTS FOR FINANCIAL COMPENSATION

In general, where an investor is seeking redress by way of financial compensation, their first option is to seek redress under the complaint process of the particular investment dealer, bank or other deposit-taking organization, investment fund company, or mutual fund dealer.[52] Where this yields an unsatisfactory outcome, the investor may bring the complaint to the Ombudsman for Banking Services and Investments (OBSI).[53] As discussed in further detail below, OBSI provides for non-binding arbitration of claims of less than $350,000. If the complaint involves a member firm of IIROC, the investor may also opt for the dispute to be resolved by an independent arbitrator under IIROC's binding arbitration program.[54] In order to be eligible for the IIROC's arbitration program, however, the investor must first have exhausted the individual firm's complaint process and the claim cannot exceed $100,000.[55]

Securities regulation in the provinces of Quebec, Manitoba, New Brunswick, and Saskatchewan also gives the relevant securities regulatory authority the power to conduct a hearing and make an order for financial compensation in favour of a complainant. In the remaining jurisdictions, compensation for financial loss is only available through the courts.[56]

Pursuant to subsection 148.2(1) of the Securities Act (Manitoba), where the Manitoba Securities Commission (MSC) holds a hearing about a person or company, on application of a claimant, the Director may request that the Commission make an order for compensation in favour of the claimant. The Director's decision to make such a request is not reviewable. The Commission may make such an order if, after a hearing, it determines that the person or company contravened or failed to comply with Manitoba securities laws (including decisions, orders, or rulings of the MSC), a written undertaking made by the person or company to the MSC or a term or condition of a person or company's registration. The maximum amount of the financial loss that can be claimed is $100,000. As well, the MSC must be able to determine the amount of the financial loss on the evidence and must find that the person or company's contravention or failure caused the financial loss in whole or in part.[58] A similar provision for compensation for financial losses also exists under the securities legislation for the provinces of New Brunswick (s. 188.1(1)) and Saskatchewan (s. 135.6).

The *Autorité des marchés financiers* (AMF) provides for financial redress for consumer complaints in those situations that fall within the parameters of its protection and compensation programs. Investors who fall victim to fraud, fraudulent tactics, or embezzlement committed by firms or representatives registered with the AMF in the areas of insurance of persons, group insurance of persons, financial planning, damage insurance, claims adjustment, group savings plan brokerage, investment contract brokerage, or scholarship plan brokerage can submit a claim for monetary compensation. The maximum amount of a claim that may be made through this program is limited to $200,000.[59]

II. COMPLAINTS AGAINST FEDERALLY REGULATED FINANCIAL INSTITUTIONS

As part of an initiative to address the informational and power imbalance between institutions and consumers, the Financial Consumer Agency of Canada (the "Agency") was established in 2001 under the federal Financial Consumer Agency of Canada Act (the "Act"). The Agency is an independent federal body and is funded by assessments paid by the financial institutions subject to its regulation (i.e., all banks and all federally incorporated or registered insurance, trust and loan companies, and co-operative retail associations). Pursuant to the authority given to it under the Act, the Agency has established various mechanisms to carry out its mandate of consumer protection through the oversight of federally regulated financial institutions and consumer education. The Agency has the following objectives as set out in subsection 3(2) of the Act:

- Supervise financial institutions to ensure that they comply with the applicable federal consumer protection measures as enumerated in the various federal acts relating to financial services (i.e., the Bank Act, the Insurance Companies Act, the Trust and Loan Companies Act, the Co-operative Credit Associations Act, and the Financial Consumer Agency of Canada Act);
- Promote the adoption of policies and procedures designed to implement consumer provisions by financial institutions;

- Monitor whether or not financial institutions follow their own voluntary codes of conduct and respect the public commitments they have made to protect the interests of consumers;
- Promote awareness of the obligations of financial institutions; and
- Foster an understanding of financial services and issues relating to financial services.

The Government of Canada appoints an individual to serve as Commissioner of the Agency. The Commissioner is responsible for ensuring that the Agency carries out its mandate and achieves its objectives. The Commissioner is required to submit an annual report to Parliament through the federal Minister of Finance detailing the Agency's activities and findings with respect to compliance by financial institutions with applicable consumer provisions. The Commissioner has the power to examine all matters connected with federal consumer protection laws, including matters respecting voluntary codes of conduct and public commitments of financial institutions.

The Agency has no mandate itself to resolve or provide redress on individual consumer complaints, working instead to promote awareness among consumers of the complaint-handling process. All federally regulated financial institutions must, by law, have a complaint-handling process in place for consumers. A consumer's initial point of contact is with the particular financial institution's complaint process. Should the complaint remain unresolved to the consumer's satisfaction, it can be reviewed by one of the three industry ombudservices within the Financial Services OmbudsNetwork: the OBSI, the Canadian Life and Health Insurance OmbudService (CLHIO) or the General Insurance OmbudService (GIO). However, the financial institution in question must be a participating member of the applicable ombudservice in order for the review to occur.[59] These independent dispute resolution services provide their services free of charge and render a non-binding recommendation to the consumer and the financial institution.

The OBSI resolves disputes involving consumers and banking services and investment firms. It is funded by the fees levied on all of the participating firms. A consumer must submit its complaint to the OBSI within six months of receiving the firm's final response to such complaint. After reviewing the final decision of the firm, if OBSI finds that the consumer suffered a loss as a result of the firm's unfair act, error, or bad consumer advice, the OBSI will recommend that the consumer be compensated to restore him to his original financial position. The maximum amount for such compensatory recommendation is $350,000. Although recommendations of the OBSI are non-binding, the names of firms that refuse the OBSI's recommendation will be disclosed to the public.

The CLHIO resolves concerns and complaints in connection with life and health insurance products and services provided by life and health insurance companies who sponsor this dispute resolution service.

The GIO resolves disputes or concerns between consumers and insurance companies in connection with home, automobile, or business insurance. Following the issuance of the insurance company's final position letter, and if the GIO Manager of Complaints determines that there is a basis on which the matter should be further pursued, the consumer may elect to have the matter go to formal mediation or directly referred to a Senior Adjudicative Officer. If mediation is selected, one of the GIO's Consumer Service Officers will help select an independent mediator who will facilitate a two-hour mediation session between the consumer and a representative of the insurer. If mediation is not successful, the mediator will produce a report for both parties. Should the GIO Manager of Complaints believe there is a basis on which the matter may be further pursued, it will be referred to a Senior Adjudicative Officer who will issue a non-binding recommendation ten days after receiving the referral. Although the Senior Adjudicative Officer's recommendation is non-binding, if the insurer refuses to accept the recommendation, the Manager of Complaints will publicize that the insurer declined the recommendation.

SCHEDULE A

Summary of complaint processes instituted by various provincial and territorial regulators

While the New Brunswick Securities Commission directs complaints against MFDA and IIROC members to be made directly to those organizations, it also has an on-line system that allows investors to make complaints involving economic crimes.[60] As stated on its website, with the increasing awareness of investment fraud, the regulators are particularly interested in receiving information regarding misrepresentations, fraudulent manipulation of stock exchange transactions, and insider trading.

The Nova Scotia Securities Commission also approaches consumer complaints in the same way as Ontario and New Brunswick, indicating on its website that complainants should speak to the relevant dealer, registered individual, or self-regulatory organization directly prior to filing a complaint. Furthermore, it is indicated that complaints alleging a breach of securities laws should be forwarded to enforcement staff at the Nova Scotia Securities Commission directly.[61] The Saskatchewan Financial Services Commission indicates on its website that complaints against a broker should be directed first to the broker, then to the firm by which the broker is employed, and subsequently to IIROC, the MFDA, or OBSI. If the matter still remains unresolved after pursuing these other avenues, then the complaint can be brought forward to the Saskatchewan Financial Services Commission. In addition, any complaints that are not against a particular broker can be brought directly to the Saskatchewan Financial Services Commission.[62] This is also the approach to consumer complaints that is taken in Manitoba[63] and the Northwest Territories.[64]

In British Columbia, complaints may be made directly to the British Columbia Securities Commission where (i) the complaint is about advisors and dealers that are not members of the MFDA or IIROC (in which cases the complaint are to be made to those organizations), (ii) the complaint is about someone selling or advising without being registered under securities laws, or (iii) the complaint has not been satisfactorily resolved by another organization.[65]

The Prince Edward Island Securities Office directs consumers to make formal complaints directly to it regarding breaches of securities law, concerns about the manner in which investments have been handled, or concerns about a company in which a consumer has invested. Where the complaint relates to the consumer's investment account, financial advisor, or investment company, the consumer is directed to IIROC or the MFDA with respect to the members of those organizations. Where the complaint surrounds the poor execution of a trade order, potential violation of the Universal Market Integrity Rules, trading violations by a regulated person, or concerns about timely disclosure of material information by a reporting issuer, the complaint should be forwarded to Market Regulation Services Inc. (now IIROC).[66]

The Alberta Securities Commission also takes this approach and indicates that only complaints regarding how investments have been handled, a particular company that the consumer has invested in, or any potential breaches of securities laws should be made directly to the Alberta Securities Commission.[67]

The AMF in Quebec requires consumers to file complaints with the relevant business or representative registered with the AMF. In the event that the consumer is not satisfied with the response provided by the business or representative, the consumer may ask the business or representative to send a copy of the file to the AMF, which will in turn assess the complaint and offer mediation services where appropriate.[68]

ENDNOTES

48 http://www.osc.gov.on.ca/Investor/Complaints/cpt_regulators-help.jsp, see also the brochure published by the Ontario Securities Commission entitled "Getting Help with Your Complaint: A Guide for Investors" available at http://www.osc.gov.on.ca/Investor/Resources/res_making-a-complaint_en.pdf.

49 http://www.iiroc.ca/English/Investors/ResolveComplaint/Pages/default.aspx.

50 http://www.iiroc.ca/English/Investors/ResolveComplaint/Pages/FilingaComplaint.aspx.

51 http://www.osc.gov.on.ca/Investor/Complaints/cpt_misconduct.jsp.

52 The Bank Act, Insurance Companies Act, Trust and Loan Companies Act and Co-operative Credit Associations Act require that the financial institutions governed by those acts establish procedures to dealing with complaints made by persons who have requested or received products or services from the particular institution. The complaint-handling process for a particular financial institution can be accessed by means of the complaint-handling process search tool at: http://www.fcac-acfc.gc.ca/eng /consumers/Complaints/CHPSearch_e.asp. Although the complaint-handling process varies between institutions, it generally consists of three steps: (1) contacting a customer service representative where the product or service was requested or delivered; (2) contacting a managerial or separate department of the institution; and (3) contacting the financial institution's own ombudsman.

53 See page 2 of the Getting Help with Your Complaint: A Guide for Investors brochure available at http://www.osc.gov.on.ca/Investor/Resources/res_making-a-complaint_en.pdf.

54 See the IIROC website at http://www.iiroc.ca/English/Investors/Arbitration/Pages/default.aspx.

55 See the IIROC website at http://www.iiroc.ca/English/Investors/Arbitration/Pages/default.aspx.

56 See, for example, subsections 122.1(1) of the Securities Act (Ontario), 194(6) of the Securities Act (Alberta), 155.1 of the Securities Act (British Columbia) and s.128.1(3) of the Securities Act (Newfoundland).

57 See subsection 148.2(2)-(3) of the Securities Act (Manitoba) and http://www.msc.gov.mb.ca/protecting_the_public/complaint.html.

58 See the AMF website at: http://www.lautorite.qc.ca/clientele/consommateur/demande-indemnisation.en.html and the information leaflet on compensation available at: http://www.lautorite.qc.ca/userfiles/File/consommateur/demande-indemnisation/Feuillet-Indemn-A.pdf.

59 The Insurance Companies Act, Trust and Loan Companies Act, and Co-operative Credit Associations Act require that the financial institutions governed by those acts be members of a complaints body designated by the federal Minister of Finance. No such designation has been made under the Bank Act.

60 See http://216.154.223.112:8080/nbsc/content.jsp?id=32&pid=6#DealerComplaint and www.recold.ca.

61 http://www.gov.ns.ca/nssc/compliancenforce/complaint.htm.

62 http://www.sfsc.gov.sk.ca/Scripts/ssc/howtomakeacomplaint.shtml.

63 http://www.msc.gov.mb.ca/protecting_the_public/msc_complaint.pdf.

[64] http://www.justice.gov.nt.ca/SecuritiesRegistry/SR_complaint.shtml.

[65] http://www.investright.org/complaintadvsr.aspx?id=17.

[66] http://www.gov.pe.ca/securities/index.php3?number=61714&lang=E.

[67] http://www.albertasecurities.com/Enforcement/Pages/FileandInvestorComplaint.aspx.

[68] http://www.lautorite.qc.ca/userfiles/File/bulletin-publications/Depliant_Plainte-A.pdf.

Appendix 7: Transition Issues: Memorandum of Understanding

The Memorandum of Understanding may be expected to include the following subject matters:

1. The manner in which the federal regime should be implemented to allow for the Commission and Tribunal to be fully functional prior to the date of final implementation of the Act and federal rules (the "Effective Date").
2. Identification of who would have oversight and provide funding for the various stages of the transition.
3. Whether and to what extent the existence of participating jurisdiction regulators and legislation would need to be continued.
4. The location of the head office and regional and local offices of the Commission and Tribunal.
5. Whether and to what extent the Commission and Tribunal would utilize existing premises and assets of the participating jurisdiction regulators.
6. The transition and transfer of human resources, including participating jurisdiction commissioners, directors, and other regulatory staff to the Commission and Tribunal and the possible outsourcing of staff and functions between the Commission and Tribunal and participating jurisdiction regulators during the transition period.
7. The transition of regulatory functions in process or those that may otherwise be ongoing such as regulatory reviews, applications, investigations, discussions, orders, enforcement proceedings, and other matters in progress.
8. The ability of the Commission and the Tribunal to continue to act upon, and hear appeals, regarding matters that arose under local securities laws and rules, regulations, and instruments, including provisions to allow the Commission and Tribunal to continue to exercise powers of participating jurisdiction regulators.

Appendix 8: Transition Provisions: Explanatory Note for the Market Participant Opt-In

As a transition matter, until all provinces and territories have opted into the federal regime (and become "participating jurisdictions"), certain categories of market participants could be regulated exclusively under the federal regime, either voluntarily or by virtue of having a substantial connection to a participating jurisdiction. This transition mechanism is referred to as the "opt-in" model, as described in further detail below. As stated previously, certain members of the Expert Panel noted their strong preference for a cooperative approach to moving forward towards the single securities regulator on a willing participation basis and their corresponding concerns about the opt-in model.

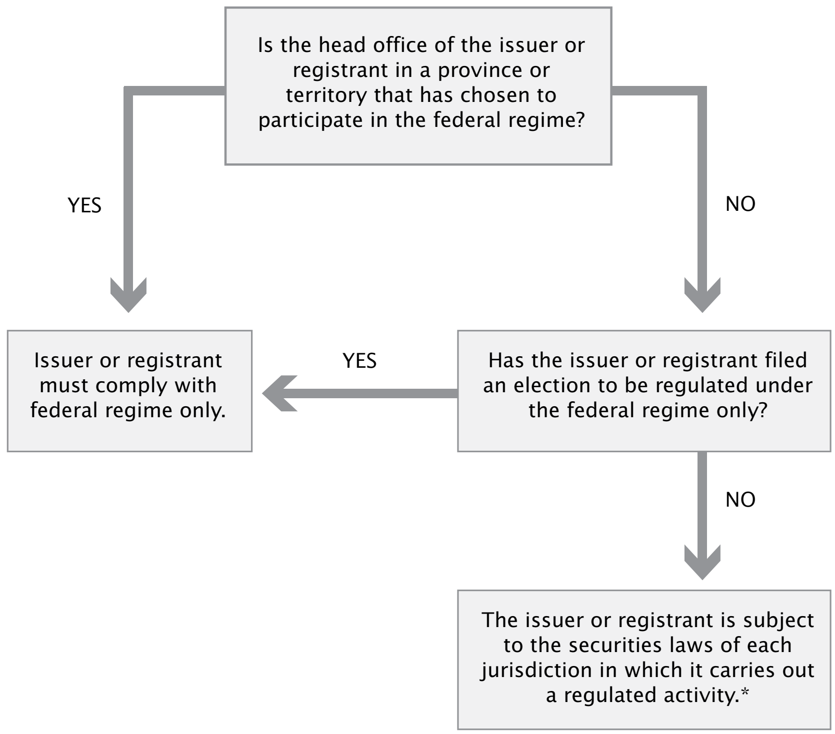
As non-participating jurisdictions (i.e., provinces and territories that do not choose to participate in this federal regime) would continue to exercise jurisdiction over securities regulation in their respective provinces or territories, issuers and registrants that have a "substantial connection" to any of these non-participating jurisdictions would be given the option to elect to be regulated under the federal regime only. Issuers and registrants who make such an election would then, for securities laws purposes, be regulated in Canada by the federal regime only, and would not be regulated by the non-participating jurisdictions. It is proposed that such an election would be made by filing a prescribed form with the federal regulator and with each applicable non-participating provincial or territorial regulator. This affirmative election would provide the regulators and the market with notice that only the federal regime is applicable in respect of such an issuer or registrant. Effectively, this means that for such issuers and registrants, only the federal offences, prospectus, registration and reporting requirements, etc. would be relevant, as applicable.

Issuers and registrants who have a substantial connection to a non-participating jurisdiction and who do not elect to be regulated by the federal regime would continue to be regulated by the securities laws of each non-participating jurisdiction in which they carry out a regulated activity, and also by the federal regime to the extent that an activity is carried out in one or more participating jurisdictions.

In order to afford issuers and registrants that have a substantial connection to a participating jurisdiction equal treatment with their electing counterparts in non-participating jurisdictions, under the opt-in model the federal regime would automatically apply to such participants in all provinces and territories of Canada to the exclusion of all remaining non-participating provincial or territorial regimes. As a result, issuers and registrants with a substantial connection to a participating jurisdiction would automatically be subject only to the federal securities laws.

For example, an issuer that does not have a substantial connection to a participating jurisdiction, but who has elected to be subject to federal securities laws, would be able to undertake a prospectus distribution in all provinces and territories of Canada in compliance with federal securities laws only, including having to obtain a receipt only from the federal regulator. Similarly, an issuer with a substantial connection to a participating jurisdiction would also be able to undertake a prospectus distribution in all provinces and territories of Canada in compliance with federal securities laws only, including having to obtain a receipt only from the federal regulator.

This opt-in (whether by election or automatically by virtue of the market participant's substantial connection to a participating jurisdiction) would apply to both reporting and non-reporting issuers and to all categories of registrants. It is proposed that to determine whether an issuer or a registrant has a substantial connection to a province or territory, the federal regime would rely on a test similar to that currently used under the passport system, which relies primarily on the jurisdiction of a person's head office to establish a substantial connection. Issuers and registrants who do not have a head office in a jurisdiction of Canada would be deemed to have a substantial connection to a participating jurisdiction, and therefore would be regulated under the federal regime only.



* The applicable law will include the laws of each province or territory that has not chosen to participate in the federal regime, to the extent that an activity is carried out there. As well, it also includes the federal law to the extent that an activity is carried out in a participating province or territory.

Appendix 9: List of Recommendations

OBJECTIVES, OUTCOMES, AND PERFORMANCE MEASUREMENT IN SECURITIES REGULATION

1. We recommend a uniform set of core objectives of securities regulation and guiding principles of regulatory conduct for Canada.

2. We recommend that a guiding principle of regulatory conduct should be to facilitate the reduction of systemic risk.

3. We recommend that appropriate interim powers be prescribed in legislation to allow securities regulators to quickly respond to market events that might pose systemic risks to Canada's capital markets.

4. We recommend that the guiding principles of regulatory conduct include the need for regulation to be cost-effective.

5. We recommend that they reflect the need to facilitate innovation and maintain the competitiveness of Canada's capital markets.

6. We recommend the development of a single, uniform performance measurement system for securities regulation in Canada that includes timely reporting to the public on the advancement of statutory objectives, service efficiency, enforcement outcomes, and the costs and benefits of regulation.

7. We recommend that a governance board provide oversight of the performance measurement system, in order to ensure that it is advanced in a transparent and effective manner.

ADVANCING PROPORTIONATE, MORE PRINCIPLES-BASED SECURITIES REGULATION

8. We recommend a more principles-based approach to securities regulation. We are convinced of the merits of this approach and believe that it would improve securities regulation in Canada. The approach, however, must be implemented with care, particularly with due regard to reducing regulatory uncertainty,

rethinking enforcement, addressing the distinct needs of small public companies, and properly engaging investors.

9. We recommend the establishment of an independent panel that would represent the views and interests of small reporting issuers in the formulation of securities regulation.

10. We recommend the further examination of opportunities to better regulate public companies through the use of more proportionate-based securities regulation.

11. We recommend a risk-based approach to securities regulation and, therefore, consideration should be given to expanding the existing use of the risk-based approach in the Canadian context.

INDEPENDENT ADJUDICATIVE TRIBUNAL

12. We recommend the establishment of an independent adjudicative tribunal. However, we believe that the securities regulator should retain jurisdiction over certain decisions, such as discretionary exemptions from securities regulations and rules, as well as matters regarding contested takeover bids. The securities regulator has the policy expertise and the quick response capability to properly address these matters in a more timely fashion, which in our opinion outweigh the benefits of referring these decisions to an independent tribunal.

BETTER SERVING INVESTORS

13. We recommend the establishment of a dedicated service to address the lack of information, guidance, and support for investors in the domain of complaint-handling and redress. We envision that this service would disseminate comprehensive information about complaint-handling and redress in Canada. The service could be provided by a securities regulator or another regulatory entity.

14. We recommend the following to improve investor complaint-handling and redress mechanisms:

    - a securities regulator with the power to order compensation in the case of a violation of securities law so that the investor would not be required to resort to the courts;
    - establishment of an investor compensation fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law; and
    - mandatory participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.

15. We recommend the establishment of an independent investor panel.

16. We recommend that securities regulators establish a dedicated investor issues group.

RECOMMENDED REGULATORY STRUCTURE FOR CANADA

17. We recommend the establishment of the Canadian Securities Commission to administer a single securities act for Canada. Our recommended structure would also include an Investor Panel, a Small Reporting Issuer Panel, a Governance Board, a Federal-Provincial Nominating Committee, a Council of Ministers, and an Independent Adjudicative Tribunal.

18. We recommend the immediate establishment of a Capital Markets Oversight Office reporting to the federal Minister of Finance.

OPPORTUNITIES TO FURTHER STRENGTHEN SECURITIES ENFORCEMENT

19. In addition to the establishment of the Canadian Securities Commission, we recommend there be a full examination of larger structural reforms to strengthen enforcement in Canada, including a complete assessment of the merits of a National Enforcement Branch that consolidates administrative and criminal enforcement functions.

IMPROVING THE REGULATION OF DERIVATIVES IN CANADA

20. We recommend that the regulation of exchange-traded derivatives be prescribed in securities legislation.

21. For OTC derivatives, we recommend that the Canadian Securities Commission have sufficient policy depth and resources to determine the best path for the regulation of OTC derivatives in the future.

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