Creating an Advantage in Global Capital Markets through Industry "Opt-In" to Newly Created Federal Regulator

The ICAC's submission to the Expert Panel on Securities Regulation

July 2008

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The Investment Counsel Association of Canada ("ICAC") represents investment management firms registered to do business in Canada as investment counsel/portfolio managers. Our Members are from across Canada and include both large and small firms managing both institutional and private client portfolios. The ICAC was established in 1952 and its 110 members manage in excess of $700B in assets. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. Member firms are in the business of managing investments for clients in keeping with each client's needs, objectives and risk tolerances.

The ICAC has been on record for many years supporting the principle and direction of a single securities regulator in Canada. Since the late 1960's, there has been a plethora of task forces and reviews on this question by the federal government, the provinces, industry groups and many registrants and issuers. Much has been written on the various reviews of securities regulations in Canada and on the shortcomings of the existing system.

Despite what appears to be a consensus that the current system is not servicing Canada optimally, we do not seem to be any closer to a solution to this legal and political quagmire. As the global marketplace continues to evolve, Canada and Canadians are the losers in this inability to strike an accord.

In light of this, our submission will not repeat the many facts and figures of each of these prior reviews and conclusions but will instead provide a succinct and compelling blueprint for a way forward.

We wish to emphasize that the key issues underpinning our strongly held continuing position on requiring a single regulator remain the primary weaknesses in the current structure, namely market inefficiencies, market protection and enforcement and global competitiveness. Regardless of the final outcome of this panel, these fundamental weaknesses must be addressed.

The Proposed Solution:

Technology and innovation continue to impact and change the global financial marketplace and has created a challenging environment for both regulators and industry. Canada needs a single securities regulator that is able to adapt to this dynamic marketplace, implement fair, balanced and harmonized securities requirements on industry stakeholders and is strong in the area of enforcement.

We remain hopeful that the federal government and the provinces will work collaboratively to create a single Canadian regulator that is able to achieve these goals Many of the prior task forces have proposed detailed governance structures that would accommodate the occupation of what is currently provincial jurisdiction with regional offices, designated appointees on operating committees by the two senior levels of government in Canada, rotating chairmanships, etc.

In the event that the collaborative approach is not successful, ICAC would propose the following model for the federal government consideration.

The Opt-In Model

At its core, we envisage an “opt-in” model established by the federal government using the criteria set out above, reflective of constitutional principles and political issues that would enable a securities issuer or a securities registrant to elect to be registered with and subject to the jurisdiction of a federal regulator.

The “opt-in” models frequently discussed elsewhere contemplate the creation of a national regulatory system into which provincial securities regulators would opt-in. However, under our proposal, the federal government would unilaterally create a separate regulatory regime into which industry participants could choose to “opt-in” and which would then exclude provincial jurisdiction over those participants with respect to the same subject matter.

Notwithstanding that a number of legal opinions going back to at least 1974 suggest that there is constitutional support for the federal government to act unilaterally in the area of securities regulation, we fully recognize that any such federal initiative is likely to face significant political resistance. However, for the reasons discussed in more detail, below, we believe it is time for the federal government to commit to this type of bold, transformational change in Canada’s securities regulatory structure.

Consistency in Regulation

A single federal structure would provide market stakeholders with a single securities legislation framework that would be clear and balanced between core and flexible principles and the appropriate mix of more detailed rules. While much progress has been made in the last number of years by the provinces to try to minimize differences between provincial legislation and/or rules, there seems to be an inevitability to the current system that fosters differentiating. Examples of recent initiatives which, with the best of intentions, were initiated collaboratively by the provincial securities regulators but that have subsequently spawned local/one-off concessions or unique rules in various provinces include National Instrument 45-106 and more recently, the pending rollout of National Instrument 31-103. The merits of uniform and consistent legislation outweigh in our view the perceived value and the practical costs and burden posed on stakeholders from a divergent regulatory landscape.

Regional Sensitivities and Expertise

The new federal structure would ideally be designed with regional branches to optimize local servicing and to avail itself of the regional expertise in various markets. Each province could have a local office that would either be a channelling office to other specialized offices handling a particular subject matter(s) or itself be the location that all national matters are forwarded. For example, matters pertaining to oil and gas (both prospectus reviews and/or policy formulation could tap the skills and experience of staff in the western regional offices with matters pertaining to fisheries doing the same in the eastern offices and financial and/or manufacturing related matters being addressed at first instance by the offices in Ontario and Quebec.

Enhanced Enforcement

From an enforcement perspective, we would envisage local enforcement offices that would report into a nationally coordinated enforcement body that would be consistent in its themes and penalties and adequately staffed and trained in securities regulatory matters. This would hopefully also lead to shorter lag times between investigations and formal enforcement proceedings or negotiated settlements.

It would also be opportune for the federal government to strengthen some intrinsic regulating tools to assist the new regulator in enforcing the rules and creating the appropriate deterrent impact on market participants.

To facilitate stronger and more efficient administrative review and enforcement, the enforcement staff of the new regulator should have the power to compel witnesses to testify before it. The absence of this power in some of the jurisdictions in Canada is a material structural deficiency that inhibits optimal enforcement.

The federal Department of Finance should work with its colleagues in the Justice Department to beef up sections of the Criminal Code pertaining to securities violations, particularly those dealing with disclosure, misrepresentation and fraud. From a structural level, it would be appropriate for the federal government to also consider establishing a federal court/tribunal, separate and apart from the regulatory agency (addressing the long held views of conflict of interest with the current system in place in various of the provincial securities commission where the adjudicative functions is not independent of the investigatory function. The establishment and staffing of a specialized court or tribunal would assist in the development of judicial expertise on securities matters, a widely perceived deficiency of the current regulatory regime in Canada.

The presence of a federal regulator might permit great information sharing at an earlier stage, with the RCMP's Integrated Market Enforcement Team and/or other local police forces on matters pertaining to securities law.

If this adjudicative body proved itself effective and efficient, it would ideally permit the remaining provincial regimes to refer cases to it under certain preset conditions.

Reducing Regulatory Costs and Cultivating Economic Growth

The new federal securities agency, with its single set of rules and filings and one-stop approach to new and existing issuers and registrants alike, would in ICAC's opinion positively assist in the cultivation of new business and stimulate Canada's economy for the betterment of all. Some of the reduced costs and burdens on market participants would be passed onto investors. Canadians, regardless of what province or territory they reside in, would be able to access new share issues rather than the case today where this might not always be possible if a prospectus was not cleared through their particular province/territory. Just as every Canadian should be entitled to certain standards in health care and public safety, they should have an equal and national access to the securities markets regardless of where they currently live.

Another advantage of the reduced administrative costs and burdens is that in the current economic environment when issuers are struggling with internals costs, the arguments in favour of any decision making process by individual issuers to list or to continue to be listed in or doing business in Canada should be strengthened.

Strengthening Canada's Influence and Interests Abroad

The new federal securities agency could also act as a strong voice for Canada internationally on associations such as the International Organization of Securities Commissions (IOSCO). As a single market, and as noted by the Canadian Bankers Association in its submission to the Expert Panel, if the Canadian market was represented by one voice at the securities regulatory, in terms of size it would rank right after the US, UK , France and China. In the current fractured state, and joining Boznia-Herzegovina as the only other member of IOSCO that is not regulated by a federal regulator (with the latter being subject to one previously when it was part of the former Yugoslovia). Ontario is the same size as Italy, Alberta the same size of the Netherlands, Quebec comparable to Denmark and British Columbia comparable to Ireland.

Responding with Alacrity to the Future Evolution of the Global Markets

Change is a constant in all facets of life and market practices and/or regulatory developments are no exception to this universal reality. As a small marketplace, representing just three (3) percent of the current global marketplace, it is imperative that we maintain our flexibility to adapt with change and to initiate regulation on new developments with greater speed than we have to date. The practical reality is that one regulator is able to respond and adapt to change more quickly than 13 securities regulators. There are many examples where Canadian regulation and/or enforcement has arrived well after similar activity occurred in the U.S., the UK and continental Europe and other markets such as Australia. It would seem to reason that a federal regulator, required to proceed through a single set of processes would inherently be more efficient than a group of thirteen (13) regulators going through thirteen (13) different processes.

Addressing Risks and Issues Associated with a Federal Securities Regulator

The above list of attributes clearly demonstrates the inherent advantages that would accompany a federal regulatory regime. As with all matters involving transformative change, and cognizant of the need to be objective and impartial in any assessment of alternative regulatory models, there are some potential risks and/or detrimental impacts associated with a federal regulator. It is ICAC's position that many of these risks or issues could be resolved or at least mitigated by considerations on how the new entity could be structured, staff and/or governed.

(a) Regionalism

The regional uniqueness that exists in Canada, both at the local knowledge and expertise on various industries and on the need to ensure regular and meaningful contact and interaction with local issuers, registrants and the public can be addressed, as noted above, by regional offices and with regional input on policies, enforcement and or general regulatory initiatives. With due respect to the views of some stakeholders on what may currently be real or perceived differences in philosophy re: the way some of the provincial regulators govern or in their local laws or regulations such as the facilitation of capital raising for smaller pools of capital in some provinces, it is ICAC's view that we should use this as an opportunity to bring best practices across the country in a uniform manner. The benefits associated with some of the local unique features would, in some areas strengthened if it was rolled out nationally.

(b) Bureaucratic Gridlock

The potential for bureaucratic gridlock always exists and is arguably increased the larger an entity becomes. Careful foresight and planning into the structure, staffing and governance of a new federal regulator can alleviate and in some cases fully resolve any potential issues. ICAC would strongly encourage processes ensuring transparency in decisions, potential public accountability in staffing, regional reviews and enhanced mandatory consultative processes be put in place. The latter could relate not only to new or proposed amendments to rules or legislation, but also to feedback on the governance and progress or failures of the proposed federal entity. It is also worthwhile to state that there is an equally strong argument that could be made that the proposed federal regulator could in fact, be better able to respond in a nimbly and forcefully fashion than the current regime requiring thirteen (13) regulators to each pass local processes.

(c) *Constitutional Wrangling*

If the federal government were to act unilaterally to impose a federal securities regulator, it would be naïve not to think that this would trigger constitutional issues related to the division of powers and the authority of the federal government to occupy this space and/or trigger ramifications on federal and provincial relations. There also exists the question of multiplicity in regulation if a constitutional assessment was done supporting the federal government's right to enter this sphere of law if a province(s) also claimed ongoing jurisdiction. ICAC is not privy to the full scope of prior constitutional assessments that the federal government and other stakeholders have initiated on many prior occasions going back at least to the 1970's and more recently with the Wise Person's Committee. It is our hope, that if a federal regulator were pursued, and if there was not deemed to be an abrogation of provincial jurisdiction if the federal government was regulating this area upon a marketplace registrant/issuer opting, that the two senior levels of government in Canada could work together in a positive and constructive matter not to bring disrepute to the Canadian marketplace.

(d)Transitional Risk

It is important to note that transitional risks associated with any major transformational change to securities regulation could be minimized with the "opt-in" approach. If a Federal regime is established and running, issuers, registrants and provinces could simply opt in to the new regulator relatively seamlessly. The risk of further dragging out any transformational change to securities regulation by requiring most or all provinces to be on board with a new approach would be avoided.

<u>Concluding Thoughts</u>

ICAC would again like to restate its strong endorsement of a single securities regulator for the Canadian market. We would also like to make it very clear that it is our preference that the process by which we would ideally arrive at a single regulator be as a direct result of fruitful negotiations between Ottawa and the provinces/territories rather than our second preferential route to the desired goal, being the federal government unilateral imposition of an Opt-in Structure.

What is clear for all key stakeholders in Canada, (the two senior levels of government in Canada, the various regulator commissions, the industry associations, the issuer community, the registrants on the buy and sell side of the street, the service providers to the industry, many in the academic community and/or the press, the investors and increasingly, to the public at large watching the competitiveness of Canada slip) is that real and meaningful change is required. We have arguably reached a point where our ability to act decisively to replicate what other nations such as Australia have done will be scrutinized by other nations, regulatory bodies and issuers alike. The omission of Canada in the recent bilateral developments with the SEC and other international regulators would tend to foreshadow our companies losing out on similar developments in the future. In short, we must work with added vigour not to let another opportunity slip by without the necessary metamorphic restructuring in our securities regulation.

As noted above, and without repeating our arguments above, we think that the importance and far reaching consequences associated with the current regulatory quagmire justify proactive and unilateral action on behalf of our national government. The "opt-in model" we have proposed above, if a more harmonious accord cannot be reached by negotiation, was designed to mitigate some of the risks and issues (including constitutional and political issues) associated with such an proactive action.

We can take solace that Canada is not breaking new ground here. Virtually all other developed nations on earth have reached an accord on what we are still trying to achieve in the 21st century, (e.g. Australia recently and to a lesser degree the reallocation of primary regulation between the SEC and the state regulators of investment advisers under the National Securities Market Improvement Act of 1996 (NSMIA) in the United States). In short, we need only to replicate the many historical triumphs that other nations have achieved while tailoring in the uniqueness that is part of the Canadian reality. Closer to home, we can draw upon the comparative rights of companies to elect or choose to be governed by federal (CBCA) or provincial incorporation statutes, or the on-going occupation of provincial and federal regulation of trust companies and/or insurance companies as proof that both levels of governments can co-exist in a regulatory sphere.

Yours sincerely,

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