Canada Steps Up
Canada Steps Up
Canada Steps Up

Chapter 11

Recommendations Put Forward by Researchers Commissioned by the Task Force

11.1 The Task Force benefited greatly during the course of its deliberations from the views put forward by researchers it commissioned. Readers are directed to the full text of each researcher's study presented in Volumes II through VI of this Report. For ease of reference we have included below a list of recommendations made by each researcher (to the extent that the researcher put forward recommendations) organized according to the key areas of enquiry upon which the Task Force built its work. Each researcher recommendation is presented verbatim based on how it appeared in the researcher's study.

11.2 It should be stressed that the Task Force does not necessarily ascribe to the views or recommendations put forward by the researchers below – the recommendations of the Task Force are specifically limited to those appearing in Chapters 3 through 7.

Characteristics of Canada's Capital Markets

Randall Morck & Bernard Yeung, *"Some Obstacles to Good Corporate Governance in Canada and How to Overcome Them"* in Volume IV.

- Securities law should create for officers and directors a fiduciary duty to public shareholders.
- Securities law should define oppression as a controlling shareholder failing to put public shareholders' interests ahead of his own.
- Securities law should protect officers, directors, and controlling shareholders from lawsuits for good faith business judgments.
- Securities law should require institutional investors be managed so their stocks lie within the public float.
- Securities law should create a fiduciary duty of institutional investor to managers to beneficiaries.
- Securities law should require all institutional investors to disclose their voting policies and records.
- Securities law should let public shareholders nominate and elect a fraction of directors proportional to the public float.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- Securities law should permit a voting cap to be enacted or removed in any listed company only if approved by a majority of the public float.
- Dual class share structures should require periodic renewal by a majority of inferior voting shareholders.
- Any shareholder who acquires 30% or more of a listed company should have to acquire 100%.

Anita Anand, *"Towards Effective Balance Between Investors and Issuers in Securities Regulation"* in Volume III.

- Securities regulation in Canada should take into account the distinctive aspects of Canada's capital markets such as the preponderance of small to mid cap issuers, ownership structures typical in Canadian capital markets, the preponderance of institutional and controlling shareholders and the types of securities issued.
- Consideration should be given to whether an access-equals-delivery model should be more broadly implemented in Canada. With the existence of SEDAR and SEDI, it stands to reason that the "next step" in the evolution of our disclosure based system is to adopt a more extensive access-equals-delivery model.
- In light of the different ways in which "efficiency" can be defined, it is necessary for securities regulators to identify the concept(s) of efficiency that are driving a particular legislative initiative and the ways in which the particular type of efficiency is being achieved under the proposed initiative. Doing so will aid in understanding whether the proposed regulation achieves an appropriate balance between efficiency and investor protection concerns.
- As a general practice prior to implementing regulation, securities regulators should commission or undertake empirical studies in order to assess the costs, benefits and risks of the initiative and to determine whether it will accomplish the intended results.
- Where it is not possible to conduct statistical analyses regarding a particular legislative initiative, securities regulators should disclose precisely why it was not feasible to do so.
- Regulation for which there is little or no empirical support should be sunsetted for a limited period of time, after which regulators will conduct a revised and formal cost-benefit analysis or regulatory impact assessment. If appropriate, such an examination should include the use of statistical analyses to determine whether the regulation has had a positive impact on affected parties and whether the costs of such regulation are justified.
- If cost-benefit analyses are to remain a central part of analyzing regulatory initiatives, the bases on which these analyses are occurring must be formalized and made more explicit as is the practice at the Financial Services Authority. Specifically, publicly available guidance which provides formalized criteria on which regulators assess costs and benefits in any given case is necessary.
- Because of its focus on risk assessment in addition to costs and benefits, regulatory impact assessments should be adopted as a means of evaluating regulatory initiatives.

- Prior to or concurrently with liberalizing rules relating to public offerings, securities regulators should implement a more formalized and national system of continuous disclosure review and make this system of review known to the public. Without certainty in this area, the deterrent mechanism that may serve to prevent inadequate disclosure cannot function effectively. This increased monitoring may include devolving responsibility for monitoring issuers' disclosure to self-regulatory organizations (particularly RS Inc.) or stock exchanges.
- Restricted periods should not apply to seasoned issuers that have complied with their continuous disclosure obligations and have filed AIFs and quarterly MD&A over a certain period of time (such as two years). If adopted, this change in the law should be sunsetted in order to determine whether investor protection concerns, particularly the amount of disclosure available to first purchasers of securities regarding the restricted securities, arise.
- Securities regulators should undertake an empirical review of the extent to which investors, both retail and institutional, review issuers' disclosure and the bases on which these investors make decisions. This review should include conducting a statistical survey of both retail and institutional investors and may also consist of determining the number of beneficial holders that have requested to receive disclosure documents.
- Exemptions from the prospectus requirements should, where possible, be based on a sophistication of the investor rationale as opposed to the assumption that certain individuals with a relationship to the issuer will be protected because of that relationship. Exemptions should strive to be harmonized, easy to understand and easy to access. In the interests of harmonization, exemptions that are acceptable in two-thirds of the provinces should be adopted as a matter of course in the remaining provinces.
- Blanket orders should be reinstated as a means for issuers to gain permission to complete transactions that are not specifically contemplated in the regulation. Such orders should include permissions to raise capital in the exempt market.
- It is necessary to discern the extent to which Canada's corporate governance regime, which contains extensive disclosure and compliance obligations, is indeed important and beneficial for investors/shareholders. To this end, further studies should be commissioned or undertaken by securities regulators with regards to whether there is a relationship between firm performance and particular governance mechanisms in place in Canada. Justification of corporate governance laws should be based on regulatory impact assessments or formal cost-benefit analyses that outline benefits and risks of the regulation as well as potential alternatives.
- Regulators should be cognizant of market-based incentives that encourage compliance with best practice regimes or voluntary standards and utilize market-based incentives when feasible in the implementation of corporate governance regulation.
- There are persuasive reasons to maintain a mandatory disclosure element in an otherwise voluntary corporate governance regime.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- This report endorses the principle of plain language. Further study is warranted on the appropriate division of responsibilities in ensuring that disclosure documents are readable as it is not clear that issuers alone should bear this responsibility. Prior to this study being undertaken, a general policy statement rather than a rule should be issued setting forth principles for plain language in all disclosure documents.
- In drafting legislation, such as rules, policy statements, and comments to market participants, regulators should adopt the practice of writing in plain language.
- Securities regulators should examine the issue of boilerplate in corporate governance disclosure and indeed, in disclosure documents more generally, to determine if boilerplate language is a concern from an investor protection standpoint.
- In light of recent case law, securities regulators should consider whether the duty of the target board in a takeover bid is to maximize shareholder value and if so, how existing case law is to be reconciled with this duty.
- Regulatory consideration should be accorded to the 15% limitation in the private agreement exemption, whether this is the appropriate amount or whether it should be higher or lower. Greater transparency regarding the rationales underlying the exemption is warranted, especially with regards to the extent to which a principle of equality is enshrined therein.
- The mandate of securities regulators should include a commitment to maintaining the competitiveness of Canadian capital markets with global markets.

Christopher Nicholls, *"The Characteristics of Canada's Capital Markets and the Illustrative Case of Canada's Legislative and Regulatory Response to Sarbanes-Oxley"* in Volume IV.

- Scaled or proportional securities regulation should be considered both appropriate and necessary in the Canadian securities regulatory context.
- Canadian regulators should consider the extent to which Canadian laws could reflect a more flexible and less rules-based approach to corporate governance than in the U.S., at least with respect to smaller Canadian issuers.
- Canadian regulatory resources could usefully be directed towards enforcement of Canada's existing market manipulation and insider trading laws.
- The regulatory emphasis on scrutinizing related party and going private transactions reflected in OSC Rule 61-501 is sensible in principle. However, it is not entirely clear that the rules-based approach of Rule 61-501 offers the optimal means of regulating such transactions. Rule 61-501 should be carefully reviewed with a view to ensuring optimal protection of minority shareholders within a framework that minimizes administrative hurdles and costs especially for small issuers.
- Consideration should be given to shifting regulatory emphasis away from the public offering process, and further toward issuer based regulation.

The Attributes of a Competitive Market

Adam Pritchard *"Well-Known Seasoned Issuers in Canada"* in Volume V.

- Canada should adopt a well-known seasoned issuer standard that balances the need for information for investors with the economies available from stream-lined regulation. A standard of $350 million in market capitalization strikes a reasonable balance between these two concerns. The standard should be periodically revisited to ensure that it remains consistent with the realities of the contemporary capital market.

Stéphane Rousseau, *"The Competitiveness of Canadian Stock Exchanges: What can we learn from the experience of the Alternative Investment Market?"* in Volume V.

- Canadian stock exchanges and regulators should abstain from transplanting the Nomad system, and related features, of the AIM model in Canada.
- Consideration should be given by Canadian stock exchanges to enhancing their attractiveness through improvements to the admission process.
- Consideration should be given by Canadian stock exchanges to exploring solutions to make their continuous disclosure requirements more responsive to the needs of capital markets participants, including further harmonizing them with securities regulation.
- To address the concerns related to the costs of corporate governance requirements, Canadian regulators should consider reviewing the cost-effectiveness of the existing corporate governance regime, with a special view at smaller issuers' interests.
- To improve the liquidity of securities issued under private placements, securities regulators should consider eliminating hold periods for securities of reporting issuers.

Mark Gillen, *"The Role of Securities Regulation in Promoting a Competitive Capital Market"* in Volume IV.

- Avoid changes to Canadian securities regulation that would make it deviate significantly from approaches taken in other major capital markets.
- The integration of disclosure in short form and shelf prospectuses should be extended to all issuers.
- Prospectus and continuous disclosure requirements should be reviewed with an eye to reducing specific requirements, simplifying presentation, improving comparability of disclosure and improving accessibility of information that has been disclosed.
- Facilitate the search of "other documents" on SEDAR by identifying the documents more clearly.
- Identify the types of media that will be considered acceptable for the purposes of providing "general disclosure" of information.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- Set a period of time after disclosure through the media after which insiders can trade without being subject to insider trading sanctions or civil liability.
- Add a provision making it clear that where an insider has knowledge of undisclosed information that indicates the securities are worth more than the prevailing market price and directs, or causes, the issuer to issue securities to the insider, such a transaction is not exempt on the basis that the insider reasonably believed the issuer had knowledge of the inside information.
- Follow through with the recommendations of the Task Force Report on Insider Trading with respect to the adoption of best practices for issuers and their directors and senior officers, and for lawyers, accountants, banks and dealers.
- Follow through with the recommendations of the Task Force on Insider Trading with respect to the detection of insider trading.
- Continue to rely on administrative sanctions as the primary enforcement technique for the prohibition of insider trading and informing.
- Consider enacting a provision that clarifies that a phantom stock option regime is neither a violation of the insider trading prohibition nor contrary to the public interest if it complies with specified restrictions.
- Examine the possibility of replacing the current combined "person connection" and "information connection" approach to insider trading with just an "information connection" approach as suggested by the Task Force on Insider Trading.
- Repeal existing takeover bid regulations and replace them with a specific requirement that poison pill plans be subject to shareholder approval. Retain the principle in National Policy 62-202 that takeover defences should not deny shareholders of the ability to make fully informed decisions.
- In the alternative, instead of repealing the existing takeover bid laws, retain them but allow issuers to opt out of the rules freeing issuers to adopt rules with less than the minimum requirements provided for under the existing takeover bid rules.
- If the alternatives above are not adopted then consider increasing the threshold for takeover bids to something more than 20% to increase returns to first-bidders and thereby improve the agency cost controlling effects of takeover bids.
- Consider increased reliance on third party enforcement techniques.
- Review of the legislation with a view to removing provisions that are perhaps no longer necessary, to make the provisions more clearly fit with the move toward rule-based modifications of the regulatory scheme and, where possible, to simplify the language of the provisions.
- Efforts to address the incremental costs that our multi-jurisdictional regulatory structure may impose should continue. In the short term this may involve continued efforts at harmonization. In the longer terms perhaps some form of the "passport" approach or joint regulatory body approach can be taken.

Douglas Cumming *"Do Companies Go Public Too Early in Canada?"* in Volume IV.

- Consistent with reforms in 2005 in Ontario, tax subsidies provided to Labour Sponsored Venture Capital Corporations ("LSVCCs") in other Canadian jurisdictions should be discontinued. LSVCCs have poorly designed governance mechanisms that lead to inefficient VC investment. LSVCCs also compete with private venture capital ("VC") funds and lower returns to VC investment in Canada, thereby discouraging private VC investment in Canada. Other forms of public support for VC markets that have been more successful (e.g., such as those in the United States) could be considered in Canada.
- Only after a sufficient period of time (i.e., a number of years) in which there are improvements to VC (pre-IPO) markets, reconsideration should be given as to whether listing standards are too low. Listing standards should not be changed currently (as at 2006), since junior stock exchanges act as an imperfect substitute for the comparatively lower quality of Canada's VC markets.

The Role of Gatekeepers in Securities Regulation

Stephanie Ben-Ishai, *"The Effectiveness of Corporate Gatekeeper Liability in Canada"* in Volume VI.

- Consideration should be given to conferring on the CPAB the status of a SRO that is subject to oversight by each of the provincial securities regulators.
- To address concerns with increasing liability for auditors and corresponding increase in the cost to issuers for auditing, consideration should be given to the UK proposal for "liability limitation agreements" with auditors.
- Credit rating agencies activities should fall under the jurisdiction of the provincial securities commissions and credit rating agencies should be required to register with the provincial securities commissions.
- The disclosure obligations formulated by the IOSCO should be a condition of registration with the provincial securities commissions.
- Mechanisms should be put into place to improve competition among credit rating agencies.
- IDA Policy No. 11 – "Research Restrictions and Disclosure Requirements" should be amended to require: (1) a statement by the analyst that the research truly reflects the analyst's opinion, and (2) a prohibition on an analyst being subject to supervision or control by the investment banking department where applicable.
- Joint task forces should be struck in each of the provinces with members from the securities commission and the law society to consider the law society's rules of professional conduct that address lawyers' corporate gatekeeping function.
- The current regime for gatekeeper liability for directors should be reviewed following a period of at least one year of experience with the new Ontario secondary market civil liability regime.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- Following consultation with industry and non-industry groups, the IDA should develop a policy similar to IDA Policy No. 11 imposing restrictions and disclosure requirements for investment advisers with liability attached.
- The academic literature and approaches to reform in the U.S. and the UK suggest that no reforms to the gatekeeper liability that underwriters are subject to in Canada are warranted at this time.

Stephen Choi, *"Thoughts on the Regulation of Investment Analysts in Canada"* in Volume VI.

- Presumption toward less intrusive regulatory options when possible.
- Increase the scope of mandatory disclosure from covered firms as a means of reducing the "information gap" to which analysts now supply needed information to the markets.
- Require analysts to disclose simple, standardized, and relative comparison (against other analysts) information relating to "cues" on analyst accuracy.
- Regulations aimed at prohibiting conflicts of interest should be accompanied with alternative means to subsidize sell-side analyst research.

Regulatory Innovation

Harry Panjer *"Insurance Against Misinformation in the Securities Market: Actuarial Aspects"* in Volume II.

- Determine the appetite for such an insurance against misinformation program by (i) governments, (ii) investors, (iii) dealers, and (iv) issuers. Without some support for a program, at least in principle, any further work may be futile.
- Determine the form an insurance against misinformation program should take. Recommends pursuing the fund model with or without government support. There is likely little appetite for insurers and reinsurers to assume this risk without significant rewards due to the high degree of uncertainty surrounding the risk.
- Determine an appropriate size for the fund and level of aggregate inflow needed. This requires some serious study of past misinformation events.
- Determine who the payor should be. There are good arguments for several options. A flat percentage per-trade fee is likely the best place to start. It can be refined using a risk-rating process at a later stage if desired.
- Determine an appropriate financing mechanism that is able to absorb large swings in losses from the fund. This may be as simple as retroactive assessment of all issuers or as complex as a financially engineered instrument that allows investors to assume misinformation risk.

Tom Baker *"Insurance Against Misinformation in the Securities Market"* in Volume II.

- Evaluate the design options and determine the most favourable form for a Securities Misinformation Insurance program.
- Gauge the appeal of such a program to stakeholders.
- If the program is sufficiently appealing, retain an actuarial firm with experience pricing D&O insurance to specify the pricing and funding needed to support the program, as outlined in the companion report of Professor Harry Panjer.

How Investors Make Investment Decisions

Richard Deaves, *"How are Investment Decisions Made"* in Volume II.

- Regulators need to recognize and explicitly take into account the limitations of many retail investors.
- Greater attention in the future should be paid by regulators to the form (rather than the content) of disclosure.
- Regulators should move to mandate increased disclosure of fees and rates of return.
- Careful attention needs to be paid by regulators to the practices and credentials of registered representatives, especially those selling mutual funds.
- Regulators should encourage the movement towards greater reliance on electronic disclosure.
- Enforcement of securities regulation needs to be strengthened.

Educating Investors

Caroline Cakebread, *"Investor Education in Canada: Toward a Better Framework"* in Volume III.

Consider Investor Education in the Financial Capability Continuum

- Include investor education as one stage of a larger spectrum of financial skills and resources needed by the general population.
- Unite the current providers of investor education in Canada as well as other key organizations, including SROs, government agencies, and industry associations to clarify/decide the role of investor education and its place within a larger context of financial education and financial capability.
- Collectively lobby at a national level for a financial capability mandate.

Canada Steps Up
Canada Steps Up
Canada Steps Up

Provide National Leadership

- Build national leadership and identify champions to drive an investor education framework forward.
- Create a single organization responsible for coordinating efforts of all the current players and for fostering and funding new programs with a national focus in areas not currently being served. This organization would contain broad membership of all organizations currently providing investor education in Canada and others with a stake in increasing the investment decision-making capacity of investors and non-investors in Canada (industry, SROs etc.).

Use Research as Foundation

- An effective framework for investor education in Canada would create and act in response to a broad agenda of research into the financial (and subsequently) investment capabilities of Canadians. Currently, much investor education is provided reactively, in response to calls and complaints.
- Research will help to establish goals and objectives for providers of investor education.
- Notably, the CSA, lead by the British Columbia Securities Commission has begun some research in this area.

Provide Sustainable Funding

- A framework for investor education in Canada must ensure sustainable funding for organizations that provide investor education on a national level. Funding could also support provincial activities as well as focused initiatives that can be used nationally.

Encourage Collaboration and Public-Private Partnerships

- Greater collaboration among providers of investor education would reduce current duplication and leverage limited resources as well as ensure that all stakeholder interests are represented.

Commit to Measurement

- Nationally agreed upon objectives and outcomes are required in order to know and agree upon what organizations are trying to achieve in the area of investor education.

Marketing and Distribution

- The old adage "if you build it they will come" appears to dominate across many investor education initiatives in Canada. A framework for the effective delivery of investor education in Canada will focus on creating awareness among Canadians of the education resources available – and it will focus on the best ways of getting them to targeted sections of the population.

Effective Disclosure

Dimity Kingsford Smith, *"Importing the E-World into Canadian Securities Regulation"* in Volume V.

- Disclosure should be made on a graduated basis, formatted according to "user needs" so that investors can choose the level of volume and technicality they desire.
- It should be compulsory to give all investors some short and salient facts about an investment – price, risk levels, fees and charges and basic terms of the investment.
- If greater reliance is to be placed on electronic transmission of securities information in Canada, SEDAR must be improved to make it more reliable and user-friendly. It must operate in a manner that ensures it provides easy access to information rather than creating barriers or obstacles.
- Reconsideration should be given to the requirement of express consent to electronic delivery, so long as access to and integrity of the delivered document is assured.
- A foundational disclosure document of three pages in standard format should be disseminated to all investors by intermediaries in the selling process. The intermediaries will not be taken to have fulfilled their suitability obligations if they do not bring this document to the attention of investors. The third page of the document should be an application form which the investor must sign or submit using a PIN.
- A document containing issuer and investment specific information of 10 pages in standard format should be made available by the intermediary to the investor. A self directed investor would be alerted to it by the URL or hyperlink in the foundational document, which must be used to apply for the securities.
- The foundational disclosure document and the document containing issuer and investment specific information should bear URLs or hyperlinks to locations such as SEDAR where the issuer's continuous disclosure record is located.

Janis Sarra, *"Modernizing Disclosure in Canadian Securities Law: An Assessment of Recent Developments in Canada and Selected Jurisdictions"* in Volume II (Professor Sarra's recommendations are presented partially as policy alternatives).

- Maintain the status quo – allow the recent changes and harmonization efforts under National Instrument 51-102 Continuous Disclosure, National Instrument 44-101 *Short Form Prospectus Distributions* and Multilateral Instrument 52-111 *Reporting on Internal Control over Financial Reporting*, for example, to take hold prior to making any further changes to disclosure regulations.
- Develop an effective electronic disclosure regime – develop a framework that would make disclosures more accessible and meaningful for investors through web-based delivery and on a "one-click full access" basis.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- Develop an integrated market disclosure document and electronic disclosure system. This will also entail consideration of the role of the underwriter as a gatekeeper in respect of an integrated market disclosure document – there could be the requirement that the underwriter provide an assurance certificate that the integrated market disclosure document contains all of the information needed by reasonable investor to make an informed investment decision.
- Ensure that disclosure documents meet the requirements of full, true and plain disclosure.

Enforcement

U. Bhattacharya, *"Enforcement and its Impact on Cost of Equity and Liquidity of the Market"* in Volume VI.

- Measured against a U.S. benchmark, enforcement of securities laws is weak in Canada. As there is overwhelming global evidence that enforcement of securities laws reduces cost of equity and improves liquidity – the effect is stronger in emerging markets, but the effect still exists in developed countries like Canada – Canada can strengthen its capital markets by increasing enforcement of its existing securities laws.
- As there is global evidence that enforcement of securities laws that improve disclosure is the most effective in improving capital markets, Canada should pay particular emphasis in the enforcement of securities laws that make firms more transparent in their dealings with the Canadian capital markets.

M. Condon & P. Puri, *"The Role of Compliance in Securities Regulatory Enforcement"* in Volume VI.

- Securities Commissions and SROs should make greater efforts to educate investors about market risks and who should bear the risk of loss when investment losses are incurred in the marketplace. Greater education should also be provided on the importance of a diversified portfolio.
- Financial advisers and their firms should be required to disclose the risk associated with any particular investment at the time that the transaction is entered into, in a manner that is easily understood, and the effect of the transaction on the client's overall portfolio in terms of risk and diversification.
- At the time of account opening, firms and financial advisers should be required to disclose the following information in a brief (1or 2 page) document: (a) a list of compensation options for the services that will be provided (whether or not available at that firm); and (b) the particular compensation options available at the particular firm and by that adviser.
- At the time of a particular transaction, the financial adviser should be required to disclose, in a transaction summary document, the total dollar value of compensation the investor has paid or is obligated to pay, directly or indirectly, to the adviser and his/her firm. Also to be disclosed would be any compensation and benefits that will be received by the financial adviser and the firm from third parties. Financial advisers should also be required to disclose the dollar value of the compensation that would have been paid by the client had he/she selected another compensation option for the relationship at the time of account opening, or another compensation method for the particular transaction.

- At year end, financial advisers should be required to disclose the total fees paid by the client over the year as well as fees that would have been paid under other options.
- Firms should be encouraged to impose higher standards of proficiency on their employees than those currently required by regulators, as a part of their business model to distinguish themselves from their competitors.
- Regulators should also consider imposing heightened proficiency requirements and professionalism standards than are currently required, to imbue a greater sense of professionalism in the industry.
- Regulators should mandate disclosure of the adviser's educational background and qualifications at the time of account opening, including any qualifications that are above and beyond minimum regulatory requirements.
- Regulators should require advisers to disclose to new and existing clients any proven complaints of unsuitability and other abusive sales practices.
- Regulators should require advisers to disclose proven claims of unsuitable investments and other abusive sales practices to new and existing clients.
- The compliance approach should not be used for persistent and egregious offenders who continuously engage in abusive sales practices. Instead such offenders should be removed from the industry.
- Regulators should be encouraged to obtain retail investor input on how the risk based methodology for sales compliance audits is defined and what factors are considered relevant in determining which firms become the subject of such audits.
- Firms should be encouraged to use a risk based approach internally within their organizations to ensure that salespeople and branch offices are meeting the baselines expected of them and also to identify and deal with particular sales people and/or branch offices that are particularly troublesome in terms of the issue of abusive sales practices.
- The IDA should be provided with statutory authority to compel third party witnesses to appear before it in regulatory proceedings, so as to enhance the effectiveness of its enforcement proceedings.
- Regulators should mandate that all reporting issuers develop and file an explicit code of conduct dealing with prohibitions on insider trading and insider reporting policies.
- The content of an insider trading policy should not be mandated by regulators, though it most likely should include the introduction of routine "blackout periods". It should also provide some indication of how the issuer proposes to monitor ongoing adherence to its internal policy.
- Issuers and registrants should better educate their officers and employees about the parameters of insider trading such as when information is sufficiently "material" to trigger the insider trading prohibitions. Firms should also engage seriously in an ethics building process with respect to insider trading.

Canada Steps Up
Canada Steps Up
Canada Steps Up

- Firms should give serious consideration to developing ongoing monitoring capabilities in the area of insider trading, especially with respect to the granting or exercise of stock options. This could include the appointment of a senior officer with responsibility for approving the exercise of stock options.
- Additional regulatory resources should be devoted to the enhancement of technological tools for detecting or preventing insider trading activities.
- Insider trading should be disclosed publicly in real time, as a further deterrent to illegal insider trading and to enhance the market information available to retail investors.
- Regulators should adopt a risk-based approach to monitoring and surveilling RIs for compliance with enhanced insider trading requirements.
- A uniform definition of material fact should be adopted across the country in the interests of ensuring compliance with the prospectus requirements. The distinction between material fact and material change should be eliminated.
- Regulators should engage in full or targeted review of only those prospectuses for which they are the issuer's principal regulator under MRRS, so as to expend their resources efficiently and avoid duplicative review.
- In light of the liberalization of the short form prospectus eligibility requirements, securities regulators should engage in more frequent and more in depth vetting of short form prospectuses (and continuous disclosure records) of those issuers who are not as closely followed by market participants such as research analysts.
- Continuous disclosure regulatory efforts should be refocused on reviewing internal control systems, as opposed to primarily reviewing the content of specific continuous disclosure documents.
- Regulators should enhance RI capabilities with respect to continuous disclosure by developing a series of best practice templates for successful disclosure control and reporting systems, targeted to areas of persistent continuous disclosure deficiency.
- Enforcement sanctioning by regulators should routinely involve orders that RIs review their internal disclosure procedures and controls, with the additional requirement that the results of this review and the action to be taken be reported to the regulator.
- Regulators should consider additional publicity concerning the existence and content of the Reporting Issuers in Default and Refilings and Errors lists that they maintain.
- Reporting issuers should be encouraged to participate in a number of disclosure-related innovations, such as (i) disclosure sub-committees of the board, (ii) the appointment of a disclosure compliance officer at senior management level (iii) enhanced disclosure in MD&A documents about the existence and nature of internal disclosure control systems.

- Additional research should be sponsored to provide detailed calculation of the costs of compliance with external regulatory and internal self-regulatory initiatives, as well as its qualitative and quantifiable benefits.

The Regulatory Response to "New" Investment Products

André Fok Kam, *"A Canadian Framework for Hedge Fund Regulation"* in Volume III.

- To keep track of systemic risk, Canadian regulators should continue exchanging information with their foreign counterparts both on a bilateral basis and on multilateral fora such as the Financial Stability Forum.
- The regulatory authorities should show continued vigilance in ensuring that banks are continuously assessing their hedge fund exposure.
- If the current borrowing framework for Crown Corporations is maintained, guidelines should be established as to the types of structured note that are appropriate for Crown Corporations.
- Derivatives such as principal protected notes should be regulated according to the nature of the underlying investment and not the wrapper.
- Retail investors should not have access to stand-alone hedge funds.
- Retail investors should be allowed to invest directly in funds of hedge funds, including multi-adviser funds.
- The opening of the retail markets to funds of hedge funds should be accompanied by initiatives to educate the investor on the subject of alternative investing.
- The regulatory framework for retail funds of hedge funds should be integrated within the existing mutual fund framework. A possible way to implement this recommendation would be to update and modernize the existing National Instrument 81-104 *Commodity Pools*.
- Purchases of retail hedge funds should not be subject to a minimum purchase amount.
- Performance fees for retail funds of hedge funds should be subject to mandatory high-water marks, and be computed on the basis of the performance of the fund of funds as a whole and not that of each underlying fund.
- Existing mutual fund regulations should not be changed to allow managers of retail funds of hedge funds to pay a portion of their performance fees to intermediaries in the form of trailer fees.
- The regulations should specify a maximum lock-up period, a minimum frequency for redemptions and a maximum notice period.
- Retail funds of hedge funds should be required to make full disclosure of all fees and compensation of the manager and the intermediary, and all conflicts of interest.

- Investment fund managers should be encouraged to experiment with outcome-based disclosure.
- Fund managers should be required to register.
- Fund managers should be required to have minimum capital amounting to expenses of a certain number of months together with a fixed amount to serve as a cushion.
- New fund managers should be required to submit a business plan as a condition of registration.
- Consideration should be given to requiring managers of retail funds of hedge funds to have a minimum level of hedge fund assets under management prior to launching retail funds.
- Errors and omissions coverage should be mandatory for fund managers.
- The employees of the adviser of a retail fund of a hedge fund should have a certain number of years' experience in applying hedge fund strategies, including specific experience with funds of hedge funds.
- The implementation of the suitability requirement should be improved through greater emphasis on knowledge of the product on the part of intermediaries.
- Consideration should be given to setting up a centre of hedge fund expertise.
- Regulatory review of fund managers should include the use of fraud predictors.