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Research Study

Heard on the Street: Interviews with Market Actors on the Future of Canadian Securities Regulation

Jeffrey MacIntosh

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Task Force to Modernize Securities Legislation in Canada

Maintaining a Competitive Capital Market in Canada

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1. Executive Summary

The mandate for this paper from the Task Force was to interview senior lawyers, investment bankers, and other decision makers in order to determine the view on the street as to what changes need to be made to Canadian securities regulation to facilitate capital flows both within Canada and between Canada and other countries. I have interpreted this mandate quite broadly to include any regulatory requirement or structure that adversely affects the cost of capital for issuers, and/or the return on investment realized by investors. However, in accord with the Task Force's own mandate, the issue of whether Canada needs to move to a national regulatory structure is not considered.

Twenty interviews involving twenty-one market participants were conducted between January and May of 2006. These included eleven lawyers practicing corporate/securities law, eight investment bankers, and two others. While for convenience the majority of interviewees were located in Toronto, seven were located elsewhere, including Vancouver, Calgary, and Montreal. Most of the Toronto interviewees were interviewed in person, while all of the others were interviewed via telephone.

Interviewees were asked to comment on what changes need to be made to the Canadian regulatory structure to meet the goals noted above. Each was asked to comment specifically on seven different subject areas: primary market disclosure; secondary market disclosure; registration of market actors; insider trading; takeover bids; the conduct of the regulators; and the conduct of self-regulatory organizations.

While no one could expect that all market participants would be unanimous in respect of all of the topics, there was a surprising degree of convergence on many. In particular, few interviewees felt that significant changes were required in respect of either the insider trading or takeover bid rules. In respect of primary market disclosure, the great majority of interviewees thought that Canadian regulators should take further strides in the direction of a fully integrated disclosure system. In such a system, issuers making initial public offerings would make the kind and extent of disclosure required under current rules. Thereafter, however, issuers would need only to keep their continuous disclosure current in order to freely access primary markets at any time with minimal or no additional mandated disclosure. It was suggested by many that a system of this nature would not materially sacrifice investor protection, while greatly enhancing an issuer's ability to capture a market window of opportunity and to tap into the primary market at minimal cost. Many interviewees commented favourably on recent changes to the disclosure regime that open up the prompt offering prospectus (POP) system to all issuers, and it was noted that these changes bring Canadian regulation close to a fully integrated disclosure system. Since investor protection is keenly tied to the effectiveness of the continuous disclosure regime, however, some had reservations about whether such a fully integrated system should be extended to small issuers. These reservations are reflected in the recommendations immediately below.

Many interviewees suggested that recent enhancements to continuous disclosure requirements have been a positive development. This was not, however, a universal view. Some suggested that the burden of continuous disclosure had become excessive for smaller firms. Despite this, virtually everyone agreed that the increasing resources that regulators have devoted in recent years to policing the quality of continuous disclosure documents and statements was a positive development.

While liability for misstatements in the secondary market was largely viewed as a positive development, many suggested that Ontario's new legislation is unduly complex and contains drafting ambiguities that needed to be addressed. Some also expressed concern that the new legislation might foster American-style "strike suits" designed to extort settlements from corporate issuers. It was suggested that both regulators and legislators be attentive to this likelihood.

Opinion was divided about the burden of registration for market actors. Some smaller dealers felt that the regulatory requirements were not only burdensome, but did not add materially to investor protection. It was also suggested that the administration of the rules had become highly bureaucratic, with rules enforced inflexibly and without regard to their purpose. It was suggested that the regulatory burden had become a barrier to entry for smaller dealers. By contrast, the larger dealers tended toward the view that the regulatory burden was appropriate and served to weed out the bad apples.

The conduct of securities regulators drew both praise and criticism. Even those who were largely praiseworthy, however, noted that their experience with securities regulators depended on the staff personnel with whom they were dealing. Some staff made efforts to understand transactions from a business point of view, while others did not. Securities regulators need to make greater efforts to ensure that all staff members understand transactions not merely from a regulatory, but from a business perspective. Without understanding the business purpose of a transaction and its impact on investors, it is difficult to apply the rules and to wield discretionary powers in a thoughtful and facilitative manner. The regulators also need to make greater efforts to ensure that regulatory requirements are evenly applied by all staff members.

The greatest criticisms of the securities regulators were aimed at the activities of enforcement staff. It was almost universally felt that insufficient resources have been devoted to enforcement efforts in Canada. Equally important, however, were the criticisms levelled at *how* the regulators have deployed their available resources. Many felt that the regulators have often made bad decisions about which cases to pursue with vigour. Many commented adversely, for example, on high profile cases of alleged wrongdoing in respect of which the regulators (and prosecutors) have been largely inactive. Canadian regulators were compared unfavourably to their American counterparts in this respect.

It was also felt, however, that in some cases enforcement staff pursued those accused of wrongdoing with excessive zeal and coerced market actors into unfair settlements. This coercion stems in part from the ability of regulators to blacken a market actor's reputation merely by making public charges of wrongdoing. It was also said to stem from the threat of draconian enforcement action, which occurs in the shadow of limited oversight either internally or externally, a perceived bias on the part of Commissioners in staff's favour (should the matter go to a hearing), and a very low probability of overturning a Commission decision in the courts, given the standard of judicial review enunciated by the Supreme Court of Canada.

The conduct of self-regulatory organizations attracted relatively little criticism, although (as noted above) some of the smaller dealers felt that self-regulatory organizations were as prone as the securities regulators to creating excessive regulatory hurdles and paper burden in connection with registration issues. The dealers generally felt that the separation of the IDA into separate advocacy and regulatory branches made good sense.

2. Summary of Recommendations

Recommendation #1: Adopt a True Integrated Disclosure System for All Seasoned Issuers

For senior issuers, securities regulators should move toward a fully integrated disclosure system, in which an issuer can come to market by filing a term sheet, without any regulatory approval requirement.

For junior issuers, the movement to a fully integrated system should be postponed until it can be determined that the extension of the POP system to such issuers has not resulted in regulatory abuses.

If abuses do occur, regulators should consider reinstating the market cap (or other appropriate) test for access to the POP system. If not, the POP system should be extended to junior issuers.

Recommendation #2: Revisit the prohibition against testing the waters prior to an issuance of securities by a seasoned issuer.

Regulators should allow the distribution of green sheets to investors, conditional on posting the green sheet on SEDAR so that it is available to all investors.

Recommendation #3: Revisit the two-day "cooling-off" period for purchasers

The two-day "cooling-off" period for purchasers of securities in primary market offerings causes practical problems for investment bankers and their advisors, is of questionable utility to investors, and should be revisited by securities regulators.

Recommendation #4: Preserve the timeliness of Canadian prospectus review when compared to the U.S.

Prospectus review typically occurs on a more timely basis in Canada than the U.S. This is a distinct advantage for the Canadian capital markets and should be preserved.

Recommendation #5: Retain the current disclosure obligations for initial public offerings (IPOs).

The current disclosure obligations for initial public offerings are appropriate and should be retained.

Recommendation #6: **Repeal the rule against testing the waters for IPOs.**

With the exception of the bought deal, investment bankers and their advisors are prohibited from assessing demand for securities prior to the filing of a preliminary prospectus. The rationale for this rule does not apply to IPOs and the rule should therefore not apply to IPOs.

Recommendation #7: **Further harmonize and simplify the private-placement rules.**

Regulators should take further steps toward harmonizing and simplifying private placement rules in the different provinces and territories.

Recommendation #8: **Canadian regulators should feel no compulsion to imitate U.S. rules.**

Canadian capital markets are sufficiently different from U.S. capital markets that Canadian regulators should strive to ensure that regulatory requirements are not merely borrowed from the U.S., but are appropriate for Canadian markets.

Recommendation #9: **Canadian regulators should rely, where possible, on general standards and broad principles of conduct, rather than exquisitely detailed rules.**

Recommendation #10: **Canadian regulators should comprehensively revisit, on a regular basis, the motivation and cost-benefit calculus of specific rules, as well as the basic assumptions and cost-benefit calculus that underlie various families of rules.**

Recommendation #11: **Canadian regulators, in consultation with regulated communities, should seek out regulatory innovations (such as the bought deal and the income trust) that pose no danger to investors while giving Canadian capital markets a competitive edge over international competitors.**

Recommendation #12: **Regulators must make greater efforts for consistency of document and transaction review.**

Securities regulators should make efforts to ensure that the quality of document and transaction review does not vary materially with the identity of the reviewer.

<u>Recommendation #13:</u> Regulators should ensure, as far as possible, that regulatory staff are schooled not merely in the law, but in the business aspects of the transactions that they are reviewing.

<u>Recommendation #14:</u> Regulators should engage senior personnel from various private communities, perhaps drawing upon the ranks of retired professionals and senior managers, to advise in respect of particular transactions and in the identification of regulatory priorities.

<u>Recommendation #15:</u> Regulators should actively engage in secondment of persons from various private communities.

<u>Recommendation #16:</u> The new regime of rules creating liability for secondary market misrepresentations should be simplified, weeded of drafting problems, and regularly reviewed to ensure that it does not encourage nuisance suits.

Regulators should attempt to simplify the rules creating a civil liability for misrepresentations in continuous disclosure documents and statements.

Working in consultation with private actors, regulators should seek to identify and correct on a timely basis drafting problems with the new legislation.

Regulators (and legislators) should keep an eye on whether the new civil liability creates an excessive risk of nuisance suits for issuers, and reform the legislation accordingly if there is evidence that this is the case.

<u>Recommendation #17:</u> Regulators (including both the OSC and the IDA) should re-examine the cost-effectiveness of their rules with a view to determining whether reductions in regulatory burden can be made without significant prejudice to investors.

<u>Recommendation #18:</u> Regulators should determine if ongoing compliance burden is excessive for smaller firms and/or constitutes a barrier to entry for new entrants.

<u>Recommendation #19:</u> **Regulatory and prosecutorial resources devoted to enforcement need to be enhanced.**

<u>Recommendation #20:</u> **Consideration should be given to increasing the quality of regulatory personnel by further enhancing pay scales.**

<u>Recommendation #21:</u> **Consideration should be given to outsourcing prosecutions, on an *ad hoc* basis, to members of private law firms.**

<u>Recommendation #22:</u> **Commissioners and commission staff need to be both functionally and physically separated, in order to ensure that Commissioners are not biased in favour of commission staff when sitting in a hearing capacity.**

<u>Recommendation #23:</u> **Consideration should be given to creating more internal accountability for enforcement personnel.**

<u>Recommendation #24:</u> **Consideration should be given to legislating a less onerous standard for appealing Commission decisions, in order to create more effective judicial oversight of enforcement activity.**

<u>Recommendation #25:</u> **The conduct of regulatory staff should be subject to oversight by an external ombudsman created especially for the purpose.**

<u>Recommendation #26:</u> **The provinces should lobby the federal government to appoint more judges with strong business backgrounds, both in order to address the timidity of some judges in reviewing regulatory conduct, and to enhance the quality of judicial decision-making in the business arena.**

3. Introduction

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The interviewees suggestions with respect to each of these subject areas are recorded in the sections that follow.

[1] I have refrained from giving details about these two individuals only because even a general description could assist in identifying the individuals involved. In order to ensure candidness, privacy was paramount.

4. Heard on the Street: Interviews with Market Actors on the Future of Canadian Securities Regulation

i. Primary Market Disclosure: Public Offerings by Seasoned Issuers

The area in which there was the greatest convergence of opinion was in respect of primary market offerings by seasoned (i.e. already public) issuers. Most of those who expressed an opinion on this issue indicated that the movement toward an integrated disclosure system has been a positive development. A plurality also indicated that further moves in this direction would be welcome.

a) Prospectus Disclosure: Historical Overview

Historically, public offerings in the primary market have required the assembly of a prospectus – a comprehensive disclosure document that has required the issuer to assemble essentially any information that might be material to potential investors. A typical prospectus is rarely shorter than 40 pages in length, and can easily run to 150 pages. The aggregate costs of assembling a prospectus can be considerable. These include fees paid to lawyers, accountants, printers, and (if the offering is marketed in Quebec) – translators, in addition to that portion of the underwriter's fee that covers the underwriter's cost of due diligence on the prospectus. The aggregate cost of assembling a prospectus is approximately $400,000 - $1,500,000.

Perhaps more importantly, assembly of a prospectus is time consuming. Given that the public offering markets are highly variable in their receptivity to new offerings, the very considerable time spent assembling the prospectus and securing regulatory approval to commence the offering may cause the issuer to miss a market window of opportunity. Because of the complexity of the disclosure requirements, teams of lawyers engaged by the issuer and the underwriter (in addition to the underwriter's investment banking personnel) will spend many hours ensuring that all required items of disclosure (in addition to any other material information not expressly required) are included in the document. Moreover, to ensure disclosure of all material information, it is necessary that the issuer's board of directors and senior officers be intimately involved in the process. This distracts the board and senior management from management of the business – a distraction that is especially serious for smaller issuers for whom the opportunity cost of management time is particularly great.

b) Movement Toward an Integrated Disclosure System

To address this problem, the "POP", or prompt offering prospectus was introduced in the 1980s to allow relatively senior issuers to assemble a relatively rudimentary prospectus and to incorporate by reference the issuer's secondary market disclosure, including the annual information form (AIF), management discussion and analysis of results (MD&A), material change reports, and proxy circulars. In order to qualify for the POP system, however, issuers were required (*inter alia*) to have a public float of $75,000,000. This made it comparatively expensive for smaller, non-qualifying issuers to bring an offering to market.

The limitation of the POP system to larger issuers was based on a lack of confidence in the continuous disclosure system for smaller issuers. In particular, it was felt that:

- continuous disclosure made by many smaller firms was of poor quality (frequently not complying with legislated standards);
- the continuous disclosure requirements were not sufficiently elaborate to produce the necessarily information with respect to smaller issuers;[2]
- even with more elaborate continuous disclosure requirements, continuous disclosure in not necessarily reflected in the publicly posted prices of smaller issuers.

Following the introduction of the POP system, other innovations were introduced to cut down the time to market. One of these was the SHELF prospectus system, pursuant to which POP-eligible issuers could prepare a base prospectus, and commence an offering at any time within 25 months by supplement the base prospectus with updated information (shelf prospectus supplements).

The PREP procedures, similar to the SHELF procedures, also allowed the assembly of a base prospectus with supplementation at the time of the offering. While PREP was open to all issuers (and not merely those that were POP eligible), the base prospectus was good for only 90 days.

In addition, for some years underwriters have been permitted to engage in "bought deal" offerings. In a bought deal, the underwriter will approach the issuer with a view to making an offering of the issuer's

[2] Continuous disclosure was no more elaborate in respect of larger issuers. However, larger issuers are much more likely to be followed by both buy and sell-side analysts, as well as the press, supplementing required disclosure with considerable market-generated disclosure.

securities. If the issuer is amenable, a contract will immediately be entered into[3] that requires the issuer to file a preliminary prospectus within two days. Contrary to the usual rule forbidding solicitation of expressions of interest from potential buyers prior to the filing of a preliminary prospectus, the underwriter may solicit expressions of interest in that two-day period. Bought deals, however, have only been available for POP-eligible issuers.

Under the POP, SHELF, and PREP systems, issuers can get to market with an offering much faster than in a traditional fully marketed offering. For SHELF and PREP, the regulatory review process takes place at the time of the filing of the base prospectus. There is no further review process at the time of filing the supplementary information. Thus, an issuer can get to market within 24 hours.

The POP, SHELF, and PREP procedures were all steps in the direction of an integrated disclosure system. Recently, a further major step has been taken in the direction of an integrated system with the opening up of the POP system to all seasoned issuers, regardless of market float. We have thus moved a considerable distance toward an integrated disclosure system.

c) Reasons for More Fully Embracing an Integrated Disclosure System

The view of a plurality of interviewees was that while we are already very far down the road toward an integrated disclosure system, more can and should be done to create a fully integrated disclosure system. This was based on the following:

- market windows of opportunity are tighter than ever, and can disappear within a few days. It is thus more important than ever that issuers be able to enter the market without delay'
- continuous disclosure requirements have become more fully elaborated in the past few years (particularly in respect of oil and gas companies);
- securities regulators have given the market a great deal more guidance than has historically been the case as to how continuous disclosure requirements will be interpreted and enforced;
- statutory liability now attaches to misrepresentations in continuous disclosure documents and statements;
- in the past few years, securities regulators have devoted more resources to continuous disclosure compliance; and

[3] In a conventional fully-marketed offering, the agreement between the underwriter and the issuer will not be signed until immediately before the issuance of the final receipt allowing the issuer to go public.

- in the past few years, both large and small issuers have made dramatic improvements in the quality of their continuous disclosure statements and filings.

The majority view was that we should be moving toward a system in which:

- continuous disclosure requirements should either absorb or dispense with all of the current prospectus disclosure requirements;
- all that would be required to make a public issuance is the supplementation of continuous disclosure with a term sheet; and
- there is no advance clearance requirement for prospectuses.

It was suggested that the last recommendation would free up resources that could be better deployed in the review of secondary market disclosure.

This view that we should move more in the direction of an integrated disclosure system was not, however, shared by all, for a number of reasons.

One view was that the changes to the securities regulator rules should be incremental in character. Because of the complexity of the system, rule changes can give rise to unintended adverse consequences. The more significant the change, the more likely it is that such adverse consequences will arise. For this reason, rule changes should be incremental.

In general, this has been the experience of our regulatory system. Indeed, innovations like the POP and SHELF prospectus systems were battle-tested in the U.S. before being adopted in Canada. The recent extension of the POP system to all issuers was supported both by experience with the POP system and gradual innovations in the continuous disclosure apparatus. However, before making even bolder changes, we should test our experience with this particular innovation. It may be that a eventually the prospectus can be reduced to a one-page term sheet, but our experience with the extension of POP (and with the reliability of the continuous disclosure system) need to be further elaborated before this occurs.

One interviewee (an investment banker) suggested that, while the Canadian primary market disclosure system works quite efficiently, there is a danger that further reductions in regulatory burden would give rise to a *perception* of laxness that would be bad for our markets.

The same interviewee suggested that very often an equity issuance is done in connection with an acquisition transaction or some other major event in the company's life. Where this is the case, there must be adequate disclosure to the market about the connected transaction (often including pro forma financial statements). The danger is that a term sheet prospectus overlooks this important disclosure. This criticism will fail, however, if the continuous disclosure system ensures that adequate disclosure of any connected transaction takes place – whether through a material change report, business acquisition report, or other means.

One caveat to this section is that virtually all of the interviewees deal with larger capitalization firms; few dealt with smaller issuers. As one interviewee noted, smaller companies are not often followed by analysts. This is likely to prejudice the quality of their continuous disclosure, and raises doubts about whether the extension of the POP system to these small firms is in fact a good idea. This interviewee suggested that a market-cap test, and/or a requirement that the firm be followed by two or three analysts may in fact be a useful limitation on usage of the POP system.

The recommendation to come out of this section is the following:

<u>Recommendation #1:</u> Adopt a True Integrated Disclosure System for All Seasoned Issuers

For senior issuers, securities regulators should move toward a fully integrated disclosure system, in which an issuer can come to market by filing a term sheet, without any regulatory approval requirement.

For junior issuers, the movement to a fully integrated system should be postponed until it can be determined that the extension of the POP system to such issuers has not resulted in regulatory abuses.

If abuses do occur, regulators should consider reinstating the market-cap (or other appropriate) test for access to the POP system. If not, the POP system should be extended to junior issuers.

d) Underwriter Due Diligence in an Integrated Disclosure System

An issue that was raised by a number of interviewees (particularly the investment bankers) was whether an underwriter can do adequate due diligence in an integrated disclosure system. This has in fact long been an issue for many investment bankers in connection with the POP and SHELF systems (especially in connection with bought deals). The investment banker does not typically participate in the issuer's continuous disclosure. Nonetheless, the underwriter is liable under securities regulation for any misrepresentation in the prospectus, and for POP issuers, this will include all of the continuous disclosure that is incorporated by reference into the prospectus.

Interviewees were divided, however, about how serious a problem this is. Some suggested that it was unfair to the investment bankers to ask them to take on the risk of liability in respect of disclosure that they had nothing to do with. This was particularly so, suggested one lawyer, given the recent enforced separation between the research side of the investment dealer and the underwriting side. Others suggested that, at the time of issuance, the underwriter can very quickly review the issuer's continuous disclosure (even in the context of a bought deal) and that there is no real problem in this respect. Others suggested that it was simply up to the underwriter to adjust its market practice to deal with the risk, whether this involved being involved in continuous disclosure on an ongoing basis, reviewing disclosure at the time of the offering, passing the risk on to the client in the form of deal pricing, or simply absorbing the risk.

Because the majority view was that the market should be left to deal with the problem, and that no regulatory steps need be taken, no recommendation arises out of this section.

e) Testing the Waters

At present, the term "trade" in the securities legislation is defined to include any act or conduct in furtherance of a trade.[4] The securities legislation forbids any trading in securities prior to the filing of a preliminary prospectus. This means that, prior to filing the preliminary prospectus, neither the issuer nor the underwriter may canvass the market (i.e. "test the waters") to assess the demand for an issuer's securities.

A number of interviewees expressed the view that these rules should be changed. The majority view was that this is often done in securities offerings – particularly bought deals. In a bought deal, the underwriter enters into a binding obligation to purchase (and then re-sell) a large block of securities, thereby assuming the risk that the issue will not sell. Securities law includes a dispensation for bought deals that allows the dealer to solicit expressions of interest in the two days after entering into the agreement to purchase securities, and prior to the filing of the preliminary prospectus. Nonetheless, the dealer will already have assumed the risk that the issue will not sell. Thus, underwriters invariably canvass the market *prior* to entering into the bought deal, in order to ensure adequate market demand.

[4] See e.g. OSA s.1(1).

Some suggested that no underwriter will enter into a bought deal without some effort to canvass demand. While this may avoid explicit pre-marketing efforts, it will involve discussions between the issuer/underwriter and investors that skirt the line between investor communications and formal assessment of market demand. Others suggested that all reputable Canadian underwriters adhere scrupulously to the rules, and do not in any way engage in pre-marketing of new issues. While opinion was thus divided, it does appear that some underwriters are prepared to walk close the line in assessing demand for new issues, and particularly bought deals.

The rule against testing the waters has been motivated by a concern about insider trading. When an issuer decides to make an issuance of securities, this decision can move the issuer's market price. A firm is more likely to sell securities into the public market when its price is too high, as compared to when it is too low. Thus, an announcement that the firm will make a public issue of securities is commonly interpreted as a signal that the market price is too high. Empirical studies suggest that the market price sags by something on the order of one percent. In addition, an equity offering will often be made in connection with an acquisition or other important transaction, in which case the price movement may be even more substantial. Thus, someone with advance (and privileged) knowledge of an issuance of securities can use that knowledge to profit (e.g. by purchasing put options, selling the stock short, etc.). This is contrary to both the letter[5] and the spirit of securities regulatory rules, which aim at ensuring equality of opportunity for investors in securities markets.

It was suggested by a number of interviewees that the likelihood that insider trading will be the outgrowth of testing the waters is small. Typically, those parties canvassed in advance of an issuance of securities will be institutional traders, and it was suggested that reputational concerns restrain professional money managers from misusing the information. As a more practical matter, it was also suggested if the current rules are not being followed (assuming that that is the case, a point on which there was no unanimity), there is in fact little downside to legalizing what is already common practice.

One interviewee (a lawyer) suggested that if insider trading is the concern, then the way to deal with that is not to bar testing the waters, but to insist that the issuer or underwriter enter into confidentiality agreements with those to whom they disclose information.

Recommendation #2: Revisit the prohibition against testing the waters prior to an issuance of securities by a seasoned issuer.

[5] See e.g. OSA ss. 76, 131.

Because of divided views on this issue, this recommendation is cast as a suggestion that securities regulators revisit the prohibition against testing the waters, rather than an unqualified recommendation that the rules be changed.

f) Materials Distributed to Investors in Connection with Primary Market Distribution

While current practice varies, the following describes the materials distributed to investor sales agents in a practice that is followed by one of the major investment banks.

The prospectus, the green sheet, and an investor presentation are all distributed to retail and institutional brokers. The green sheets consist of material that is drawn from the prospectus and/or public statements of the issuer, and are a précis of the most important aspects of the offering. In no case does the green sheet go directly to the investor. The investor presentation might be in hard copy form, or on the issuer's web site.

Current regulation requires that the green sheet be filed with the securities regulators. Despite this, the green sheet is not reviewed by regulators. One critique that was made was that there did not seem to be any particular reason to require filing, if no review was made or contemplated. Another criticism that emerged was that there is no requirement that the investor presentation be filed, despite the fact that it will contain virtually the same information as the green sheet.

Two interviewees pointed out that the law requires that anything that is distributed to investors find its origin in the issuer's prospectus, and suggested that current practice frequently diverged from this requirement. These interviewees felt that this rule had a solid foundation, and should be enforced more rigorously.

The most frequently voiced criticism, however, was that there did not seem to be any particular reason not to allow investors (both retail and institutional) to view the green sheets.[6] A broker will typically use the green sheet as a "cheat sheet" to summarize the main points of the offering to his/her client. But if this is the case, then why not allow the client to view the document? Moreover, most clients who read a portion of the prospectus will read seek out only those pages that contain the information contained in the green sheet. Rather than putting investors to the trouble of wading through a lengthy document to obtain what

[6] One investment banker specifically dissented from this view, suggesting not only that green sheets are currently being distributed to investors (contrary to law), but that it is not a good idea to allow this to happen.

they are seeking, it was suggested that investors should be allowed to get it directly from the green sheet – with supplementation, if desired, from the prospectus.

The second part of **Recommendation #2** is thus:

Regulators should allow the distribution of green sheets to investors, conditional on posting the green sheet on SEDAR so that it is available to all investors.

Under current law, every purchaser of securities in a primary market offering has two days from the receipt of the prospectus to back out of its obligation to purchase securities.[7] A number of interviewees suggested that this was an anachronistic feature of securities law borrowed from consumer protection legislation, and should be dispensed with. As noted above, few people actually read the prospectus, and fewer still (if any) exercise the right to withdraw after reading the prospectus. However, the cooling-off right can make life more difficult for the underwriter, particularly if material changes occur after purchase orders are received.

Recommendation #3: Revisit the two-day "cooling-off" period for purchasers.

A universal view was that public money can be raised more expeditiously in Canada than in the U.S. Compared to their counterparts in Canada, U.S. regulators were seen as glacially slow in reviewing prospectuses, to the enormous detriment of issuers. While it was felt that the Canadian system could be made yet more expeditious, the relative speed of the Canadian primary market offering mechanism attracted a great deal of favourable comment.

Recommendation #4: Preserve the timeliness of Canadian prospectus review when compared with the U.S.

ii. Primary Market Disclosure: Initial Public Offerings

There was also virtually unanimous agreement that the current primary market disclosure system in the case of initial public offerings (IPOs) should be retained without significant change.

[7] See e.g. OSA s.71(2).

It was suggested that very few people actually read an entire prospectus. Even buy and sell-side analysts rarely read the whole document; many will read perhaps three or four key pages. Nonetheless, the overwhelming view was that requiring the issuer to assemble a prospectus imposes an important discipline on first-time issuers. Assembling the required information requires that the issuer's internal information systems be brought into an adequate condition to allow the issuer to meet its ongoing public disclosure obligations. It also prompts the issuer to examine its capital structure, management, governance arrangements and practices, and other matters that are germane to the issuer's ability to meet its public disclosure obligations and governance requirements.

No particular suggestions were forthcoming for simplifying the IPO disclosure requirements. In general, it was thought that the disclosure obligations currently imposed are appropriate.

Recommendation #5: Retain the current disclosure obligations for initial public offerings (IPOs).

In respect of IPOs, there is no concern that those who receive advance knowledge of an impending public offering will engage in insider trading, since there is no public market. A number of interviewees thus suggested there is an unambiguous case in favour of abandoning the rule against testing the waters in the case of IPOs.

Recommendation #6: Repeal the rule against testing the waters for IPOs

iii. Primary Market: Private Offerings

An alternative to a public offering of securities is a private placement[8] by means of one of the exemptions to the prospectus requirement in the securities law.

The nearly unanimous view of the interviewees is that the private-placement market in Canada works extremely well. The private-placement market offers a relatively low-cost forum for issuing securities, since no prospectus need be assembled. The quality of disclosure is a matter for bargain between the issuer and the investors. While in some instances an offering memorandum (OM) may essentially replicate what is in a prospectus, in others disclosure is very rudimentary. Even when the OM replicates

[8] The term "private placement" is used in a number of different ways by securities lawyers and regulators. In what follows, I use the term in its broadest sense to mean any private offering of securities.

prospectus-level disclosure, the absence of regulatory review and associated costs means that the private-placement route will be cheaper than a public offering.

The criticisms of the private-placement rules were more at the margin than the core. It was generally agreed that the recent reformulation of the private-placement rules to generate harmony between the various provinces and territories was helpful. It was also felt, however, that more could be done in this respect. In particular, many interviewees felt that too many differences remain between the different provinces, and that further steps could and should be taken to harmonize the rules across the country.

In addition, while the latest iteration of the national instrument is simpler than its previous incarnation, some interviewees felt that the private-placement rules were still too complicated, and that this interferes with the efficiency of the private market.

The recommendation in this section is thus:

<u>Recommendation#7:</u> Further harmonize the private-placement rules.

Regulators should take further steps toward harmonizing private-placement rules in the different provinces and territories. Regulators should also make further efforts to simplify the private-placement rules.

iv. Regulatory Innovation and the Distinctiveness of Canadian Capital Markets

There was universal praise on the part of the interviewees for the bought deal and the income trust, which are uniquely Canadian innovations. It was suggested that these innovations had been very good for Canadian issuers and capital markets, and an example of the competitive advantage that regulatory innovation can bring to our capital markets. On this basis, some interviewees suggested that the securities regulators should be more pro-active in producing regulatory innovations, and not simply following the lead of the Americans.

One interviewee (a lawyer) suggested that if Canadian regulators follow U.S. regulators and move toward a unified North American standard, this could mean the disappearance of the unique Canadian capital market. This interviewee suggested that the only reason why any multi-national deal will ever be led by Canadian lawyers (or in which Canadian lawyers have a significant presence) is because Canadian standards are different from those of the United States. If the regulatory standards are the same, then all deals will be led from the U.S. and Canadian lawyers will have a strictly ancillary role.

While there is no doubt some truth to this, the Task Force might well consider the extent to which a uniquely Canadian capital market is a private, as opposed to a public benefit. That is, would a uniquely Canadian capital market only service the interests of lawyers, investment bankers, accountants, and other professionals who service corporate activity? Or would it service a wider public interest? Is the interest of the professional community allied with the public interest, or is it distinct?

While this issue was raised with a number of interviewees, it appeared to be ground on which most feared to tread. Thus, whether securities regulators should pursue a uniquely Canadian regulatory apparatus for the purpose of maintaining the autonomy of Canadian capital markets is not something in respect of which there is any recommendation.

It was also suggested by a number of interviewees that there is a very good substantive reason for maintaining a difference from U.S. rules: Canada is a relatively small-cap, illiquid market. By New York standards, the vast majority of the companies that trade on the Toronto Stock Exchange are "small" firms (*a fortiori* for those firms that trade on the TSX Venture Exchange). In addition, Canadian markets are characterized by a vastly greater preponderance of controlled companies, (although the percentage of controlled companies has decreased markedly in the past 10 years). It was thus felt by a number of interviewees that the cost-benefit regulatory tradeoff is somewhat different in Canada than in the U.S.

A number of interviewees also suggested that the U.S. rules are far too complicated, and should not be emulated by Canadian regulators. This issue was intertwined with the debate between broad rules or principles and finely honed and detailed rules. Those who held the view that U.S. rules are too complicated also tended to subscribe to the view that regulation by general principles and standards was more effective than regulation by highly elaborate rules that attempt to anticipate every possible means by which investors might be harmed. These interviewees attributed the dramatically increased complexity of Canadian securities laws over the past ten years to regulatory emulation of U.S. rules. One lawyer suggested that this increased complexity had not improved investor protection one iota, and had mainly served to alienate the business community which it is designed to serve.

The view that Canadian regulation should rely more on general principles than detailed rules was held by the vast majority of interviewees. It was suggested that the formulation of detailed rules, applied with little discretion, only leads to further and more elaborate attempts at evasion, which leads to more complicated rules, which leads to yet more elaborate attempts at evasion. This endless cycle of point and counterpoint was said to lead to rules of baroque complexity that do little to service the interests of capital markets. Virtually every interviewee described the U.S. system as excessively complex, needlessly expensive, and time-consuming. Many commented adversely on the growing complexity of regulation in Canada and the lack of a corresponding benefit to investor protection.

In this respect, there was much sympathy for the recent (now postponed) attempt by British Columbia to greatly simplify its securities laws and to rely more on general standards than highly specific rules. A number of interviewees suggested that the B.C. proposal was potentially harmful to the pan-Canadian unification of regulatory regimes (which was thought to be a good thing). Nonetheless, as a matter of substance, the majority of interviewees thought that the B.C. proposal was substantively appealing and should serve as a cynosure for future regulatory reform by other provincial commissions. It was generally thought that the exercise of reviewing securities regulatory requirements with a view to determining their cost effectiveness is something that should be done at regular intervals by securities regulators. Developments both in capital markets and in information technologies (and hence the ability of investors to obtain information about various issuers on a timely basis) can quickly change – changing the cost-benefit calculus of various features of the regulatory apparatus. It is thus essential to continually revisit the need for particular rules. This is especially true given the inevitable tendency of rules to multiple rather than divide as time passes.

Thus, despite some differences of opinion on the part of interviewees, four recommendations come out of this section of the study:

Recommendation #8: Canadian regulators should feel no compulsion to imitate U.S. rules.

Canadian capital markets are sufficiently different from U.S. capital markets that Canadian regulators should strive to ensure that regulatory requirements are not merely borrowed from the U.S., but are appropriate for Canadian markets.

Recommendation #9: Canadian regulators should rely, where possible, on general standards and broad principles of conduct, rather than exquisitely detailed rules.

<u>Recommendation #10:</u> Canadian regulators should comprehensively revisit, on a regular basis, the motivation and cost-benefit calculus of specific rules, as well as the basic assumptions and cost-benefit calculus that underlie various families of rules.

<u>Recommendation #11:</u> Canadian regulators, in consultation with regulated communities, should seek out regulatory innovations (such as the bought deal and the income trust) that pose no danger to investors while giving Canadian capital markets a competitive edge over international competitors.

v. Consistency and Quality of Document and Transaction Review

A common criticism of the document review process (particularly that for prospectuses) was in respect of the application of inconsistent standards by different regulatory personnel. One investment banker, for example, suggested that some prospectus reviewers will fuss over the terms of green shoe or underwriter's options, while others will not. Some will insist on the filing of green sheets, while others will not – and so on. More generally, some reviewers are "picky", while others are more lax.

The view that the character of review depended a great deal on the identity of the reviewer was shared by many of the lawyers. It was felt that the securities regulators should make greater efforts to apply the rules in a more consistent manner than is currently the case.

The recommendation is thus that the securities regulators make further efforts to ensure that the quality of review does not vary materially with the identity of the reviewer.

<u>Recommendation #12:</u> Regulators must make greater efforts for consistency of document and transaction review.

A common comment on the part of both lawyer and underwriter interviewees was that staff members are often unschooled in matters of business and apply regulatory standards in an abstract manner that disregards the business realities of the transaction. This was said to lead to concerns, whether about the quality of disclosure or about particular substantive aspects of a transaction that were not justified in the circumstances. This in turn can lead to delays in prospectus or transaction approval that do not result in a corresponding increase in investor protection.

Many interviewees suggested that the cure for this problem was quite simple: upgrade the quality of the personnel who review prospectuses, ensuring that they understand not merely the rules but the nature of the transactions that they are reviewing. Only then will they possess the judgment to know when to press on a particular issue, and when to take a light-handed approach.

Two interviewees suggested another tack; that regulators should bring in senior people from law firms, investment banks, accounting firms, or CEOs or others to act as advisors on specific transactions or to help regulators identify potentially problematic transactions. Both interviewees suggested that the ranks of retired lawyers, accountants, etc. are replete with highly qualified people who would be not merely willing, but anxious to do this as a public service.

Other interviewees lauded the benefits of a secondment program, pursuant to which lawyers or others from private firms serve a term on the staff of a regulator. It was suggested that this had played a very valuable role in the past[9] in bringing practical skills and a "street" perspective to the regulators. It was also suggested that a useful secondment involves at least a two-year term – since much of the first year is spent in becoming a functional member of the team.[10]

There are thus three parts to the recommendation in this section:

Recommendation #13: Regulators should ensure, as far as possible, that regulatory staff are schooled not merely in the law, but in the business aspects of the transactions that they are reviewing.

Recommendation #14: Regulators should engage senior personnel from various private communities, perhaps drawing upon the ranks of retired professionals and senior managers, to advise in respect of particular transactions and in the identification of regulatory priorities.

Recommendation #15: Regulators should actively engage in secondment of persons from various private communities.

[9] Regrettably, the OSC's secondment program was suspended by Chairman Brown during his tenure, and has not been reinstated.
[10] One interviewee suggested three-year secondment terms.

vi. Secondary Market Disclosure

In recent years, securities regulators have focused much more closely on secondary market disclosure than has historically been the case. As noted above:

- continuous disclosure requirements have become more fully elaborated in the past few years (particularly in respect of oil and gas companies);
- securities regulators have given the market a great deal more guidance than has historically been the case as to how continuous disclosure requirements will be interpreted and enforced;
- statutory liability now attaches to misrepresentations in continuous disclosure documents and statements;
- in the past few years, securities regulators have devoted more resources to continuous disclosure compliance; and
- in the past few years, both large and small issuers have made dramatic improvements in the quality of their continuous disclosure statements and filings.

These changes were the basis for the extension of the POP system to all issuers, and not merely those with meeting prescribed size and/or quality standards.

Not all felt that the changes to the continuous disclosure system were an unambiguous good. A number of interviewees felt that the burden of continuous disclosure had become excessive for smaller issuers, and that this discouraged companies from going public.

Others felt that the new focus on avoiding selective disclosure had tended to reduce the flow of information into the market. However, these interviewees tended to be somewhat agnostic on whether the rules should be relaxed, recognizing the beneficial aspect of preventing selective disclosure.

The new focus on and resources devoted to ensuring an effective and reliable system of continuous disclosure was welcomed, however, by most interviewees. As noted above, many of the interviewees felt that regulators should engineer even more of a shift away from primary market disclosure to secondary market disclosure – to the point at which the continuous disclosure system is sufficiently comprehensive that an issuer raising money in the public market need only file a term sheet to do so.

The introduction of statutory civil liability for misrepresentations in continuous disclosure statements and documents was viewed by most as a positive development.[11] However, many expressed the view that the legislation was unnecessary complex. Many also suggested that there were technical problems with the drafting that created ambiguities and difficulties in interpretation.

A minority of interviewees worried that the introduction of civil liability would create a U.S.-style environment in which issuers are exposed to a serious risk of strike suits seeking to extort money by making groundless but potentially harmful allegations of wrongful disclosure. Those who expressed this view noted that U.S. class action litigation is mostly driven by lawyers, who stand to earn huge fees, and not by nominal plaintiffs. They feared that the proliferation of nuisance suits would raise the cost of D&O insurance, in addition to discouraging qualified individuals from serving as directors. Those who expressed this view were generally satisfied with the way in which securities regulators have policed continuous disclosure, particularly given the new attention devoted to continuous disclosure in the past few years. These interviewees (a small minority) would have preferred to leave regulation of continuous disclosure to the public domain.

The recommendations that come out of this part are thus the following:

<u>Recommendation #16:</u> The new regime of rules creating liability for secondary market misrepresentations should be simplified, weeded of drafting problems, and regularly reviewed to ensure that it does not encourage nuisance suits.

Regulators should attempt to simplify the rules creating a civil liability for misrepresentations in continuous disclosure documents and statements.

Working in consultation with private actors, regulators should seek to identify and correct on a timely basis drafting problems with the new legislation.

Regulators (and legislators) should keep an eye on whether the new civil liability creates an excessive risk of nuisance suits for issuers, and reform the legislation accordingly if there is evidence that this is the case.

[11] See OSA Part XXIII.1.

vii. Registration and Policing of Market Actors

Few interviewees had specific complaints about the registration process. However, there were widely divergent opinions about whether the ongoing burden of OSC and IDA compliance had in the aggregate become excessive. Predictably, the split tended to be between the larger and the smaller investment banks. The larger investment banks tended to view the degree of policing as appropriate and necessary to keep the bad apples out of the game. While yearly compliance costs were well into seven figures, the large investment banks could absorb this cost without great difficulty.

One interviewee from a large investment bank suggested that the "Partners, Directors, and Senior Officers" course[12] required for every partner, director and senior officer of an investment bank needs to be expanded. In particular, rather than administering one test to all, the course materials should reflect the individual's specialty within the firm. This interviewee also suggested that the test needs to be re-administered on a regular basis, and not merely when an individual become a partner, director, or senior officer.

Interviewees from the small investment banks, however, tended to view ongoing registration costs as highly excessive, bureaucratic, and inflexible.[13] The view of these dealers was that there are an abundance of rules that have little or nothing to do with investor protection. It was suggested by more than one interviewee that the real purpose of these rules (and their rigid administration) was to create work for the regulators (both OSC and IDA) to justify their employment. These interviewees suggested that the regulators rarely pause to reflect on the purpose of the rules they are administering – and so apply them blindly and inflexibly without consideration of their benefit to investors.

These interviewees also viewed the registration burden as anti-competitive. Because the costs of compliance are relatively invariant for larger and smaller firms, the burden of compliance falls much more heavily on small firms, who cannot as easily absorb the cost. This was said to create a significant barrier to entry for prospective new players. It was also suggested that the regulatory process was driven by the larger dealers, who would be quite happy to see the smaller dealers driven out of business.

[12] IDA By-Law 7 and Policy 6 require that every partner, director, and senior officer of an investment bank complete the "Partners, Directors, and Senior Officers" course administrated by the Canadian Securities Institute.

[13] This was not, however, a unanimous view among the smaller dealers. One interviewee from a relatively small firm indicated satisfaction with the current regime.

The recommendations of this section are, therefore, that:

<u>**Recommendation #17:**</u> **Regulators (including both the OSC and the IDA) should re-examine the cost-effectiveness of their rules with a view to determining whether reductions in regulatory burden can be made without significant prejudice to investors.**

<u>**Recommendation #18:**</u> **Regulators should determine if ongoing compliance burden is excessive for smaller firms and/or constitutes a barrier to entry for new entrants.**

viii. Takeover Bids

The regulation of takeover bids in Canada was an area in which there was near unanimity amongst the interviewees. The regulation of takeover bids was said to be working extremely well. No interviewee had any suggestions for how the regulatory framework might be changed to effect improvements.

One lawyer felt that the regulators had tipped the scale too much in favour of bidders by making it difficult for target firms to keep poison pills in place. However, this view was not shared by other interviewees.

There are no recommendations that come out of this part of the study.

ix. The Conduct of Staff, Enforcement Personnel, and the Commissioners

Without question, the conduct of staff, enforcement personnel, and the Commissioners were the areas that attracted the greatest number of comments. The comments ran the gamut from highly positive to highly negative. On balance, however, there were more negative comments than positive, with most of the negative comments centering on enforcement staff.

In the positive category, some interviewees had unreserved praise for particular departments or individual staff members at particular regulators. Staff members who attempted to view a transaction from a client's perspective and to be transaction facilitators were singled out for the greatest praise. A majority, however, indicated that their experience with regulatory staff depended keenly on the persons and departments with whom they were dealing. Many suggested that staff were most likely to be unhelpful or obstructive when they failed to understand a transaction from a business point of view, including its impact on investors. This was said to lead to concerns about investor protection that were not warranted on the facts, leading to unnecessary delays in concluding transactions.

The majority of negative comments were reserved for enforcement staff. Concerns centred on five aspects of the conduct of staff, enforcement personnel, and Commissioners:

a) Insufficient resources devoted to enforcement.
b) Bullying tactics by Commission staff.
c) Bias on the part of the Commissioners in favour of Commission staff.
d) Uneven application of the rules by enforcement staff and Commissioners to different market participants.
e) Poor judgment by enforcement staff and Commissioners about which cases merit enforcement action and/or sanction.

These are dealt with in turn.

a) Insufficient Resources Devoted to Enforcement

There was essentially unanimous agreement that too few resources have been devoted to enforcement efforts. Many interviewees spoke disparagingly of high profile abuses that had occurred that had not become the subject of enforcement actions, or in respect of which the regulators had suspended inquiries pending the outcome of criminal proceedings. The conduct of the Canadian regulators was invariably compared unfavourably to American regulators, who were seen as moving quickly and decisively to address market abuses. One lawyer called the situation a “disaster”, and suggested that Canadian regulators cannot be relied upon to redress wrongdoing.

One lawyer suggested that the problem goes far beyond the securities regulators. This lawyer pointed out that the U.S. Attorneys General in New York and Chicago have been highly proactive in prosecuting corporate cases, while the various Attorneys General in the Canadian provinces have shown little or no interest in such cases. While the RCMP has indicated an interest in pursuing corporate cases, they lack the necessary resources.

One lawyer suggested that, in respect of interlisted companies, it is not particularly important that Canadian regulators and prosecutors be active, since the U.S. regulators can be relied upon to do the job. This, however, was a minority view.

b) Bullying Tactics by Commission Staff

The staff of the various Commissions, but the Ontario Securities Commission in particular, were seen as often being overly aggressive, heavy-handed, and bullying in their dealings with market participants. This was said to occur in three contexts:

- in day-to-day dealings between staff and market actors
- in the levelling of allegations of wrongdoing against market actors
- in coercing unfair settlements once allegations of wrongdoing have been made

With respect to the first, many suggested that Commission staff tended to be uncompromising in their views. One lawyer, for example, suggested that in a number of instances clients had been forced by staff to frame public disclosures in a manner that was both damaging and unfair to the client. This lawyer suggested that it was difficult or impossible to negotiate with commission staff; staff members tend to simply dictate their own views and require compliance.

In respect of the second matter noted above, many interviewees stressed that the very act of publicly levelling charges of misconduct against a market actor can have deleterious consequences. It was suggested that staff were not always as cautious as they should be in levelling public accusations against market actors. One interviewee suggested that the Ontario Commission likes to make law by press release.

In respect of the third matter, many complained that enforcement staff frequently coerce settlements from those against whom allegations of wrongdoing had been raised. This was accomplished by threatening to pursue draconian remedies against those who refuse to settle on the commission's terms. Many suggested that once allegations of wrongdoing have been made, there was little alternative (given the bias of the Commissioners in staff's favour) but to settle on terms dictated by staff.

It was also suggested that both staff and Commissioners have a tendency to paint the world in black and white, and to lump market actors in "good" and "bad" categories rather than seeing the world in its full complexity. The vast bulk of the criticism in this respect was again reserved for enforcement staff (and again, particularly at the OSC), who were described by some as "a power unto themselves", a "rogue elephant" and a "black hole".

Some interviewees felt particularly strongly on this point. Two suggested that once enforcement staff became involved, the process became a "kangaroo court". Two others used the phrase "star chamber".

c) Bias on the Part of the Commissioners in Favour of Commission Staff

It was felt by the majority of lawyer interviewees that should a matter go to a hearing before the Commissioners, there was a less than even chance of getting an unbiased hearing. The perception was that because the Commissioners rub shoulders with the staff on a daily basis they are biased in favour of staff submissions. It was also felt that the Commissioners, like the staff, tend to paint the world in black and white, and, at least in some cases, to mete out burdensome and excessive penalties.

d) Uneven Application of the Rules as Between Different Market Participants

Amongst the lawyers, there was virtually unanimous agreement that the rules are applied unevenly. As noted, many expressed the view that high-profile cases involving potential wrongdoing had gone unaddressed, while in other cases market actors had been punished well beyond what their conduct merited, or had been coerced into unfair settlements.

A number singled out the *Donnini* case as an example in which market actors who settled with the Ontario Commission were treated far more favourably than those who refused to settle, without material differences in the extent of their misconduct. Many characterized the result of the case as unfair and inappropriate. Some interviewees suggested that the *Donnini* case was an example of the Commission acting "vindictively" or "on a vendetta" against someone who they had taken a disliking to. One lawyer went so far as to characterize the result of the *Donnini* case as "obscene" and "outrageous".

e) Poor Judgment about Which Cases Merit Enforcement Action and/or Sanction

As already noted, many interviewees expressed the view that the regulators had essentially turned a blind eye to examples of potentially egregious wrongdoing. Many expressed amazement, for example, that the regulators have failed to act decisively in respect of a number of high profile cases such as Bre-X, Hollinger, and Livent, while aggressively pursuing far less serious breaches of securities law.

f) Potential Solutions

Resources

Many suggested an obvious solution for a lack of enforcement resources: more resources. Others suggested, however, that this was only half the solution. The other, equally important part of any solution is to get "the right people" bringing or assisting in enforcement actions and prosecutions.

One lawyer suggested that the best way to address the problem is for regulators to outsource prosecutions, as is done in the U.S. This lawyer suggested that there are many talented litigators who would be more than willing to assist in, or take charge of, high-profile prosecutions.

A number of others suggested that the Commissions increase their pay scales and hire more capable and experienced personnel. They suggested that one reason why the SEC has more capable people is simply because the SEC pays significantly more than Canadian regulators.

Others suggested that active secondment programs would bring people in from the private sector who could share their skills and practical experience with enforcement departments.

Two others suggested that retired lawyers, accountants, investment bankers, etc. could be brought either on an *ad hoc* basis to assist with enforcement actions or prosecutions, or to assist in prioritizing enforcement actions.

Commission Conduct

A number of interviewees suggested that the fundamental problem with the exercise of arbitrary authority by regulators was a lack of accountability. Some expressed the view that the conversion of a number of provincial authorities into Crown corporations had only exacerbated the problem, since the result is that the Commissions are even further removed from political control.

Many interviewees indicated that going to a hearing before the Commissioners, or appealing a Commission decision to the court were not realistic options in most cases. First, there are practical exigencies of business. Going to a hearing (let alone appealing a Commission decision to a court) consumes so much time that a market window of opportunity will be often be lost. Thus, even a win can frequently mean a loss for the client. Second, many of the lawyers felt that being aggressive with commission staff would prejudice their ability to continue to service their clients' interests, given the likelihood of "retaliation" on the part of regulatory staff. Third, the likelihood of success in overturning a Commission decision was small, given judicial deference to Commission holdings. For all of these reasons, two lawyers suggested that the regulators "hold all the cards".

Nonetheless, some solutions were offered. Most supported the separation of Commissioners and Commission staff. As noted, the perceived bias of Commissioners in favour of staff was thought to result, at least in part, from Commissioners and staff sharing common premises.

Many stressed that the best way to address the problem of commission overreaching was simply a matter of hiring the right people and training them properly. It was felt by many that problems with enforcement, for example, were largely a function of having the wrong people in key positions.

One or two raised the issue of re-organizing the Commissions so that there was more internal oversight over enforcement personnel, who were perceived as largely unregulated. No one, however, had specific ideas about how this might be done.

One interviewee suggested that a key part of the problem with excessive judicial deference to regulatory decisions lay in the absence of judges schooled in corporate matters. Judges who lack expertise are less likely to trust their own judgment and more likely to take the path of least resistance and simply defer to Commission decisions. Thus, the interviewee suggested that efforts should be made to appoint judges with expertise in corporate matters.

Some interviewees suggested that legislatively changing the judicial standard of appeal would also assist in creating a counterweight to Commission power. The current standard of appeal has been fashioned by the Supreme Court of Canada in a number of key judgments that have instructed courts to be highly deferential in cases involving expert tribunals acting within the area of their particular expertise. The legislative might easily reverse this standard of deference, possibly even allowing a hearing *de novo* on the merits of the case.

As already recommended, regulators should employ active secondment programs as a method of bringing outside expertise into the regulatory process. Again, regulators should draw upon the expertise of retired lawyers, accountants, investments bankers and corporate managers to assist in identifying cases for regulatory review, and for guiding or reviewing enforcement action in respect of ongoing cases.

Additional recommendations that come out of this section are thus the following:

Recommendation #19: **Regulatory and prosecutorial resources devoted to enforcement need to be enhanced.**

Recommendation #20: **Consideration should be given to increasing the quality of regulatory personnel by further enhancing pay scales.**

Recommendation #21: **Consideration should be given to outsourcing prosecutions, on an *ad hoc* basis, to members of private law firms.**

Recommendation #22: **Commissioners and commission staff need to be both functionally and physically separated, in order to ensure that Commissioners are not biased in favour of commission staff when sitting in a hearing capacity.**

Recommendation #23: **Consideration should be given to creating more internal accountability for enforcement personnel.**

Recommendation #24: **Consideration should be given to legislating a less onerous standard for appealing Commission decisions, in order to create more effective judicial oversight of enforcement activity.**

Recommendation #25: **The conduct of regulatory staff should be subject to oversight by an external ombudsman created especially for the purpose.**

Recommendation #26: **The provinces should lobby the federal government to appoint more judges with strong business backgrounds, both in order to address the timidity of some judges in reviewing regulatory conduct, and to enhance the quality of judicial decision-making in the business arena.**

5. Conclusion

The recommendations in this paper for reform of Canadian securities regulation are the result of interviews with twenty-one senior lawyers, investment bankers, and other market participants. While, not unexpectedly, there were differences of opinion, there was a surprisingly high degree of convergence in respect of the majority of the areas canvassed. The most significant divergence of opinion arose in respect of the burden of registration, and the split that occurred reflected the different viewpoints of smaller and larger firms. In respect of insider trading, takeover bids, primary market disclosure, secondary market disclosure, and the conduct of securities regulators, however, significant areas of congruence materialized. This congruence is reflected in the recommendations made in this report.

While no more than the opinions of those interviewed for the purposes of this report, it nonetheless seems probable that the views expressed are a reasonable approximation to those of other members of the private communities canvassed. It is thus hoped that these recommendations will be a useful input for Canadian securities regulators as they consider the future of our securities regulatory apparatus.

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