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Executive Summary of Recommendations

The following is a summary of the recommendations we have made within the text of our Report which follows. We have organized our recommendations below according to the theme of each of Chapters 3 through 7. We also direct readers to the summaries of the recommendations provided by the various researchers we have commissioned. Those recommendations, which we do not necessarily endorse, are contained in Chapter 11.

We note that we have not conducted cost-benefit analyses in respect of the implementation of our recommendations and, consistent with one of our recommendations, we encourage securities regulators to conduct such analyses prior to implementing our recommendations.

In Chapters 8 and 9 we have presented additional "ideas for consideration" dealing with the role of securities analysts and other "gatekeepers" in securities regulation and a programme for insurance against misinformation in Canada's capital markets, respectively. We have not achieved the consensus necessary to endorse the views and ideas presented in these chapters. Nonetheless, we do feel that it is important to present these ideas in our Report; not only to memorialize the thinking on these issues, but also to allow those who are interested to use this work as a starting point to consider these issues further.

Summary of Our Recommendations

Recommendations regarding approaches to securities regulation and general principles:

1. The Task Force recommends that Canadian securities legislation include as one of its purposes the enhancement of the competitiveness of Canada's capital markets.

2. The Task Force recommends that rules that are enacted in anticipation of a market failure be revisited on a regular basis to determine whether market forces are able to address the issue in the absence of regulatory intervention.

3. The Task Force recommends that prior to enacting new rules to address a market failure, a thorough and systematic review of existing rules should be undertaken to determine whether, if enforced, existing rules are adequate. This requires that the regulator clearly define the failure that is to be addressed and the outcome which the rule is intended to produce, including identifying measurements to be used to determine whether the failure has been addressed adequately.

4. The Task Force recommends that all securities regulators in Canada undertake empirical cost-benefit analyses prior to the introduction of a significant new rule.

5. The Task Force recommends that a uniform set of published guidelines be established outlining the methodology to be used in cost-benefit analyses.

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6. The Task Force recommends that each cost-benefit analysis include a clear description of the uncertainties (i.e., the predictions, assumptions, forecasts, etc. that have been applied) that are associated with the analysis.

7. The Task Force recommends that third-parties affected by a proposed rule be encouraged to undertake their own cost-benefit analysis for consideration by securities regulators.

8. The Task Force recommends that where regulations are adopted despite evidence that their expected benefits are less than the expected costs, securities regulators be required to explain why they have adopted the rule. Moreover, there should be a mandatory re-evaluation of such rules after a set period of time to ensure that the objectives of the rule are still being met.

9. The Task Force recommends that an independent body, staffed by capital markets experts from all stakeholder groups, be established for the specific purpose of conducting, at defined intervals, a systematic cost-benefit analysis of every significant regulatory intervention into capital market activity.

10. The Task Force recommends that Canadian securities regulation be based on clearly enunciated regulatory principles which do not need a detailed set of interventionist rules for sound implementation.

11. The Task Force recommends that regulation be scaled according to the size of an issuer's market capitalization and other issuer specific considerations in order to ensure that regulation is appropriate.

Recommendations regarding understanding how investors make investment decisions and better meeting the needs of investors:

12. The Task Force encourages securities regulators to work to make disclosure documents more effective by improving the method by which information is made available to investors to enhance the penetrability and comprehensibility of that information.

13. The Task Force recommends that:

    - the search features of SEDAR be expanded to allow for more detailed searches of disclosure documents, and
    - the taxonomy for disclosure documents filed on SEDAR be further refined to reduce the dependence on the use of "catch-all" categories.

14. The Task Force recommends the adoption of a full "access equals delivery" system. Specifically, we recommend:

    - that all requirements for the delivery of disclosure documents be abolished and, instead, that all disclosure documents be required to be filed on SEDAR and on the issuer's website, and
    - that the elimination of any requirement to "deliver" a document would render investor consent to "access equals delivery" unnecessary.

15. The Task Force recommends that MERIT (Model for Effective Regulatory Information Transfer) be thoroughly considered and that securities regulators encourage and facilitate the use of XBRL, information layering and interactivity within electronic disclosure documents, all as detailed in the technical white paper included at Schedule 4-A.

16. The Task Force recommends that, until MERIT and the use of XBRL can be implemented, paper-based disclosure be presented in layered format with each layer being of increasing depth and complexity thereby allowing investors to determine the depth of disclosure which is informative for them.

17. The Task Force recommends that financial literacy be treated as a matter of national priority.

18. The Task Force recommends the creation of a national coordinator of public and private sector investor education initiatives.

19. The Task Force recommends that further study be undertaken by capital markets stakeholders to design programmes that ensure that the objective of financial literacy as a national priority is achieved.

20. The Task Force recommends that insiders of an issuer be obliged to give at least two business days advance notice of their intention to sell some or all of their securities in the issuer.

Recommendations regarding accessing the Canadian capital markets:

21. The Task Force recommends that a Canadian version of the "well-known seasoned issuer" concept be introduced in Canada to allow eligible issuers the ability to access the capital markets with increased speed.

22. The Task Force recommends that Canadian well-known seasoned issuer (C-WKSI) status be granted to those issuers meeting the qualification criteria for the POP system and with market capitalizations of $350 million and over.

23. The Task Force recommends that C-WKSIs be permitted to come to market in a follow-on offering with an offering document (that would not be subject to regulatory review) which contains only the details of the offering, the use of proceeds and related disclosure which would be tantamount to a material change statement.

24. The Task Force recommends that the certificate of a C-WKSI using a C-WKSI offering document speak only to material facts as at the date of the C-WKSI's last annual information form and material changes since that date, specifically saying: "The foregoing, together with the documents incorporated by reference herein, constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business and affairs of [issuer] since that date."

25. The Task Force recommends the underwriter's certificate for offerings by C-WKSIs take into account the restricted time that underwriters will have to complete a full-blown due diligence review of the issuer, specifically saying: "To the best of our knowledge, information and belief, based on a review reasonable under the circumstances, the prospectus constitutes full, true and plain disclosure of all material facts as at [the date of the last filed Annual Information Form] and of all material changes in the business and

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affairs of [issuer] since that date." We would expect that securities regulators would provide guidance as to how the standard of reasonable review could be achieved.

26. The Task Force recommends broadening the category of individual regarded as an accredited investor under the private placement exemptions to include not only those who are wealthy, but also those who rely on a registered adviser. The limits on this exemption would be: (i) sales (utilizing the exemption) limited to no more than 50 investors for any one private placement, (ii) the issuer must be a "reporting issuer", and (iii) a registered adviser would be prohibited from advertising to encourage investors to rely on this exemption and sales under this exemption would only be permitted to clients with whom the registered adviser had a pre-existing relationship.

27. The Task Force recommends that hold periods for privately placed securities of reporting issuers be eliminated.

Recommendations regarding the regulation of hedge funds:

28. The Task Force recommends that a regulatory framework be established for the public offering of hedge funds just as a regulatory framework was established for the public offering of mutual funds and that while the framework will incorporate full regulation some of the features will be as follows:

    - full disclosure of all performance, management, administrative, referral and other fees (including the compensation of the investment adviser and manager),
    - a description of the relationship between the hedge fund manager, adviser, administrator and prime broker and appropriate cautionary language regarding any conflicts of interest between them,
    - mandatory disclosure of any "side letter" and other collateral agreements between the hedge fund and investors who receive special fee or liquidity arrangements,
    - a description of the mechanism or process by which the assets of the hedge fund are valued,
    - a description of the hedge fund structure and its investment strategies, and
    - in the case of principal protected note products linked to hedge funds, a full description of the underlying hedge fund or fund of hedge funds incorporating all of the features listed above.

29. The Task Force recommends that the distribution of principal protected notes where the economic value is based upon an underlying hedge fund be regulated according to the nature of the underlying investment rather than according to the exempt character of the related principal protected note with which the underlying investment is "wrapped".

30. The Task Force recommends that all financial intermediaries selling hedge fund products and other structured products, such as principal protected notes linked to an underlying hedge fund, be required to meet certain proficiency requirements to ensure that they properly understand the products they are selling.

31. The Task Force recommends that consideration be given to the registration of hedge fund managers in order to ensure that there is an appropriate level of regulatory oversight of the activities of the manager as well as its capitalization and governance procedures.

Recommendations regarding the enforcement of securities laws:[1]

32. The Task Force recommends that a co-operative national program be established and funded by securities regulators, self-regulatory organizations (SROs) and law enforcement agencies: (1) to establish priorities for enforcement, (2) to develop reporting systems that would provide a basis for assessing the effectiveness of enforcement processes in achieving their objectives, (3) to identify and collect any additional relevant data, and (4) to report the data and their qualitative analysis of it to an independent research body which will evaluate and issue public reports on the effectiveness of enforcement processes.

33. The Task Force recommends that a study be undertaken to assess the needs for police services in the investigation of capital market crime in various jurisdictions, and to inquire into the appropriate contributions that should be made by municipal, provincial and federal police services.

34. The Task Force recommends that a study be undertaken to assess the needs for investigative services by securities regulatory authorities in various jurisdictions, and the capacity to provide those services effectively.

35. The Task Force recommends that if the Integrated Market Enforcement Teams (IMETs) established by the Royal Canadian Mounted Police are to succeed, there must be a renewed and continuing commitment to developing and retaining the expertise required to lead and conduct complex investigations of capital markets offences by:

    - identifying and reviewing the competencies that are required,
    - recruiting officers and other staff with specialized backgrounds,
    - providing professional development and mentoring programs,
    - establishing and complying with policies that restrict secondments of these officers to other duties, and
    - establishing and complying with promotion policies that enable investigators to establish long-term careers in the investigation of capital market crimes.

36. The Task Force recommends that either the capacity of IMETs should be expanded to conduct all the necessary criminal investigations relating to capital markets, or the capacity of other police agencies should be enhanced in order to address the kinds of cases that IMETs is not authorized or able to undertake.

[1]In this section we have endorsed a majority of the recommendations made by P. Cory & M. Pilkington, "Critical Issues in Enforcement" in Volume VI.

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37. The Task Force recommends that the role of IMETs in each locale should be defined in accordance with the investigation needs in that locale, without diluting the overall mandate and accountability of IMETs.

38. The Task Force recommends that to make the best use of limited investigative resources within each jurisdiction, it will be necessary to establish processes for consultation, co-operation and co-ordination among all levels of police forces and the enforcement staff of securities regulators.

39. The Task Force recommends that IMETs and other police forces recognize the prime responsibility of securities regulators to intervene early in a securities matter to preserve assets, protect investors, and, if possible, protect the long-term viability of the issuer. They should co-operate in obtaining and sharing evidence and information both to support that responsibility, and, as appropriate, to investigate suspected crimes with a view to prosecuting those responsible.

40. The Task Force recommends that consideration should be given to processes for focusing and expediting investigation, and ensuring quality control and the exercise of good judgment. What is needed, in each IMET locale and each securities regulator, is an experienced lawyer with the seniority, status and confidence to exercise independent and sound judgment, a record of skills in supervision and management, and expertise (or the ability to acquire it expeditiously) in the specialized field of capital markets regulation. The role of this individual, whom we refer to as a "Senior Independent Review Officer", would be to provide focus, supervision and a locus of accountability for strategic decisions in an investigation. He or she should have status similar to that of a Securities Commissioner. Such persons might be found among the senior ranks of counsel in private practice or the prosecution service. In particular, they may be found among individuals recently retired who remain at the peak of performance, and can bring their abilities and experience to bear.

41. The Task Force recommends that investigators have access to effective legal advice in the course of an investigation. However, it must be provided by individuals who will not be involved in the prosecution of the case.

42. The Task Force recommends that every effort be made to enable IMETs to complete current investigations expeditiously and in a focused manner.

43. The Task Force recommends that consideration be given to the accountability structure for IMETs, and the need to develop a national enforcement strategy that takes into account the strategic importance of investigation to the effectiveness of securities regulation in the provinces.

44. The Task Force recommends that in light of concerns expressed about constitutional hurdles to the sharing of information by regulatory investigators and police investigators, protocols be developed to guide those who must determine and substantiate the point at which a regulatory investigation crystallizes into an investigation for the purpose of criminal or quasi-criminal prosecution, and specifying the investigatory techniques that can be employed at various stages of inspection and investigation.

45. The Task Force recommends that the securities regulator's Senior Independent Review Officer, recommended in recommendation 40, should also have independent authority to determine whether a matter should be sent forward for hearing by the securities tribunal.

46. The Task Force recommends that processes should be instituted for identifying priorities in the investigation and prosecution of regulatory matters, and ensuring that enforcement processes are being used effectively in addressing those priorities.

47. The Task Force recommends that the securities regulator's Senior Independent Review Officer, recommended in recommendation 40, should also have independent authority to determine whether a matter should be sent forward for prosecution as a provincial offence.

48. The Task Force recommends that where the Senior Independent Review Officer has authorized prosecution of a provincial offence, it may be appropriate to authorize counsel employed or retained by the securities regulator to prosecute it. The provincial prosecution service should provide guidelines to assist in ensuring that such counsel are thoroughly familiar with the principles that govern the role of a prosecutor.

49. The Task Force recommends that every effort be made to develop a nationally co-ordinated program for the prosecution of capital markets cases, with a view to ensuring the development of a public prosecution service that has the experience, capability and commitment to meet the difficult challenge of prosecuting capital market offences.

50. The Task Force recommends that the adjudicative functions of securities commissions be transferred to an independent tribunal or tribunals. Membership in the tribunal should be structured so as to ensure its expert knowledge of law, procedure and the operation of capital markets. Consideration should be given to the establishment of a national tribunal which could deploy hearing panels throughout the country as needed.

51. The Task Force recommends that the National Judicial Institute ("NJI") develop programs to prepare judges to manage the adjudication of complex offences relating to capital markets and to understand the contexts in which they arise. The NJI should call upon the Canadian Securities Administrators, SROs, and experienced counsel (for the prosecution and the defence) to participate in these programs.

52. The Task Force recommends the establishment of a separate capital markets court to which jurisdiction, both provincial and federal, is ceded. Such a court would have jurisdiction with respect to all capital markets regulatory offences and could potentially be granted jurisdiction over civil liability cases arising from capital markets regulatory violations.

53. The Task Force recommends that legislatures consider enacting legislation similar to s. 380.1 of the *Criminal Code of Canada*, to specify the aggravating circumstances that must be taken into account in imposing a sentence for offences under securities legislation and the non-mitigating factors that must not be taken into account.

54. The Task Force recommends that, so far as possible, the penalties and orders available for the enforcement of securities laws should be harmonized across the country yet applied with regional sensitivity.

55. The Task Force recommends that ministries and regulators review and harmonize provisions governing costs in securities matters, and consider adopting best practices of other jurisdictions, which should include:

    - authorizing the regulator to order costs in favour of the respondent in appropriate circumstances;

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- developing policies and guidelines regarding the circumstances in which costs may be ordered, the basis upon which costs will be calculated and the manner in which the respondent may test their calculation;
- providing for review of costs orders by a person or body independent of the regulator; and
- providing for the recovery of costs on usual principles, rather than requiring the payment of costs on the basis of full cost recovery to fund the investigation, prosecution and adjudication of securities matters.

56. The Task Force recommends that when regulators identify a course of conduct that breaks no specific provision of securities laws, but arguably contravenes a declared principle of the law and is considered to be contrary to the public interest, they notify the capital markets that the course of conduct is unacceptable and will, if repeated, attract prosecution.

57. The Task Force recommends that the "contrary to the public interest" regulatory tool be used sparingly and only with the greatest care if the behaviour which is criticized has not been publicly identified in advance as unacceptable. Where the behaviour that is criticized has not been publicly identified, the contrary to the public interest provision should only be used if the conduct is egregious and a reasonable person in the circumstances would view it to be contrary to the public interest. If the conduct is not egregious, the public should be duly warned before any enforcement action is taken. The risk that so-called "gotcha" enforcement brings the entire securities enforcement apparatus into disrepute must not be overlooked.

58. The Task Force recommends that

- securities regulators consider utilizing their jurisdiction to apply to courts more frequently for restitution, compensation, and/or damages on behalf of aggrieved persons,
- regulators and ministries should consider whether any further statutory provisions or regulations are required in order to provide the basis upon which these procedures may be invoked, and
- regulators should develop practice guidelines to facilitate appropriate use of these procedures.

59. The Task Force recommends that consideration be given to authorizing securities tribunals to order compensation or restitution in appropriate circumstances.

60. The Task Force recommends that consideration be given to

- authorizing courts adjudicating capital markets offences under provincial or criminal legislation, and in appropriate circumstances, to make orders of restitution and compensation, and
- establishing rules to ensure the fairness of the process.

61. The Task Force recommends that securities regulators and Ministries monitor developments in class actions for failures of disclosure, with particular attention to concerns about the effective management of class actions.

62. The Task Force recommends that the appropriate roles and jurisdiction of SROs in the enforcement of standards within the securities industry and the assessment of penalties be reviewed. In particular, consideration should be given to

    - whether SROs are exercising statutory powers of decision in their discipline jurisdiction and are subject to the protections guaranteed by the *Charter of Rights and Freedoms*,
    - in what circumstances and by what means SROs should be able to obtain production of documents from, and the attendance as witnesses of, former members and other third parties,
    - the means, if any, by which the decisions of SROs should be enforceable against former members, and
    - the circumstances and process by which an SRO could apply to a court for the appointment of a monitor.

63. The Task Force recommends the provision of immunity from civil liability for those acting in good faith on behalf of SROs.

64. The Task Force recommends that regulators consider the extent to which the new processes and requirements which have been established by SROs to provide arbitration and dispute resolution options to claimants should now be required, as a condition of recognition, for all SROs.

65. The Task Force recommends that regardless of whether Canada adopts a unified or harmonized approach to securities regulation, it is fundamentally important that enforcement be managed on a national basis to ensure the effective use of resources, the development and deployment of expert skill and knowledge across the country, and the independence and accountability of enforcement processes.

Conclusion

In conclusion, it is interesting to consider what Canada's capital markets, and their regulation, would look like if the recommendations we have made are adopted. The picture could look like this:

- Young Canadians becoming young investors would be financially literate having benefited from a nationally co-ordinated financial education program.

"Who should be responsible for deciding a client's 'risk appetite' – the investment adviser or the client? In other words, should an investment adviser be responsible for recommending and trading only 'suitable' securities or should the adviser be responsible for only ensuring the client understands what are 'suitable' securities?"

– Global Securities Corporation (written submission to the Task Force in Volume VII)

- Residents tasked with responsibility for selecting investments for their own retirement would similarly benefit from such a program directed and focused as a national priority.
- The alternatives for investment diversification, or concentration, would be thoroughly explained to investors by qualified investment advisers who would disclose the comparative costs of available options. Investment advisers recommending specialized investment products would be qualified to give that advice by virtue of product specific education.
- Investors wishing to be informed prior to an investment decision would be attracted to disclosure presented in a user-friendly manner, readily able to be penetrated and absorbed at varying levels of complexity, to suit their needs and abilities.
- Senior issuers would deservedly have immediate access to the market to raise capital without the delay of regulatory oversight of their offering document.
- Regulators, consequentially, would be able to focus their attention in areas where external gatekeepers are less common and less central to the regulatory system.
- Issuers would benefit from the savings which would result from the end of the "paper world", accepting the reality of the "e-world" being today's disclosure medium for virtually all investment products.
- It would be commonly regarded as a serious mistake in judgment to contravene Canada's securities laws, due to a focused and effective enforcement system – particularly due to the recommendations to invigorate the investigative, prosecutorial and adjudicative functions in the securities law enforcement system.
- Lastly, as a result of the foregoing, the "made in Canada" discount might become a "made in Canada" premium and the competitiveness of Canada's markets would be markedly enhanced.

That was our mandate and our goal. It is now up to others to determine to what extent this vision is achieved.