Canadian Securities Regulation: An Alberta Perspective in the National Regulator Debate

Luncheon Address by

Bill Rice, Chair

Alberta Securities Commission

Knights of the Round Table

January 15, 2008

The Ramada Hotel

Calgary, Alberta

Good afternoon. I am honoured to be here to speak to you on the subject of securities regulation.

It is not surprising that the media would serve up, and that their listeners, viewers and readers would become interested in, white collar crime stories in which individual investors have been financially devastated, major companies have collapsed or fraudulent businesspersons have stolen fortunes. Those kinds of stories compete with the best of fiction. But it is surprising to me that the structure of securities regulation in Canada is paid so much attention when it is not generally understood, it in fact functions comparatively well and it generally evolves in unison with regimes in the other developed countries in the world.

Before I go any further I want to emphasize for you that the structure of securities regulation in Alberta is the responsibility of the Alberta government. It is not the place of the ASC or its Chair to lobby for the preservation of the status quo. However, as a daily participant in the structure at both the provincial and national levels, and an occasional participant at the international level, I do have observations I believe to be relevant to an evaluation of our current system, the criticisms made of it and proposals made for its replacement. My observations, and any opinions you may

infer from them, are my own and are not made on behalf of the ASC.

In evaluating our current system, one must consider its effectiveness in practice and the criticisms levied against it. I will deal first with my observations of the system's record of achievement to date and then the criticisms made against it.

All systems have deficiencies that need to be addressed and all systems must evolve to match changing environments. The Canadian system has had deficiencies, but I would observe that those deficiencies have been and continue to be addressed. The Canadian system has also evolved to adapt to an ever and quickly changing market environment. There are, of course, still deficiencies and there are always new problems. But if the existing system has proven itself capable of effectively dealing with its deficiencies and problems and adapting to the changing environment to implement improvements, one must question whether it is prudent to throw the whole system out and build a new one simply for the reason that the existing system has some unique features when compared to some other countries' regimes. The bottom line is that our current system fundamentally works. Is it prudent to discard a proven system

simply to replace it with one whose optics are more appealing to some?

One relevant question to be asked is: how are we judged internationally? The critics claim that Canada's reputation as a place to do business suffers because of our securities regulatory system. Well, a 2006 study by the OECD (Organization for Economic Co-Operation and Development), measuring the impact of regulation on economic growth, ranked Canada 2nd out of 30 countries, behind only New Zealand. A World Bank Study in 2006 analyzed investor protection and ranked Canada 3rd of 156 countries, behind only New Zealand and Singapore.

Those are only studies, you might say - what evidence is there that our regulation actually has a positive impact on Canadian business or, to counter the critics, does not have a negative impact? Statistics show that between the end of 2003 and the end of 2006 market capitalization of companies listed on the TSX increased by 93%. It was indeed growing elsewhere in the world at the same time. But as a comparison, during the same period of time market capitalization on the New York Stock Exchange grew by 36%, on the NASDAQ by the same 36% and on the London Stock Exchange by 54%. A study by John S. Herold, reported in

a September 2006 edition of the Daily Oil Bulletin, concluded that Canada led all countries in the growth of upstream investment in the prior three years. A quote from the report read: "investment has been pouring into Canada in the past three years."

If one were attempting to evaluate whether Canada's securities regulatory regime had had a positive or negative influence on international perceptions in recent years, one would have to conclude that it was positive, not negative.

Historically, the Canadian securities regulatory system has been criticized for two legitimate reasons: (1) a single participant in the Canadian capital markets had to deal with up to 13 different regulators and (2) a single participant had to conform to up to 13 different sets of laws. Over a course of time those criticisms were addressed with the introduction of the Mutual Reliance Review System in 2000 and the National Registration System in 2004, which essentially provided for the numerous securities regulators to rely on the judgment of only one regulator to issue a prospectus receipt, grant an exemption or register a dealer or adviser and the gradual introduction of substantially harmonized securities laws across the country.

In the fall of 2004 a further major leap was made to address the acknowledged deficiencies. The Ministers across the country responsible for securities regulation, excluding the Minister in Ontario, entered into a Memorandum of Understanding which called for the creation of a “Passport” system, intended to provide a guaranteed single window of access to capital markets for all Canadian participants and for the further evolution of highly harmonized, streamlined and simplified securities laws. The harmonization effort was one in which all jurisdictions, including Ontario, participated and has been successful. With few exceptions, and I would argue that the exemptions are a benefit and not a detriment for regional market participants, securities laws have been harmonized across the country. The Passport System would, but for Ontario’s non-participation, permit a single window of access to the Canadian securities regulatory regime. But for the resistance of Ontario, the longstanding legitimate criticisms have been addressed: a participant will need to deal with only one regulator and only one set of laws.

That is today’s reality. But that is not what we continue to read in media reports.

I have a copy of a speech given by the honourable federal Minister of Finance, to the Canada West Foundation in Calgary on August 30, 2007. This is not the most recent or most forceful pronouncement made on this subject, but I have it for reference because it was made by a very senior federal minister, it is consistent with statements he continues to make, it was presented in Alberta and it is illustrative of statements made by others who persist in criticizing the existing structure and advocating a single national securities regulator.

The Minister first applauds the initiatives of the Passport system I have just described. The Minister then states, and I quote:

> "As I told the provincial and territorial finance and securities regulation ministers, the passport system is simply inadequate for where Canada needs to be."

He then goes on to provide three reasons to support that judgment of inadequacy. The first is that:

> "With the passport system, Canada still has 13 securities regulators, with 13 sets of laws, however harmonized, and 13 sets of fees;".

That is a true statement; but I have to question its relevancy given what I have just described concerning the establishment of a single point of contact and the harmonization of laws. What is the disadvantage for market participants, the users of the system, of there being 13 regulators, when in practice they need only deal with one, and that one is the one in their own neighbourhood? What does it matter for market participants and their professional advisers if there are 13 sets of laws, if the laws are all substantially harmonized? As for the matter of fees, two realities must be accepted: firstly, administration of the system will in aggregate cost the same, whether under one umbrella or 13; and secondly, those provincial and territorial governments who are currently the recipients of the fees are not likely to forego that revenue under any system.

Just this past week, I read a media report of a presentation made by the head of the Canadian Bankers Association to the Competition Policy Review Panel established by the federal government. She advocated the lowering of interprovincial trade barriers in Canada and stated: "The single securities regulator… is the kind of poster child for this situation. People come to this country and they find they have to deal with 13 securities

regulators, and they say ‘you’ve got to be kidding’”. This just isn’t true.

The second reason expressed by the federal Minister of Finance for his judging the inadequacy of the passport system is that:

> “The passport system lacks national coordination of enforcement activities making it difficult to maximize results on this critical part of the system;”.

Now the implication is of course that a national program of enforcement will be better than a provincial and territorial system of enforcement. There are a couple of facts that one should have regard to when considering this argument.

Firstly, provided that the necessary resources are both available and can be afforded, enforcement is most effective when undertaken at the local level. No major city would propose that its policing responsibilities be delegated to a national police agency. Calgary has witnessed violent and non-violent crime since its creation and still endures those same criminal activities. Nevertheless, no one would suggest that a national body centred in Toronto, Vancouver or Fredericton would be more successful

than the City of Calgary Police Department in controlling crime in Calgary.

The second fact of importance is that national agencies in Canada do not have reputations or records of obvious success. Criminal fraud offences, the most egregious of offences within the environment of the capital markets, are the subject of the Criminal Code, a federal statute. Policing of serious criminal fraud in Canada is the responsibility of the RCMP, Canada's national police agency. The criticisms of Canada's securities enforcement regime are that sentences are too light and that the RCMP is not productive. What evidence is there that the replacement of provincial agencies with a national one would lead to more effective enforcement? I don't know on what basis can one even make that argument.

Certainly, it is essential that there be cooperation among regulators in order that there be no roadblocks to effective enforcement and there be no wasteful duplication of processes. The fact is that securities enforcement officers in securities commissions across the country themselves attest that there is excellent cooperation among the Canadian securities regulators as well as between those regulators and both Canadian police

agencies and international enforcement agencies. The police agencies do not disagree with those representations. Their complaint is that they are limited by law in the access they may have to compelled evidence. But that limitation is not the responsibility of provincial securities commissions and will not disappear just because a national securities commission is created.

Both Alberta and British Columbia have provisions in their respective securities acts that provide for the reciprocal granting of enforcement orders by their securities commissions based solely on the existence of an order in another jurisdiction. If an individual has been prohibited from participating in the capital markets in another jurisdiction in Canada, the ASC may make an order for a similar prohibition in Alberta, without proof of an offence in Alberta. Interestingly, in Ontario, where there is heard the loudest complaints concerning ineffective securities laws enforcement in Canada, there are no comparable legislative provisions permitting the making of reciprocal orders. In Ontario, every order must be supported by specific proof of an offence in Ontario, even though an offence may have already have been proven in another jurisdiction in Canada. We would not need the creation of a national securities commission in order for this

deficiency to be corrected in Ontario. To improve the efficiency of the system, Ontario could amend its own laws, but has not done so.

The third reason given by the federal Minister for a national securities regulator is that:

> "The passport does not address our need to improve policy making. It is still necessary to obtain agreement from 13 regulators to make changes to rules."

To begin with, it is not now, and has not been for some length of time, necessary to obtain agreement from 13 regulators in order to enact new, or make changes to existing, policy. The Canadian Securities Administrators or CSA, which is the umbrella body comprised of the 13 securities regulators in Canada, has delegated policy making to a committee entitled the "Policy Co-ordination Committee", comprised of the chairs of the commissions in B.C., Alberta, Manitoba, Ontario, Québec and Nova Scotia. It is the practice that decisions of the PCC are reached by consensus. In that regard a number of observations are relevant.

Firstly, the record shows that, in fact, consensus is reached, changes are made and stalemates are rare. Evidence of all of that can be seen from the volume of regulation that the CSA generates and the harmonization of its application that has been achieved across the country. If logjams were the rule, the financial and related professional communities would not be continuingly complaining about the torrent of new and ever-changing rules they must observe.

Secondly, because the CSA exists as a result of the cooperative agreement of all jurisdictions and does not have binding authority on its members, in the absence of consensus, jurisdictions are nevertheless free to enact changes they consider to be essential to the interests of their constituents. The rule changing process does not have to await total consensus. Jurisdictions can act on their own.

Thirdly, it is interesting that the criticism of Minister Flaherty which complains that agreement is required from 13 regulators is made only a few paragraphs away from the claim that one of the benefits of a single national regulator would be that all regions would have a “real say”. With respect, I think that the Minister is advocating contradictory positions. If it is desirable that all

regions have a real say, we have already achieved that desirable result under our current consensus system and it needs no change. If it is intended that a single national regulator would do away with the necessity of agreement among jurisdictions, then it will also do away with the stated desirable feature of all jurisdictions having a real say. One cannot both abolish the consensus model and retain a process wherein all have a real say. One cannot have both a hierarchical decision mechanism and a system built on the consensus model.

Having summarized the three aforementioned problems with the Passport system: that it leaves us with 13 regulators and 13 sets of laws; that it does not provide for a national coordination of enforcement activities; and that it does not do away with the consensus model, the Minister proceeds to propose the better answer. He states that the benefits of a common securities regulator are well known. If they are well known it is because they continue to be repeated, but they are certainly not well understood and I would suggest that they are very often misrepresented.

The first alleged benefit of a common securities regulator is that it will “lead to more investment and jobs”. With all due respect, I

think this alleged benefit is preposterous. There is no evidence that the number of securities agencies in a country - be they just right, too few or too many - has anything to do with investment and jobs. What actually matters is whether there are strong companies in a country worthy of investment. Secondarily, an investor might inquire whether in that country the securities regulatory system has integrity, whether it is comparable in substance to that of other recognized jurisdictions, whether it is more expensive for participants than comparable jurisdictions, and whether participants must undertake a more time consuming process than in comparable jurisdictions. All anecdotal evidence and all comparative research suggests that Canada ranks at the top of the scale for integrity, legal substance, cost and speed. There is neither fact nor logic that would argue for a common securities regulator impacting positively on investment or jobs.

The next benefit enumerated by the federal Minister is that a common securities regulator would protect investors. I do not understand how it would do this any more effectively than is done under our current system. Would a common regulator result in a change in Canada's laws of evidence in criminal proceedings? Would it improve the investigative efficiencies of the RCMP? Would it cause judges to deliver more harsh sentences for white

collar criminals? Would it be funded by the federal government with so much money that it would pay back all the losses incurred by defrauded investors? Would it be able to hire more clever and diligent enforcement personnel in Calgary than the ASC is able to currently hire? I may be confessing my own lack of vision, but frankly, I can't see the basis for answering any of those questions in the affirmative.

The next benefit cited by the Minister is that the common regulator would save money. It is not likely that the setting up of another layer of national bureaucracy somewhere in central Canada is going to make securities regulation in Vancouver or Calgary less expensive. The costs for participants in the capital markets in Canada now compare favourably to those for participants in other countries. What magic will this newly structured regulator perform to reduce costs in this large and varied country? No study has ever demonstrated how an alternative national structure will save money. I am inclined to the view that, with all the attention historically paid to this subject, if it could be shown how a national regulator could save money, it would have been shown by now.

Lastly, it is alleged by the Minister that a common regulator would give all regions a real say. As discussed earlier, we all have a real say now. If there is to be a substantial change in that circumstance it can only result in us not having a real say.

I want to go back to the subject of enforcement because this is the area where people are generally being made unhappy and most concerned. The Minister stated in his address that a common securities regulator would better protect investors through attributes that would provide for: a common set of sanctions and remedies; a single point of contact for law enforcement agencies to share information and detect market fraud; clear enforcement priorities across the country; and the efficient deployment of investigation and enforcement resources.

On the point of common sanctions and remedies, there is no evidence that white collar criminals move from jurisdiction to jurisdiction in this country in search of lesser sanctions. In any event, there is no evidence that one jurisdiction would demonstrate a pattern of treating offenders less harshly than other jurisdictions. There is always the possibility that one individual, one enforcement team, one panel or one judge would make a sanction order that would differ from someone else's, but

this is the case in respect of all administrative, criminal or quasi-criminal bodies. Under a single common securities regulator, there would still be different enforcement teams, different administrative panels and different judges involved in different cases. Total consistency is impossible, but even if it were possible, I would argue that that circumstance neither adds nor detracts from the deterrence factor.

In respect of establishing a single point of contact for the sharing of information, there is no evidence that our current system suffers from a lack of sharing of information. Domestically, securities regulators communicate and share information regularly across the country and regulators share with criminal enforcement agencies to the extent the law permits. I suggest that the current system is more efficient in this regard than a national system would be because the agencies are now in close proximity to one another in the very jurisdictions where the information is relevant.

At the international level there is an open exchange of information between the Canadian regulators and all of the state regulators in the U.S., the SEC and the state attorneys general. Each of the bodies is free to and does frequently go directly to the best identified source of the required information. Canadian

enforcement is not deficient because of any lack of information sharing by or with Canadian securities regulators.

To address the last two attributes of a national agency applauded by the federal Minister, I suggest that the setting of national priorities and the national deployment of investigation and enforcement resources would be detrimental to those jurisdictions that are not host to the biggest defaults, strongest criminal elements or most visible crimes. It is hard to believe that in setting national priorities and allocating national resources, issues of illegal distribution in Grande Prairie, Alberta would receive the same level of attention as organized crime issues in Montreal, Québec. Conversely, there has never been any suggestion by the AMF in Québec or the OSC in Ontario that their resources are spread thin for the reason that enforcement teams are independent and active in Alberta and British Columbia. I would suggest, to the contrary, the existence of separate teams in Alberta and British Columbia allows the AMF and the OSC to address freely the priorities of their own jurisdictions.

One of the remaining and often expressed criticisms of our current structure is that it does not recognize the modern day globalization of the capital markets. That is such a broadly stated

criticism that it is difficult to know what it really is. The generalization is expressed in terms that the world has changed, markets are global and Canada must speak as one voice on the global scene. I would point out a couple among a number of facts that should be understood in addressing this generalization.

Firstly, Canada's capital markets represent some 2 - 3 % of the world's total. Our influence is limited very much by the fact that we are not particularly relevant on the global scene.

Secondly, only a small percentage of Canadian public companies play in the global markets. It is estimated that over 80% of reporting issuers in Canada are small and medium sized companies. For this vast majority, there must be a viable domestic capital market in which initial public capital can be raised and in which public companies may grow until they are of a size to enter the global arena. Most of Canada's public companies are just too small to attract any attention, nevermind interest, in the global markets. It is true that the globalization of capital markets has occurred and is continuing, but only at a certain level and Canadian securities regulation cannot be restricted to the small percentage of Canadian participants at that level. Furthermore, for the large Canadian public companies that

enter the global markets, they are likely to choose to have their securities traded on an exchange in the United States where they may gain access to a larger pool of investors and greater liquidity. Canadian issuers are not running away from 13 Canadian securities regulators when they migrate to the New York Stock Exchange. Rather, they are deciding to endure regulation by the SEC in order to participate in the depth and liquidity of the U.S. market.

Those are some of my observations on the effectiveness of our current structure and the common criticisms made by persons advocating for the replacement of that structure with a national securities commission. The expression of my observations should not be interpreted so to conclude that I see no deficiencies or problems with our current system. There are deficiencies and there are problems. But I happen to believe that if all members of the CSA were so directed, the current structure would prove to be the best structure from which to address the deficiencies and problems. If we could end the distracting debate on structure and concentrate on solving the deficiencies and problems, the capital markets would be better served.