

# **Separating Fact from Fiction**

## **Canadian Securities Regulation in the 21<sup>st</sup> Century**

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**Check against delivery.**

#### **Introduction**

I would like to thank the Economic Club of Toronto for giving me this opportunity to speak to you today about Canadian securities regulation. The recent turmoil in global financial markets has reminded us why we need efficient and responsive regulation for Canada's markets. It has also added another dimension to the seemingly endless debate in this country about whether our decentralized regulatory structure is up to the job.

It is natural and appropriate to challenge our public institutions. Healthy debate and a continual search for improvement are how we make progress.

If we really want to improve securities regulation, though, let's debate facts, not myths. Sadly, many of those who speak confidently about what we need to do to improve Canadian securities regulation seem uninterested in facts — particularly if they get in the way of a preferred solution.

I'm here to bring a dose of reality to this debate by talking about what's really happening in Canadian securities regulation and what we need to do to move forward.

- I'll explain how the Canadian Securities Administrators are making real progress in streamlining regulatory processes. We are focusing on effective investor protection while others continue to debate structural change.
- I'll explain why many comments you hear about Canada's enforcement record miss the mark — particularly the comparisons with enforcement in the United States. They ignore features of our legal system that have nothing to do with regulation or how it is organized.
- And I'll comment briefly on the misinformation that surrounds the so-called "common regulator" debate.

As the title of this speech says, I am going to attempt to separate fact from fiction to promote a more informed discussion about the important challenges facing the Canadian securities market and how best to deal with them.

#### **CSA — A record of accomplishment**

For more than 70 years, the Canadian Securities Administrators has been a forum for our provincial regulators to share ideas, assist each other, and work on common solutions to common problems. In the past dozen years, we have significantly ramped up the CSA's work to make Canadian securities regulation more efficient and more effective. Our Policy

Coordination Committee meets bi-weekly to review and approve all regulatory projects and the output is impressive.

Let me cite just a few of CSA's recent accomplishments.

- *Harmonization* — First, we have harmonized, indeed made uniform, most of the regulatory requirements governing our markets. We have projects underway to harmonize most of what's left.

We now adopt almost all of our new rules in the form of national instruments, which are virtually identical in all provinces.

- *Coordination* — Second, we have efficient processes to coordinate regulatory decisions.

The prospectus system, for example, allows a public company to deal directly with only one regulator and clear a national public offering very quickly. This process gives the lie to the myth that financing in Canada involves dealing with 13 regulators and 13 different sets of laws.

- *Electronic filing* — Third, we have national electronic systems for market participants to make regulatory filings and obtain regulatory information.

These systems simplify dealing with regulators and provide a central repository of useful information for regulators, investors and industry.

We are now building on these accomplishments to take cooperation and coordination to a new level. By the spring of 2008, our new passport system will give public companies single window access to the market across Canada, based on a set of harmonized rules.

### **Passport — Raising our game**

So, what is the passport system?

The concept is really quite simple.

A public company will get a decision from the regulator in its home province to grant a prospectus receipt or a discretionary exemption. That decision will apply automatically in each other province, with no human intervention. Similarly, an investment firm or representative already registered in the home province can register automatically in each other province, with the same conditions of registration applying everywhere.

This system will make dealing with regulators simpler, faster and cheaper.

- **Simpler** — You will need only one decision, from your home province regulator.
- **Faster** — You won't have to wait for other regulators to opt-in.
- **Cheaper** — You can cut professional costs for dealing with multiple regulators.

Last spring we published a proposed rule to implement passport. Public comments generally supported passport as an improvement but we heard some concerns. Let me deal with them.

- *Fees* — You will still pay most types of fees to all jurisdictions.

I know that's a bone of contention, but let's put it in perspective. Fees are a small fraction of the overall cost of conducting an offering or carrying on business.

Harmonization and passport will, however, help reduce the much larger costs of complying with regulatory requirements.

Governments plan to review fees in light of passport. Don't expect a significant reduction, though. Most fee revenue is plowed back into the nuts and bolts of regulation — keeping rules and policies up to date; educating investors; examining compliance; investigating complaints and suspicious activity; taking enforcement action. Industry will continue to pay for these things under any conceivable system of regulation.

- *Harmonization* — We still have some non-harmonized requirements. Some people are concerned that provinces will keep those or bring in new ones. Let me say two things about that.

First, you should take comfort from our track record. We have made huge strides in harmonizing and we intend to continue. If the regulators' spirit flags, the Council of Ministers will press us to keep moving.

Second, though, we will always have some regional differences. We shouldn't apologize for that. Canada's a big country and regional markets differ. We have the flexibility to deal with regional problems that aren't national priorities.

The BCSC is just now proposing some targeted requirements for people in British Columbia who trade in the US over-the-counter markets. Abusive trading in those markets isn't a big issue east of the Rockies but it's big for us. We're determined to deal with it through local action, but in a way that doesn't undermine passport or our general commitment to harmonization.

- *Consistency* — Some people worry that, even if the law is harmonized, we might interpret or apply it inconsistently.

This is a risk in any multi-office organization. How many of you have noticed that our single national air transport security agency applies different standards in screening passengers at different airports? I've seen a carry on bag that sailed through at Pearson get sent back in Winnipeg. Apparently, the staff in Winnipeg have a different interpretation of the plastic bag rule.

CSA recognizes this risk and we have strategies to deal with it. We won't be perfect — no organization is — but you'll point out our inconsistencies and we'll deal with them.

- *What about Ontario?* — Can we make passport work despite Ontario's decision to stay out?

Yes, we can.

Passport would be better with Ontario in so all Canadians would benefit equally. We know that Ontario has another dream, which other provinces don't share — to create a common securities regulator. But we can't let dreaming interfere with real progress now.

We are moving forward with a set of interfaces between Ontario and the passport provinces. To achieve maximum efficiency for the benefit of the market, the passport regulators will accept the OSC's decisions under passport, even though it won't accept ours. The result, ironically, is that market participants in Ontario will see the greatest benefit from passport. They get access to all of Canada through the OSC. Others have to deal with their home regulators and the OSC.

We considered whether to disadvantage Ontario issuers, to give Ontario an incentive to join passport. We think it's better to do as much as we can to improve efficiency, and leave the politics to others.

Passport will be in place next year, beginning with issuers in the spring. Real progress in real time.

### **Enforcement — what's the real story**

Let me turn to Canada's record of enforcing securities laws.

Public criticism of securities enforcement has now replaced hockey as Canada's national sport. Unfortunately, the play-by-play announcers don't know hooking from icing. And they naïvely think that Canada would win the Stanley Cup every year if we had a single team. That team would presumably be the Leafs.

It is fair to criticize Canada's overall enforcement record against securities fraud. It isn't fair, or helpful for finding a solution, to point the finger at securities regulators for problems in the criminal justice system.

The media delivers an endless stream of commentary that makes no distinction between regulatory and criminal enforcement. How many times have you heard the complaint that Canadian regulators never send crooks to jail?

Guess what! Regulators have neither the responsibility nor the authority to send people to jail — that's the job of police, prosecutors and courts.

Those who attack our enforcement record point to tough US enforcement actions and say we need to change Canadian regulation so we will measure up. But the major disparity between Canada and the US is in the criminal justice sphere — not regulatory enforcement. Most of the US cases cited as examples of tough enforcement are not regulatory matters at all, but criminal cases prosecuted in court by the US Department of Justice or state attorneys general.

Less active criminal enforcement against securities fraud in Canada reflects two differences. First, Canadian courts generally impose lighter sentences than US courts for all types of crime, because of differences in the social and legal cultures of our countries. Second, our criminal justice system takes white collar crime less seriously in relation to violent crime than does the US system. The combined effect is that Canada has fewer securities-related prosecutions and convictions than the US and we impose much lighter sentences for securities fraud.

If Canadians want stronger deterrence against securities fraud, our governments have to remove the obstacles in the criminal justice system. Pointing fingers at regulators or getting rid of provincial regulation will do nothing to strengthen criminal enforcement.

Criminal and regulatory enforcement serve different but complementary purposes. Criminal enforcement punishes wrongdoers for past misconduct. Regulatory enforcement protects investors and markets from future misconduct. Both provide deterrence but in different ways.

Criminal enforcement offers more serious penalties, including jail, and the stigma of a conviction. It requires proof beyond a reasonable doubt. Strict rules govern how authorities can obtain and use evidence. The accused has a right against self-incrimination.

Regulatory enforcement, by contrast, offers less severe sanctions — monetary penalties and disqualification from the market — but is more flexible. The standard of proof is lower, as are the thresholds for gathering and using evidence.

Because of these differences, the courts have drawn lines between the two processes, so authorities can't use regulatory investigation powers to conduct a criminal investigation. Regulators and police can and do cooperate, but there are limits and we cannot intertwine the processes.

Regulators are working on improvements to our own enforcement programs, but we already do quite a lot. The CSA produces a semi-annual enforcement report summarizing our activities. The latest report, for the six months to March 31, 2007, shows that CSA members commenced 65 proceedings, issued 66 interim enforcement orders, ordered sanctions in 32 cases and concluded 37 settlement agreements. During the same period, the self-regulatory organizations we oversee issued 19 enforcement decisions and concluded 21 settlement agreements.

As an example, the BCSC's enforcement division — with 20 investigators and 11 lawyers — has processed over 10,000 calls to our inquiry line over the past six years; we opened over 2500 files, investigated over 180 cases, held 125 hearings, and concluded over 115 settlements with 188 parties. In the last year, the average time from case opening to completion was 22.8 months.

This reality shows that, at the regulatory level, Canada is not the “enforcement-free zone,” of popular mythology.

Nevertheless we are working both individually and collectively to improve the effectiveness of regulatory enforcement.

Our staff already work well together in sharing information and providing assistance. We are now getting more strategic in identifying trends. We want to intervene sooner to disrupt scams before they harm a lot of investors. We are using new statutory powers to impose reciprocal orders based on enforcement actions in other jurisdictions. We are linking

investor education and enforcement to warn investors about abusive or illegal schemes, even before we can take overt regulatory action. We are also trying to shorten the time it takes to complete enforcement files. In all of this, we face a constant battle against efforts to delay investigations and formalize our processes.

The major problem we face, though, is that Canada relies too heavily on regulatory enforcement to deal with serious fraud. Because our criminal justice system largely ignores these cases, we divert regulatory resources away from regulatory violations, for which our powers are best suited, and toward serious fraud, for which they provide an inadequate deterrent.

For that reason, we need to mobilize our criminal justice system to attack securities fraud.

### **Efforts to Strengthen Enforcement**

Let's look at the efforts that have been undertaken to strengthen criminal enforcement. In 2003, the federal government announced a plan to create new Integrated Market Enforcement Teams within the RCMP. Although the commitment was welcome, the results have been disappointing. Despite spending about \$100 million on this program so far, the federal government has achieved almost nothing. The Minister of Finance recently appointed the retired Superintendent of Financial Institutions, Nick Le Pan, to advise the RCMP commissioner how to salvage the IMET program.

IMET's problems are not new or unexpected. The RCMP commercial crime division units have for many years had difficulty developing and retaining the expertise necessary for this type of work.

In the mid-1990s, the BCSC attempted to develop a criminal deterrent against securities fraud by funding for three years a Securities Fraud Office, comprised of additional RCMP officers and a special team of crown prosecutors. The results were disappointing. The RCMP told us when it started the IMET program that it had learned from that experience, but it appears that little has changed.

By commissioning the Le Pan review and allocating additional funding to the RCMP, the federal government has signaled that it is giving them another chance to show that the IMET program can succeed. Fair enough. But, given the years of experience, isn't it time to consider other options? What can we do to bring to this job the energy and skills needed to make a difference?

In parallel with this review, securities regulators are working with justice officials and police to identify options for strengthening investigation and prosecution. The Securities Fraud Working Group is co-chaired by my colleague David Wilson of the OSC. They will report to justice ministers in November with recommendations for improvement in the criminal justice area.

We know that Canadians would like our justice system to treat securities fraud more seriously. The CSA recently surveyed Canadians on their experiences with and attitudes

toward investment fraud. The results, to be released in October, show most Canadians agree that the “impact of investment fraud can be just as serious as the impact of crimes like robbery and assault.”

That view is consistent with an earlier study we did on the victims of a large mortgage broker fraud in British Columbia. We found that investors suffered serious harm to their retirement security, emotional well-being, physical health, friendships and marriages.

Canadians do not feel that the authorities treat investment fraud as seriously as other crimes. They think that people who defraud others “generally get away with it.” Unfortunately, they’re right.

Canada will have to work hard to fix this problem. Our focus should be on changing the dynamics in the criminal justice system, not on blaming provincial regulation.

### **Single Regulator Debate**

Let me conclude with a few remarks about Canada’s never ending single regulator debate.

Most speakers are able to get a cheap laugh when introducing this subject, by comparing Canada to Bosnia-Herzegovina. One-liners are more fun than reality, but they won’t help you understand how our system works or what the alternatives really offer.

Canada has debated for decades whether some form of national securities commission should replace our decentralized system of provincial regulators. This is a legitimate public policy debate. But, in their zeal to promote their favoured option, the proponents of a national regulator have been making statements that are untrue and harmful to Canada’s capital markets.

Here are some examples.

*Proponents regularly say that Canada is the only major country that does not have a single securities regulator.*

That statement is false.

Let’s focus on the large market economies of the world — the G7. Three of the G7 countries are federations, and all three of those regulate at the sub-national level. Both the US and Germany have significant state regulation, in addition to federal regulation. The Frankfurt Stock Exchange, one of the world’s largest exchanges, is regulated not by the German federal authorities but by the Exchange Supervisory Authority in the state of Hesse. Do German bank executives call that a national embarrassment?

Another variation we hear is that Canada is the only country that doesn’t have a common securities regulator. That term refers to the model proposed by Purdy Crawford’s panel for the Ontario government. Common regulator supporters emphasize that it would not be a federal agency but a new type of body — a single regulatory

agency operating under 13 or 14 identical securities acts and reporting to 13 or 14 governments. No other country that has a structure like that!

*Proponents constantly claim that a national regulator would strengthen Canadian enforcement and make it more like that in the US.*

It's not true that centralizing regulation would necessarily improve enforcement.

I've already pointed out that the greatest need for improving enforcement is in the criminal sphere, which is quite separate from regulation.

You should also know that the majority of regulatory enforcement actions in the US are at the state level, not the federal level. The SEC takes about 600 enforcement actions each year. State agencies take about 1400. Single regulator advocates in Canada like to pretend that state regulation doesn't exist in the US, but it does — and it's an important part of the investor protection system.

If we didn't have provincial regulation in Canada, we would probably have to invent it. Securities regulation has to deal with activity at all levels — international, national, and local. It's relatively easy to do national and local regulation through a single agency in a country that's entirely in one time zone. It's much harder in a country that spans a continent, which is why the state regulators play such a crucial role in the US. Monitoring and investigating illegal and abusive market activity requires boots on the ground, people in the area who know the market players

I'm sure some of you are now bursting to point to Australia, which had state regulation and now has a single national commission. The Australian Securities and Investments Commission deals with local issues by having a substantial office in each state and territory and it seems to work for them. Would it work for us? Maybe. Maybe not. National institutions in Canada tend to be highly centralized. Regional offices are generally remote outposts with little influence. Would we be able to attract and retain in our regional offices the kind of talent needed for this work? I wouldn't count on it.

*Proponents claim that we are too slow in developing and implementing new rules.*

We hear that complaint a lot. We also hear the opposite complaint from those on the receiving end of our rules. Some say we are too fast, and that industry can't keep pace with our rule-making initiatives. Perhaps the truth is that we have the speed about right.

Let's compare how we fare against others.

A few months ago, I attended a presentation by an eminent professor from Columbia University, who told the audience that the SEC has ramped up the pace of its policy processes. As an example, he pointed out that the SEC had concluded that rapid dissemination of corporate disclosure through the internet meant the traditional one-year hold period for private placements was unnecessarily long. As a result, the SEC had published a proposal to reduce the hold period to six months. If Canada's regulators



can't keep up with this kind of innovation, he thundered, Canadian markets will become even more uncompetitive.

It might surprise the good professor to learn that Canadian regulators actually noticed the internet some years ago, and that we came to the same conclusion. As a result, we reduced our hold period from 12 months to 4 months. That was in 2001. We aren't too worried about falling behind our US colleagues on this one!

Indeed, Alberta and British Columbia pioneered this change in 1998. Demonstrating one of the strengths of our decentralized system — innovation — our successful implementation in the west led to national adoption a few years later.

*Proponents claim that our regulatory system puts Canada at a competitive disadvantage.*

Canada's capital markets are actually very competitive.

The president of the TSX recently said that Canada is the best market in the world for publicly financing small and medium sized companies. That doesn't sound like a disadvantaged market. I would suggest that our regulatory system has contributed to Canada's success by facilitating the development of innovative approaches like bought deals, special warrant offerings, and capital pools.

If ditching provincial regulation for national regulation would make a country's capital markets more competitive, we would expect to see Canadian companies rushing to list in Australia. In fact, the reverse is true. There are 19 Australian-based companies listed on Canadian exchanges and only 6 Canadian companies listed on the Australian Stock Exchange.

*We recently heard that provincial regulators were "unable to cope" with the summer credit crunch.*

There is simply no basis for that statement.

Coping with the credit crunch had little to do with securities regulation. It fell mainly to central bankers and financial institution regulators. We've been in touch with them and we've handled our part just fine. Securities regulators are considering longer term policy implications but we are being careful not to over-react.

We often hear that foreigners think Canadian securities regulation is weak and ineffective. Why do suppose that is so? Maybe it has something to do with Canadians running off to New York and London to criticize our system, spinning the same misinformation abroad that they do at home. For most foreigners, what they hear from our self-appointed experts is all they know about Canadian regulation.

The kinds of statements I've been describing create a false impression that Canada's securities regulatory system is not effective. It's fine to propose and argue for structural or other changes to make our system better. I've argued for reforms myself. But it's

irresponsible to promote an alternative by using misinformation to denigrate our regulatory system, which actually stands up well in international comparisons.

Let me emphasize that the British Columbia Securities Commission neither supports nor opposes creating a single regulator for Canada's markets. What we do oppose is advocating a single regulator, or any other type of reform, on the basis of mythology.

We constantly hear that it's a no-brainer for Canada to adopt the common regulator proposed by the federal government and Ontario. I don't accept that.

No other country has tried a structure like that for securities regulation and we in Canada have never tried it for anything else. Some will tell you that the Canada Pension Plan Investment Board is a good model for how this can work. It isn't. The functions of that board are in no way similar to those of a regulatory agency that adopts law, makes regulatory decisions, investigates misconduct and determines what's in the public interest.

The proposal relies on provincial legislatures to delegate the authority to make laws to an agency over which individual governments have almost no influence. The Ontario government is reluctant to give that kind of discretion even to the OSC, over which it has power of life and death. Does it really expect others to accept what it won't?

The fact is that the common regulator proposal involves a leap into the unknown.

Our current regulatory system works reasonably well but, like all human creations, it has faults. It's far too easy to construct a fictitious alternative that has no faults and say that reality doesn't measure up.

A common regulator, or any other form of single regulator, would have its own faults.

Before deciding whether to make this kind of change, Canada should do a hard nosed assessment of how the proposed alternative would really work — based on facts, not myths — and whether any likely benefits are worth the costs and risks of transition.

Finally, I want to point out that the campaign for a common regulator pits province against province, at a time when Canada does not need divisive influences. By contrast, the passport system is inclusive. The best way forward for securities regulation would be for everyone to get behind the passport system and the progress it offers. Maybe it will ultimately lead to a single regulator. Maybe it won't.

Either way, it offers real progress in real time. That's better than a dream.

Thank you.