

# **Securities Regulation in Canada:**

## **An Inter-Provincial Securities Framework**



***Discussion Paper***

**June 2003**

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# **Securities Regulation in Canada:**

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Effective securities regulation is key to investor protection and efficient, vibrant and competitive national and local capital markets.

Many stakeholders have expressed concerns about the ability of the current securities regulatory framework in Canada to keep up with the pace of change. At the same time, investor confidence has been shaken by substantial downturns in world equity markets and corporate scandals in the United States.

In recent years, all of Canada's provinces and territories and their securities regulatory authorities have made significant progress towards a more harmonized securities regulatory framework. Provincial and Territorial Ministers recognize that even more needs to be done to make the framework efficient and effective and they understand the importance of addressing the issues raised by stakeholders.

Ministers have agreed to work together to identify improvements to the existing framework that will inspire investor confidence and create a more efficient, streamlined and effective securities regulatory framework. The initiative is being led by a Steering Committee of Ministers, chaired by Alberta's Minister of Revenue, and includes the provincial Ministers responsible for securities regulation in British Columbia, Saskatchewan, Manitoba, Ontario and Québec.

This paper sets out the goal and principles that will guide Ministers in this reform initiative and the issues identified by stakeholders. It then proposes a system to be considered by all provinces and territories that would be an important step forward in addressing many issues in the short term, while leaving the door open for future improvements.

Ministers are seeking the views of stakeholders on how to build on the strengths of the current framework to better meet the needs of Canadian investors and market participants. After sections two and three of this paper are questions that may be useful in structuring your comments.

Please send your written comments in hard copy or, preferably, in electronic format to:

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**The deadline for all submissions is July 15, 2003.**

Please direct any questions regarding the content of the discussion paper with your contact information to [securities.submissions@gov.ab.ca](mailto:securities.submissions@gov.ab.ca).

All comments and opinions received in response to this discussion paper will be shared with provinces and territories and become the property of the provincial and territorial governments of Canada. While personal or confidential business information will be protected where possible, the provinces and territories reserve the right to publicly disclose the submissions in accordance with freedom of information and protection of privacy legislation. A summary of the submissions will be made public and will be posted on the Alberta Revenue website.

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# 1.0 Introduction

## 1.1 Background - Need for an Inter-Provincial Securities Initiative

Capital markets are evolving at an unprecedented rate. The convergence of financial service providers, international competition for investment opportunities and capital for economic growth, and advances in information technology are reshaping the world of finance.

The forces of change will continue to affect markets in coming years. Regulators, industry representatives and legal practitioners have suggested that the securities framework can be further improved, particularly by reducing the barriers faced by issuers and registrants that wish to access markets in more than one jurisdiction in Canada.

In response, Canadian securities regulators have initiated a number of substantial reforms to harmonize and streamline the rules and administrative practices in the securities field. The Mutual Reliance Review System (MRRS) and the System for Electronic Document Analysis and Retrieval (SEDAR) were developed and adopted in the late 1990s. More recent initiatives include the National Registration Database (NRD) and the System for Electronic Disclosure by Insiders (SEDI), which are now being implemented. In addition, the Uniform Securities Legislation (USL) project, a major initiative of the Canadian Securities Administrators (CSA), will propose amendments to securities laws and rules to eliminate a significant majority of the remaining differences in laws.

These advances in harmonizing securities regulation should not be underestimated. Nevertheless, many participants in Canada's capital markets have advocated a more comprehensive approach to reforming the securities regulatory framework across Canada. The active support and involvement of provincial

and territorial governments is vital for any successful reform to the securities regulatory framework.

In mid-February 2003, the ministers responsible for securities in Alberta, British Columbia, Ontario and Québec met to discuss the potential for a securities reform initiative driven by provinces and territories. In subsequent discussions, all provincial and territorial ministers personally committed to making significant reforms to the existing framework that will build upon the work of their regulators. Ministers have set an ambitious timeframe: a concrete action plan for the establishment of an improved provincial/territorial approach to securities reform is targeted for development by September 30, 2003.

In addition to this provincial-territorial initiative, the federal government has established a seven-person committee to study ways to improve the securities regulatory framework in Canada. This committee will report to the federal Finance Minister by November 30, 2003. The Wise Persons' Committee came into being on the suggestion of Harold MacKay in a report to the federal Finance Minister John Manley in November 2002. While the federal Wise Persons Committee may be a source of input to the inter-provincial securities initiative, securities regulation is an area of provincial jurisdiction and leadership for reform must come from the provinces and territories.

Additional sources of input could include the Final Report of the Five-Year Review Committee on Ontario's Securities Laws which was released recently and the British Columbia Securities Commission's legislative proposal called "*Securities regulation that works - the BC Model*" which has been published for comment.

## 1.2 Goal of Inter-Provincial Securities Initiative

Ministers identified the goal of the reform initiative. It is:

*To develop a provincial/territorial framework that inspires investor confidence and supports competitiveness, innovation and growth through efficient, streamlined and cost-effective securities regulation that is simple to use for investors and other market participants.*

## 1.3 Principles of the Inter-Provincial Securities Initiative

Ministers also identified the following principles that will be used to assess the appropriateness and effectiveness of the changes being considered:

- ◆ **Highest standards of investor protection that are effectively and consistently applied**
- ◆ **Efficient and cost-effective, streamlined and simplified, regulation**
- ◆ **Able to adapt to future marketplace changes**
- ◆ **Transparency, accessibility and accountability for stakeholders, within a clearly defined framework for accountability to governments**
- ◆ **"Harmonized" securities laws and rules, with well-defined parameters for exceptions to accommodate local and regional differences.**

A new regulatory structure must significantly improve the current framework, addressing most, if not all, of the issues raised by stakeholders.

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## 2.0 Existing Structural Regulatory Issues

Some of the key concerns expressed by market participants about the current regulatory structure include calls for: greater efficiency in regulating issuers, registrants and others; more streamlined and simplified regulation that reduces the compliance burden on market participants; more responsive regulation; and better enforcement. This section includes some overview comments, followed by an outline of the structural issues. The tables embedded in the text describe the CSA's many initiatives that respond to the issues.

### 2.1 General Issues

#### Dealing with Different Laws

Over the years, reporting issuers and firms in the securities industry operating in more than one jurisdiction have noted significant direct and indirect costs incurred in identifying and complying with inter-jurisdictional variations in laws, rules and administrative procedures.

As part of their efforts to address this concern, the CSA has harmonized many regulatory

requirements. More recently, the CSA has set up a committee of Securities Chairs and Vice Chairs to formulate and propose uniform securities laws that would apply throughout Canada. The committee reviewed existing securities legislation in Alberta, British Columbia, Manitoba, Ontario and Québec to identify best in class among existing provisions. On January 30, 2003, the CSA released a discussion paper outlining the securities regulators' proposals for a uniform law (see



Table 2.1 Uniform Securities Legislation (USL) Project). Going forward, it is recognized under the USL proposal that, if the USL proposal becomes law, it will be important to establish a workable mechanism to identify and adopt common legislative amendments on a timely basis to maintain uniformity.

### **Complexity of Laws and Rules**

Some commentators characterize existing securities laws and rules as complex, prescriptive and voluminous. Although some degree of complexity in securities regulation is unavoidable given the complex nature of capital markets and many of the instruments and activities involved, regulation should be clear and avoid being duplicative or excessive relative to its benefits. While much of Canadian securities regulation has, in fact, already been

made uniform through the cooperative efforts of Canadian regulators, complaints about the regulatory burden (in dollars and time) continue. Legislative harmonization, at least in key areas, may be a necessary but not sufficient solution to the problems raised by stakeholders.

An efficient, effective, streamlined and simplified regulatory framework remains an important, as yet unrealized objective.

As well, some commentators have argued that the current regulatory structure has hindered the ability of Canadian capital markets to compete internationally. Given the size and make-up of Canadian national and local capital markets, it is important that the securities regulatory framework be structured so that it is as efficient, effective, streamlined and simplified as possible to enhance Canada's ability to attract investors and issuers.

### **Table 2.1 Uniform Securities Legislation (USL) Project**

- ◆ In recognition that each of Canada's provinces and territories have different securities legislation, in the fall of 2001, the CSA embarked on a project to develop, within two years, uniform securities legislation for the consideration of governments across Canada. This project, known as the USL Project, is the CSA's top priority and is part of a broader proposed regulatory reform strategy to reduce the burden of regulation on market participants and make regulation more effective in protecting investors and preserving market integrity.
- ◆ Although the primary focus of the USL Project is to harmonize securities legislation, the CSA has taken the opportunity to simplify and streamline the regulatory framework in areas where this complementary goal can be achieved within the project timeframe. Once the common platform is in place, further initiatives aimed at rationalizing and streamlining the legislation can proceed.
- ◆ The Concept Proposal outlines proposals for the harmonization of securities legislation developed during the study period. In some areas, substantive changes to current laws are contemplated. For the most part, proposed changes are either well-advanced CSA initiatives for which the USL Project presents an ideal opportunity to make necessary legislative amendments, or proposed changes that would further the project's complementary goal of streamlining and harmonizing the framework of securities regulation in Canada. The most significant proposed policy changes are:
  - ▶ A streamlined and uniform securities act with details contained in regulations to allow future changes to be made in a timely and harmonized manner through the rule-making process.
  - ▶ The ability for a securities regulator to delegate decision-making across all regulatory functions to another securities regulator.
  - ▶ A streamlined system for inter-jurisdictional registration of investment firms and individuals.
  - ▶ A civil liability regime for secondary market participants.

See [http://www.albertasecurities.com/documents/58/Proposal\\_235.pdf](http://www.albertasecurities.com/documents/58/Proposal_235.pdf) for further detail on the USL.

## 2.2 Detailed Structural Issues

In elaborating on these general issues, a number of specific issues concerning the existing regulatory structure in Canada have been identified. The following sections highlight specific problems and issues raised by stakeholders with respect to the current securities regulatory framework.

### 2.2.1 Problems for Issuers and Registrants

Under the current system, investment dealers, advisers and their representatives (registrants) and companies that raise financing in our capital markets (issuers) have said that they face a number of burdens due to differences in securities laws across Canada and the need to deal with a number of securities regulators.

Registrants must register in each jurisdiction in which they have clients and registration requirements are not identical across jurisdictions. This is thought to be more of a concern for registered firms that operate in more than one province than for individual representatives who tend to operate in only one province (see first two bullets in Table 2.2.1 for a description of CSA initiatives to address this concern).

Issuers typically must file a variety of documents with more than one securities regulator. For example, issuers must file a prospectus when they raise capital and afterwards must comply with continuous disclosure requirements such as the need to file material change reports. Prospectus, continuous disclosure and other filing requirements vary among jurisdictions. This can create additional costs and delays, as companies must often hire lawyers in each jurisdiction to make sure they are in compliance. Some issuers claim that the current system of prospectus and continuous disclosure requirements is costly, apart from any differences among jurisdictions, and hinders financing opportunities (see third, sixth and seventh bullets in Table 2.2.1 for a

description of CSA initiatives to address this concern).

Insider trading reports for most issuers must be filed in multiple jurisdictions, making compliance costly and causing delays in reporting to investors (see fourth bullet in Table 2.2.1 for a description of CSA initiatives to address this concern).

Documents and applications for exemptions from securities laws must be submitted to regulators in each jurisdiction where the filing or exemption is required. Multiple filings and applications add time and expense for participants in Canada's capital markets and compliance is more difficult in cases where regulators' decisions are not consistent.

Some stakeholders argue that, while the Mutual Reliance Review System (MRRS) has enhanced harmonization and co-ordination, it is limited in what it can achieve since securities law is not uniform across jurisdictions and separate decisions are needed in each jurisdiction. These stakeholders also maintain that MRRS is not well-suited to increasingly common complex or novel transactions.

### 2.2.2 Problems for Marketplaces and Self-Regulatory Organizations (SROs)

Securities marketplaces and self-regulatory organizations operate nationally and each is recognized in several jurisdictions. They are subject to the rules of operation of each jurisdiction in which they operate; however, oversight primarily is undertaken by their principal regulator(s). Being subject to oversight of more than one regulator can result

### **Table 2.2.1 CSA Initiatives to Address Problems for Issuers and Registrants**

- ◆ The National Registration Database (NRD), launched on March 31, 2003, is a web-based system that permits firms and individuals to file registration forms electronically. It has been designed, in consultation with industry representatives, to harmonize and improve the registration process across most of the jurisdictions of Canada. Separate arrangements apply in Québec.
- ◆ The CSA's Registration Streamlining System (RSS) allows salespersons registered in one jurisdiction to use copies of their registration form to apply for registration in other jurisdictions. This system changed administrative practices, not regulatory requirements. All existing local requirements remain in effect, and each participating CSA member continues to apply them. Each individual's suitability for registration continues to be assessed in each jurisdiction in which they work. Separate arrangements apply to salespeople registered in Québec or those who wish to apply to register in Québec.
- ◆ Under the CSA's Mutual Reliance Review System (MRRS), one regulator relies on the analysis and examination of a regulator in another province. Under MRRS, an issuer reporting to more than one regulator files documents with each of them, but generally deals with only one regulator.
  - ▶ MRRS is used now for the review of prospectuses and applications for exemptions that are filed in more than one jurisdiction. Work is underway to extend MRRS to the review of continuous disclosure filings.
  - ▶ MRRS is a mechanism to coordinate decision-making among securities regulators and to provide a single window for filers to deal with one regulator even when many jurisdictions are involved. While filers receive a single MRRS decision document evidencing the decisions of all jurisdictions, each jurisdiction still makes a local decision.
- ◆ The CSA has developed the System for Electronic Disclosure by Insiders (SEDI), which was brought into service in May 2003. Potential benefits include the ability for insiders to file a single report electronically, that is accepted in all jurisdictions, faster public access to insider reports for investors and more effective regulatory monitoring of compliance.
- ◆ In June 2002, CSA members published for comment a proposed rule that would allow public companies to abide by a single set of securities requirements in filing their financial statements and other continuous disclosure documents. They propose to introduce the rule later in 2003.
- ◆ In January 2000, the CSA published for comment a proposal for an integrated disclosure system that would allow faster and more flexible access to public markets for companies meeting more comprehensive and more timely continuous disclosure requirements.
- ◆ The System for Electronic Document Analysis and Retrieval (SEDAR), launched on January 1, 1997, allows reporting issuers and others to file electronically in one place, prospectuses, financial statements, annual reports and news releases, to satisfy the requirements of all provinces.

in added compliance costs and an inefficient administrative structure for vitally important components of our capital markets, such as the TSX Venture Exchange. Higher costs for stock exchanges lead to higher fees levied on companies seeking to raise capital, which restricts access to capital for companies and limits the investment choices available to investors. While steps have been taken to streamline oversight and approval processes, (see Table 2.2.2) there are still situations where duplication of oversight activities occurs across jurisdictions.

## **Table 2.2.2 Current Efforts to Address Problems for Marketplaces and SROs**

- ◆ The CSA has created standardized trading rules and rules regulating the operation of marketplaces and allowed for the operation of alternative trading systems. This led to the creation of Market Regulation Services Inc. (RS Inc.), a self-regulatory organization charged with regulating the market conduct of persons trading through stock exchanges and other marketplaces.
- ◆ To reduce the administrative burden on stock exchanges and other marketplaces, securities authorities have signed a memorandum of understanding (MOU), assigning oversight of certain exchanges to a lead regulator(s). Some securities authorities have also signed MOUs to provide more streamlined supervision of other SROs such as RS Inc. and the Investment Dealers' Association.

### **2.2.3 The Need for a Responsive, Resilient Framework with a Strong International Voice**

The securities regulatory framework must be able to assess and respond to changes in the marketplace and securities industry in a timely and co-ordinated manner to ensure that regulations remains current. A responsive framework enables innovation in capital markets while ensuring investor protection.

A number of provincial securities commissions now have the power to make rules that have the force of law. These powers are subject to requirements that proposed rules must be published for comment and, in most provinces, they also must be delivered to the responsible Minister for consideration. While rulemaking powers permit flexible and responsive securities regulation, concerns have been expressed that the time it takes to implement rules does not match the speed at which markets change. There may be ways to co-ordinate the development of rules across jurisdictions to improve current methods.

Some jurisdictions regularly update their securities legislation and regulation. However, there is no formal mechanism in place to co-ordinate legislative changes across jurisdictions (see first bullet in Table 2.2.3).

The securities regulatory framework also must be resilient enough to withstand stress in capital markets. The tools must be available to ensure urgent issues are managed smoothly in the immediate term and that any needed longer-term responses are appropriately crafted and implemented in a timely way. In response to corporate accounting scandals in the United States, and resulting changes in US securities regulation, some Canadian jurisdictions, including the federal government, have either introduced or announced measures intended to bolster investor confidence. However, these measures were taken without formal coordination. Some commentators have noted the importance of ensuring that any such moves are appropriate for the Canadian context (see third bullet in Table 2.2.3 for a description of CSA initiatives to address this concern).

Under the current framework, each provincial and territorial securities regulator participates in international organizations of securities regulators. The securities commissions of Ontario and Québec are each members of the International Organization of Securities Commissions (IOSCO) and actively participate in IOSCO committees. The Alberta and British Columbia commissions are associate members. All four of these commissions are members of the Council of Securities Regulators of the Americas (COSRA). All provincial and territorial securities regulatory authorities are members of the North American Securities Administrators Association (NASAA).

Some commentators are of the view that Canada's regulators do not speak with a single voice internationally. In an era of increasingly global capital markets and investment opportunities, some commentators have stressed the importance for Canada's securities regulators to speak with a single and authoritative voice. This concern reflects the need for strong representation of Canadian views in international forums that address global capital market issues and in discussions with key foreign agencies like the Securities and Exchange Commission (SEC), the federal securities regulator for the United States. Despite these concerns, however, Canadian regulators have played a significant role in international regulatory discussions and activities.

#### **2.2.4 Enforcement-Related Problems**

Concerns have been raised that the current regulatory framework may not include all the measures needed to allow regulators to work together effectively in enforcement matters.

For example, there is no statutory authority for regulators taking enforcement actions on behalf of others. However, some jurisdictions have a practice of imposing reciprocal enforcement orders, based on the orders in another jurisdiction, on registrants who engage in

securities business in those other jurisdictions. Similarly, mechanisms are needed to ensure that regulators take a similar and coordinated approach to surveillance, investigation and enforcement to facilitate consistent regulation across jurisdictions (see first two bullets in Table 2.2.4 for a description of CSA initiatives to address this concern).

Concerns also have been raised by some that the objective of consistent regulation across jurisdictions may be frustrated by varying local procedural requirements that apply in court and securities commission hearings and differing judicial interpretations of similar securities laws. More common procedural requirements and practices could ensure common standards of due process and better facilitate joint hearings before more than one regulator.

In addition, the existence of differing local interpretations of the meaning and effect of harmonized securities laws is inconsistent with the objectives of harmonization.

Some in the regulatory community feel that harmonizing the areas of hearings and sanctions is less important than harmonizing the rules of access to and operation in the capital markets (see third and fourth bullets in Table 2.2.4 for a description of CSA initiatives to address this concern).

#### **Table 2.2.3 Current Efforts to Make Regulation More Responsive and Resilient, with a Strong International Voice**

- ◆ Through co-ordination by the CSA, many uniform national instruments have been implemented across Canada.
- ◆ The CSA consults with market participants and collaborates with other public bodies to ensure that regulatory responses are appropriate. This process has resulted in timely responses to urgent developments.
  - ▶ The CSA collaborated with the Office of the Superintendent of Financial Institutions and the Canadian Institute of Chartered Accountants in creating the Canadian Public Accountability Board in 2002.
  - ▶ The CSA responded to concerns about Y2K and the 2001 terrorist attacks in the United States, by developing contingency plans with industry and others to ensure that Canadian capital markets would continue to function normally in the aftermath of catastrophic events.
  - ▶ CSA members have cooperated in providing coordinated responses to IOSCO questionnaires and the IMF review of Canadian financial regulation.

## **Table 2.2.4 Addressing Enforcement Issues**

- ◆ Statutory powers and administrative arrangements are in place in most provinces that permit sharing of information among CSA members. These arrangements also permit sharing information with other regulatory bodies and, subject to specific limits, with police or other persons responsible for the administration of criminal laws. These powers extend to sharing information with regulators and police in other countries.
- ◆ A series of bi-lateral and multi-lateral agreements (e.g. an MOU with the International Organization of Securities Commissions, IOSCO) facilitates the sharing of information and co-operation in enforcement matters between Canadian regulators and regulators and police authorities in other countries. The CSA concept proposal on the development of uniform securities laws includes provisions that would permit greater coordination among regulators on enforcement matters.
- ◆ Some stakeholders have raised the question of whether a greater separation of the tribunal function from other functions of securities regulators is required to deal with real or perceived conflicts of interest in provincial Commissions that perform multiple roles (e.g. policy setting, enforcement and adjudication). Canadian courts have held that the administrative tribunals, as they are currently structured, meet the requirements of their constituting legislation. In Québec, Bill 107 has created the Bureau de décision et de révision en valeurs mobilières, which is distinct from its securities regulatory agency, to act as an administrative tribunal in securities matters.
- ◆ In recent years, some enforcement proceedings national in scope have been resolved through joint hearings by regulatory authorities. If this approach were to be expanded, it could benefit from the development of rules and processes for joint hearings, as recommended in the USL paper.

### **2.2.5 Questions Regarding Existing Structural Regulatory Issues**

**The following questions, as well as those listed on page 14, may serve as a guide in preparing your response.**

- Q1** Do you share the concerns respecting the issues described in this paper, and if so, do you feel they demand structural change? Are there additional, existing structural regulatory issues that have not been identified in this paper that would need to be addressed by a new securities regulatory framework?
- Q2** Which of the structural regulatory issues identified in this paper should be treated as highest priorities during this review of the securities regulatory framework?
- Q3** How well do current regulatory initiatives being undertaken by securities regulators through the Canadian Securities Administrators address the existing structural regulatory issues identified in this paper? What remains to be addressed in the Ministers' review?
- Q4** How important is it to the success of a new securities regulatory framework that we streamline and simplify regulatory requirements in addition to reducing duplication?

### 3.0 A New Securities Regulatory Framework

Ministers are strongly committed to building on, and fundamentally improving, the Canadian securities regulatory framework.

This paper presents for discussion a passport system, which Ministers have agreed should be consulted on as a practical and timely response to issues that have been identified in the marketplace.<sup>1</sup> Ministers believe that it is vital to consult with stakeholders in developing an approach that would be an important step forward in meeting their common goal for the Canadian securities regulatory system.

The passport system would result in each market participant dealing with only one regulator with respect to market access rules. The degree to which securities laws are harmonized across participating jurisdictions is a key factor in determining the extent to which the passport system would be adopted by jurisdictions. If securities laws were not substantially harmonized, there would be greater potential for jurisdictions to decline to join or to withdraw from the passport framework because of dissatisfaction with the application of different laws.

Harmonization could be characterized as meaning that laws and rules in each jurisdiction would be uniform to the greatest extent possible, and would be similar in intent when uniformity is not possible. Alternatively, some

would argue that harmonization could rely on a common set of principles designed, for example, to provide equivalent investor protection and to avoid imposing conflicting requirements on market participants. Provinces would like to hear stakeholders' views regarding their views on the degree of harmonization that would be necessary to achieve the goal identified by Ministers, that is:

*to inspire investor confidence and support competitiveness, innovation and growth through efficient, streamlined and cost-effective securities regulation that is simple to use for investors and other market participants.*

During their initial deliberations, Ministers also examined several other possible models that could serve as the basis for a new securities regulatory structure. Two of the options, a single, federal regulator and a dual, federal-provincial regulatory framework (similar to the framework in the United States) did not respect provincial responsibility for the area of securities and were rejected. The following section describes more fully a passport system, followed by a discussion of how the system is consistent with the principles of this initiative (see Section 1.3) and how it would address issues raised by stakeholders (see Sections 2.0 to 2.2).

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<sup>1</sup> Ontario supports consulting on a passport system based on the view that, if implemented, it would represent an incremental improvement to the current securities regulatory framework. However, Ontario believes that this model does not go far enough in addressing the concerns of national and international issuers and registrants. As well, Ontario feels that an alternative approach of a single provincial-territorial regulator with law that is uniform or very closely harmonized in almost all respects and which includes a well-defined mechanism for amendment or use of local rules would make capital markets more attractive to both domestic and foreign participants as well as providing for consistent high standards of investor protection across Canada. Consequently, Ontario feels that the consultation would benefit from the discussion of this alternative approach.

## 3.1 Passport System

### Description:

The passport system would, through legislation, authorize jurisdictions to enter into agreements that would enable a host jurisdiction's regulator to rely on a primary jurisdiction's regulator to perform its supervisory duties regarding market access rules. (A host jurisdiction is the province or territory in which the market participant is operating or offering securities. A primary regulator is the regulator responsible for overseeing the market participant. Market participants include issuers and registrants.) This system would be relatively simple to implement and could be adopted in a timely manner as it builds on the existing regulatory structure and mutual reliance review system.

Registrations and filings for national or multi-jurisdictional market access would be done solely with the primary regulator for all participating jurisdictions on the basis of the primary jurisdiction's rules.

The filing requirements of the primary jurisdiction would be deemed to be the requirements of a host jurisdiction for the purpose of the application of the host jurisdiction's legislation. Filing with the primary jurisdiction would be deemed to be filing with a host jurisdiction. The approval of the primary jurisdiction's regulator would be deemed to be an approval from the host jurisdiction's regulator, subject to the payment of fees, which would be done through a single electronic transaction.

Provinces and territories participating in the passport framework would need to build on the existing base of harmonized law to ensure that investors and other market participants benefit from consistent rules in each participating jurisdiction. Processes and mechanisms for ensuring the upkeep of harmonized law would be developed, to ensure that harmony is preserved and enhanced over time. Ministers

are committed to working with the regulators to ensure the timely consideration of proposed legislative changes.

### Determining the Primary Regulator:

The primary regulator would be determined using agreed-to indicators, such as head office location, incorporation or economic activity of the regulated market participant.

The primary regulator for federally incorporated entities would be determined using one of the indicators other than incorporation. The primary regulator for non-resident entities could be chosen based on common indicators as well, such as location of major economic activity or the location of their principal Canadian office. Not all provinces/territories would be required to participate as a primary jurisdiction. If a jurisdiction chooses not to participate as a primary jurisdiction, the jurisdiction (through an MOU) could choose to delegate or assign responsibility for regulating entities to a primary jurisdiction, or to assign responsibility to another jurisdiction on a case-by-case basis. In either case, the prospective primary jurisdiction would reserve the right to refuse to regulate an entity.

### Scope of Matters for the Primary Regulator:

The passport process would allow a market participant to meet every jurisdiction's requirements for market access by meeting only the primary jurisdiction's requirements.

The responsibilities of the primary regulator regarding issuers would include the issuing of prospectus receipts or exemptions, the review and analysis of continuous disclosure information, and monitoring insider trading. Issuers would thus have to comply solely with the rules of the primary regulator, including any rules governing proxy solicitations, related party transactions and corporate governance requirements.



The responsibilities of the primary regulator regarding registrants (dealers, advisors, fund companies, representatives and marketplaces) would include registration and monitoring for compliance with requirements, such as solvency and fitness qualifications, to maintain registration.

With respect to market access rules, every jurisdiction would rely primarily on the primary regulator for enforcement (as agreed in a MOU). This would involve referring a complaint to the primary jurisdiction for investigation and enforcement action.

### **Scope of Matters for the Host Regulator:**

Local regulators are in the best position to assess investor complaints. Thus, relations between investors and market participants would continue to be governed by the regulatory authority and the courts of the investor's jurisdiction, which would apply the local laws of that jurisdiction. Accordingly, an investor who is wronged by a market participant who obtained access to the market via the passport would deal with the regulatory authority of the investor's jurisdiction to lodge a complaint or seek an investigation.

With respect to market access rules, the host regulator would only take enforcement action if dissatisfied with the actions of the primary regulator. Any recourse by an investor against a market participant would be pursued in the courts of the investor's jurisdiction.

As is the case today, any entity attempting to participate in the marketplace without registering or filing required documentation would be subject to securities law and enforcement.

### **Accommodating Local or Regional Needs:**

Provinces and territories note the advantages of preserving their ability to implement measures to meet local and regional capital market needs

in innovative ways. Examples introduced in a province that subsequently gained broader acceptance include Junior Capital Pools and Labour Sponsored Venture Capital Corporations. In a rapidly evolving and complex environment, regulatory innovation can be an important tool in ensuring effective regulation.

Principles for acceptable departures from harmonized standards could be agreed to in advance. Such principles would preserve the integrity of the passport system.

For example, a province or territory wishing to introduce an innovative measure would consider:

- ◆ Whether the initiative was necessary to meet a policy objective
- ◆ How the impact on other jurisdictions would be minimized
- ◆ How the impact on the efficiency of the inter-provincial/territorial passport framework would be minimized
- ◆ Whether the measure would be restricted to a limited portion of the Canadian marketplace
- ◆ Making the measure subject to regular sunset reviews.

Proposals for local rules would be discussed by the CSA to determine if they could be adopted nationally. Ministers would be informed of all such initiatives.

### **Governance and Accountability:**

Ministers would remain accountable to their constituents for the quality of securities regulation.

Existing regulatory structures would remain in place but would be complemented and enhanced by mechanisms to further the achievement of the principles identified in this paper (see Section 1.3).

Provincial and territorial ministers responsible for securities regulation would meet regularly to:

- ◆ Review their objectives for the securities regulatory framework
- ◆ Preserve and enhance the harmonization of securities laws
- ◆ Oversee regular annual or bi-annual reviews of securities legislation
- ◆ Monitor the condition and operation of the passport framework
- ◆ Develop responses to key international issues.

Senior officials would meet at least twice a year to:

- ◆ Review the status and functioning of the new regulatory framework
- ◆ Develop recommendations to enhance the achievement of the goals and principles approved by Ministers
- ◆ Develop responses to key international issues.

The CSA would develop uniform rules and undertake other initiatives consistent with the goals and principles approved by Ministers.

## **Evaluation of Passport System vis-à-vis Principles:**

### **1. Highest standards of investor protection**

Regulators with competent, well-trained staff and a thorough knowledge of the local markets would facilitate high standards of investor protection in their respective jurisdictions. Matters that are clearly multi-jurisdictional or national in scope would require the co-operation of enforcement staff from affected jurisdictions and, possibly, joint hearings.

Harmonized laws and rules applied by qualified regulatory staff would ensure that all Canadian investors are protected by equivalent standards.

Since local regulators are in the best position to assess investor complaints, relations between market participants and investors would continue to be governed by the regulatory authority and the courts of the investor's jurisdiction.

### **2. Efficient and cost-effective, streamlined and simplified, regulation**

Market participants would need to learn and comply with only one set of market access rules and, with respect to enforcement of those rules, would deal with only one regulator in most cases, as the host regulator would only take enforcement action if it was not satisfied with the actions (see above) taken by the primary regulator. Dealing with one set of rules and a single regulator would eliminate the current requirement for market participants to deal with multiple regulators for market access. Investors would continue to deal with only the rules and regulator in their jurisdiction. At the same time, the passport system would retain the advantage of providing access to local regulatory expertise within each jurisdiction.

As well, the passport system would enable streamlined and simplified regulation because it would be relatively simple to implement, as it builds upon the existing regulatory structure and the mutual reliance review system.

### **3. Able to adapt to future marketplace changes**

Adapting to future marketplace changes would be facilitated through a well-developed process for amending legislation and rules. The CSA would continue to play an important role in this regard, perhaps with an expanded mandate to review the development of new products and processes and reach consensus on recommended improvements.

#### **4. *Transparency, accessibility and accountability for stakeholders, with a clearly defined framework for accountability to governments***

Harmonized securities laws would promote transparency in the regulatory framework for market access by eliminating jurisdictional differences that tend to complicate compliance and enforcement. Efficiencies gained from greater harmonization contribute to lowering costs and improving accessibility to capital markets for issuers. Further, participants and investors would continue to benefit from local regulatory expertise. Strong accountability would be maintained by highlighting clear lines of responsibility from regulators to elected governments under the passport system.

Investors would continue to deal with their own jurisdiction's regulator, which makes the framework simple for them to use. Any recourse by an investor against a market participant would be pursued in the courts of the investor's jurisdiction.

#### **5. *Harmonized securities laws and rules with well-defined parameters for exceptions to accommodate local and regional differences***

Harmonizing securities laws to the greatest extent possible throughout the country would facilitate the adoption of an effective passport framework, facilitating working mutual reliance and acceptance.

The use of harmonized securities laws reduces overall complexity and duplication in the regulatory framework and helps reduce information asymmetry for the benefit of investors. Harmonization by itself does not necessarily reduce the actual complexity of the regulatory requirements.

#### **Evaluation of Passport System vis-à-vis Existing Structural Regulatory Issues:**

The passport system responds positively to key concerns raised over the years by market participants that it is costly and inefficient to deal with multiple provincial/territorial regulators and legislation to gain access to the securities market. The passport system, in conjunction with harmonized laws and the application of electronic systems such as NRD and SEDAR, would allow true "one stop shopping", that is, the ability to deal with a single regulator when registering or filing in more than one jurisdiction. While filing fees to host jurisdictions would still apply, the process would be significantly streamlined.

Reporting issuers (and their insiders) would only have to file documents with one regulator; they would have to comply with one set of prospectus and disclosure requirements; and documents and exemptions from securities laws would have to be submitted to one regulator for review and approval. Other jurisdictions would rely on decisions of the primary regulator. This would address concerns raised by reporting issuers that the current system of filing prospectus and continuous disclosure documents in multiple jurisdictions creates costs and/or delays.

Adopting the passport system would encourage harmonized regulatory development. Since the system is based on the recognition by one jurisdiction of the decisions made by another, on the basis of the rules applicable in the latter, jurisdictions will be more favourably disposed to accept the decisions of others when the rules are harmonized. Accordingly, an established structure to co-ordinate future changes to harmonized base law would ensure that participants and investors continue to benefit from harmonization and a responsive regulatory framework that is resilient to stress.

In the area of enforcement, the primary jurisdiction would remain responsible with respect to its market participants, to the degree that market access rules are involved. The host jurisdictions would leave enforcement to the primary jurisdiction for any such issue.

Currently, there is no statutory authority in place for one regulator to take enforcement actions on

behalf of others. Harmonization would facilitate the application of a consistent set of market access rules. Jurisdictions would continue to co-operate with other regulators regarding cross-border offenders. This would provide investors with the assurance that they would only need to deal with local authorities and courts.

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### **3.1.1 Questions Regarding Passport System**

**The following questions may serve as a guide in preparing your submission.**

**Q5** Would the passport system substantially address all of the structural regulatory issues that have been identified in this paper? If not, what issues remain outstanding?

**Q6** Are there additional elements that could be added to the passport system to address these issues?

The willingness of jurisdictions to enter into the passport system and rely on other jurisdictions' laws and decisions with respect to market access will depend on a sufficient degree of harmonization of laws and rules.

**Q7** What elements of securities regulation are most important to harmonize across jurisdictions?

**Q8** What degree of "harmonization" is necessary for a passport system to succeed?

**Q9** What should the principles be to determine acceptable departure from harmonized standards?

**Q10** Are there elements that could be added to enhance the suggested governance structure?

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## **4.0 Conclusion**

The Provincial and Territorial Ministers recognize that an effective, streamlined and efficient securities regulatory framework is essential to the vitality of the Canadian economy, by inspiring investor confidence and facilitating capital formation. Input and comments from stakeholders on issues with the current framework and the passport system proposed to address these issues will constitute an important step forward in achieving the common objective of an improved securities regulatory framework for the benefit of all Canadians.