



CREATING AN ADVANTAGE IN GLOBAL CAPITAL MARKETS

***CANADIAN COUNCIL OF CHIEF EXECUTIVES
SUBMISSION TO THE
EXPERT PANEL ON SECURITIES REGULATION***

JULY 2008



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The members of the *Canadian Council of Chief Executives* (CCCE) head many of Canada's largest public issuers, which often are listed on international and Canadian stock exchanges. The CCCE is dedicated to promoting sound public policy that will enhance the competitiveness of the Canadian economy and the wellbeing of all Canadians.

The *Expert Panel on Securities Regulation* has asked for advice on the substance, structure and enforcement of securities regulation in Canada. The CCCE has been engaged in discussion of these issues for many years: with ministers and senior officials at both the federal and provincial levels; with securities regulators across the country; and with other relevant panels and committees.

Efficient and dynamic capital markets are vital to innovation, productivity, competitiveness and economic growth. While Canadian securities markets are regulated provincially, the strategic objectives of securities regulation do not vary from one jurisdiction to the next. Investors need clear information, fair treatment and confidence that rules will be enforced quickly and consistently. Issuers need efficient, orderly and fair markets that provide access to capital on a globally competitive basis.

Because Canada is a relatively small market, this country's regulatory system must be as responsive as possible to the needs of smaller but growing enterprises, and therefore must keep the compliance burden as simple and inexpensive as possible. This is why, in the wake of the 2002 Sarbanes-Oxley Act in the United States, the CCCE supported calls by Canadian regulators and market participants for a "made-in-Canada" response.



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In our September 2002 paper, *Governance, Values and Competitiveness*, we noted that “adding rules does not necessarily make markets work better” and that “an excess of rules and regulations can easily suffocate the very spirit of innovation and risk-taking that makes markets so successful in driving human progress”. We called for a focus on stronger enforcement, greater transparency and more effective collaboration across jurisdictions, with additional regulations only as a last resort.

We emphasized the need to keep Canadian rules compatible with those in the United States for large, cross-border issuers. But it was already clear that Sarbanes-Oxley would impose disproportionately higher compliance costs on small-cap issuers in the United States, and most of the Canadian market is small-cap or even micro-cap by United States standards.

We therefore spoke in favour of a more proportionate approach in Canada, one that would offer greater flexibility and lower compliance costs for smaller issuers. We supported the resulting two-tier Canadian approach that allows a more relaxed standard for companies traded only on the venture exchange. The more principles-based “comply or explain” approach available to smaller publicly traded companies enables lower-cost compliance with the rules while using greater transparency both to protect investors and to provide an incentive for companies to strengthen their governance practices as they grow.

The major risk involved in moving toward a more principles-based system lies in the area of compatibility between jurisdictions. Ontario’s rejection of British Columbia’s first attempt to move to a dramatically



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simpler and more principles-based approach to securities regulation essentially meant that the proposed regime in the latter province would only have been useful to companies not planning to raise capital outside British Columbia. As Canada contemplates moving to a more principles-based approach on a national scale, it will be essential to ensure that any new system not only provides consistency from coast to coast, but also is seen internationally as a strengthening of our regime rather than a weakening. In particular, it is essential that Canada's regulatory process and standards remain compatible with the requirements facing Canadian enterprises that also issue shares in the United States and other jurisdictions.

While a more principles-based approach may offer lower compliance costs to issuers than a heavily rules-based system, it does expose issuers to greater risk. A rules-based system allows those accused of misconduct to mount a narrow legal defence that their actions did not break the rules. Those accused of misconduct under a more principles-based system face a greater onus to prove -- to investors, to elected officials and to the public as well as to regulators -- that what they did was right rather than wrong. Regulators in such a system may find it more difficult to win clear legal convictions, but even a successful defence against legal enforcement would not be free of consequences if the actions fail the "smell test" with the broader public. A shift to a more principles-based system might lead to fewer convictions but could prove to be more rather than less effective in deterring misconduct.

Whether Canada opts for a more principles-based approach or not, there is a need for stronger and more coordinated enforcement.



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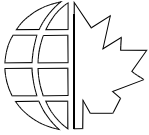
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Tougher enforcement leading to sanctions with nation-wide impact in turn requires a separation of the regulatory and adjudicative functions. The greater the consequences of conviction for misconduct, the more important it becomes for judge and prosecutor to be, and to be seen, as independent of one another.

The real key to more effective enforcement, however, is to move Canada toward a single set of rules and a single regulator. To their credit, provincial and territorial governments and regulators have worked diligently to move toward harmonized rules, simplified compliance requirements and more effective enforcement. The passport system adopted by all provinces except Ontario is a well-meaning attempt to create a more coordinated regulatory environment, but it falls short of what is needed to meet the goal of an efficient, orderly and fair market across Canada.

The passport system is burdened by three fatal flaws:

- First, it *maintains excessive costs to market participants*. It reduces some of the legal and compliance costs to issuers, but does nothing to reduce the size and cost of a fragmented regulatory structure, and still requires the payment of fees in all jurisdictions to cover those costs.
- Second, it *cannot ensure consistent interpretation and enforcement*. Even if all provinces achieved complete harmonization of rules, differences between jurisdictions either in rigour of enforcement or in interpretation could undermine the confidence of issuers and investors alike in the system's ability to deliver consistent and predictable outcomes.



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- Third, it *cannot provide timely and consistent responses to changing market needs*. The passport system depends on each province to amend its respective legislation over time as changing conditions require amendments to the rules. Experience shows that even when all provinces agree on the need for specific rule changes, years can pass before the legislative process is completed in all jurisdictions.

The current impasse between Ontario and the other provinces illustrates another weakness of the passport system. As it stands, an issuer choosing any province other than Ontario as its primary jurisdiction must satisfy the regulators in Ontario as well as in its home base. This drives home the instability of the passport system. Nothing prevents any participating jurisdiction from choosing to pursue an independent course on regulations to a degree that one or more other jurisdictions could no longer accept as equivalent or adequate.

In short, only an agreed common set of rules enforced by a single regulatory authority can deliver the efficiency, consistency and stability that Canadian markets need.

There are legitimate concerns about the impact of moving to a single regulator. Some flow from a perceived need for provinces to preserve local approaches to what are seen as unique aspects of their capital markets, especially affecting small issuers. Some flow from fear that a single regulator would be dominated either by Ontario or by the federal government. Some flow from the desire to ensure a strong local presence, in terms of access to services and of the jobs and economic activity generated by the current regulatory structure.



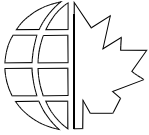
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Almost all of these concerns have been addressed convincingly over the years. The work of the Canadian Securities Administrators (CSA) has shown that it is possible to achieve uniform securities legislation while making reasonable provision for local rules. The Crawford Panel developed a credible and effective governance model that would prevent dominance by any jurisdiction. Discussions among provincial governments have shown great willingness to spread the functions and key jobs of a single regulator among different cities, ensuring local access and a fair distribution of the economic activities.

The transition to a single regulator would be aided by agreement on a common securities act. Discussions to date suggest that any jurisdiction's current legislation would be acceptable as the base for developing a common act. The precise substance of such an act is less important than the achievement of consensus on a combination of principles and rules that will work for Canada as a whole.

The second step would be agreement on a structure and governance model. In the absence of any proposed alternative, the Crawford Panel's model should be adopted. This model would give all jurisdictions equal decision-making power, and also respect provincial authority by allowing provinces and territories to opt out. By the same token, lack of unanimous support would not prevent the establishment of a common regulator. In line with this model, those jurisdictions willing to proceed should move forward on a joint basis, and enable other jurisdictions to join if and when they see fit. Clearly, though, those who participate from the outset will be making key decisions about the structure of the organization, the initial composition of its



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executive team, the location of its head office and the geographic distribution of its other functions.

During the transition phase, the passport system would be maintained between the newly formed common regulator and non-participating jurisdictions, minimizing short-term disruption. Over time, however, the inherent instability of passport arrangements likely would require non-participating provinces either to join the single regulator or accept the consequences of a lapse of the passport benefits. In the meantime, even a partial consolidation of the current 13 regulators in conjunction with agreement on a common act would mark a huge step forward toward the goal of efficient, orderly and fair markets in Canada and a more competitive platform for the global growth of Canadian enterprise.

Despite years of effort by federal and provincial governments, regulators, advisory panels and market participants, Canada remains saddled with a regulatory system that is too fragmented, too costly and too slow to manage change. Growing Canadian enterprises need more efficient access to capital. Canadian markets need to attract greater investment from abroad. Canadian investors need stronger protection and broader access to investment opportunities.

Moving to a single regulator would have many advantages to investors and to issuers large and small: one set of rules for all; lower administrative and compliance costs; consistent interpretation and enforcement; more timely response to changing market needs; and a more effective Canadian presence internationally.