

Questions & Answers
New British Columbia *Securities Act*
SBC 2004 c 43

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General

What is the new BC *Securities Act*?

Answer: The new Act is part of a new way to regulate securities in British Columbia. This new approach leaves behind the over-use of detailed and prescriptive rules in favour of an outcomes-based approach founded on time-tested principles of investor protection: disclosure to investors and the regulation of dealers and advisers. The new legislation consists of a *Securities Act* and Rules, organized logically, and drafted in a simple, plain-language style. The system is designed so that directors and officers of public companies, and people registered to trade and advise in securities, can easily understand the regulatory requirements under which they operate.

Why are you bringing it forward at this time?

Answer: Securities legislation needs reform. The current system is too complex and imposes costs on investors, companies and securities firms that exceed the benefits of investor protection. Technological advances have made some provisions obsolete. The new legislation provides better investor protection at lower cost by improving disclosure and by requiring companies and securities firms to focus on what is best for investors and markets.

What benefits will the new *Act* bring?

Answer: More effective and more efficient regulation.

More effective because:

1. It protects investors better:
 - results-based regulation focuses companies and securities firms on what is right for investors and markets
 - improved, plain language disclosure
 - new investor remedies for breaches of the legislation
2. It enhances enforcement:
 - new and stronger enforcement powers of the Commission
 - new compensation and disgorgement powers for the courts
 - increased quasi-criminal penalties

More efficient because

- Companies will be able to raise capital faster and at much lower cost
- Detailed and prescriptive requirements for securities firms have been replaced by a results-based Code of Conduct; other rules have been streamlined.

How was the new legislation developed?

Answer: The BC Securities Commission developed the new legislation through a disciplined, zero-based analysis of the current law. The Commission asked: What problem was each requirement designed to address? Is that still a problem? Is there a better way to address the problem, such as through education or enforcement? If not, can it be streamlined, simplified, and put in plain language?

- The Commission then consulted with more than 2,000 people in BC and across Canada who would be affected by the law. Public company directors, dealers and advisers, lawyers, accountants, and academics joined focus groups, attended seminars, completed surveys, responded to regulatory impact studies, and wrote comment letters between March 2002 and September 2004.
- In addition, the Commission rigorously analyzed the impact of the most significant changes in the new legislation in five studies published between October 2002 and May 2004.

How do you know it will work?

Answer: The new legislation is the product of three years of analysis, study and consultation. It was built up in three stages—a concept phase, then full proposals, and finally a discussion draft of the legislation and rules. Each phase involved extensive public consultations in British Columbia and across Canada. Through this process, the BCSC consulted extensively with industry and received 160 comment letters. In addition to conducting studies on the major areas of change, the BCSC analyzed the legislation’s enforceability and compliance with international standards.

How radical are the changes?

Answer: The new legislation is evolutionary, not revolutionary. It is fully compliant with the Objectives and Principles of Securities Regulation established by the International Organization of Securities Commissions (IOSCO) and, like the legislation it replaces, it is founded on the basic principles that have governed securities regulation for decades: full disclosure by issuers and regulation of dealers and advisers. It adapts these principles to reflect new trends and realities, emphasizing outcomes, not processes, to focus industry on what is best for investors while allowing it the flexibility to adapt to changing market conditions. Market changes that have set the stage for BC’s new *Securities Act* include:

- Continuous disclosure is now recognized as critical to the proper functioning of markets and current disclosure requirements reflect that.
- Material information about public companies is now available on a continuous basis, so prospectus disclosure for these companies is essentially redundant.
- Similarly, unprecedented participation by retail investors has resulted in a proliferation of financial products and services. The rigid, “tick the box” regulatory systems of the past cannot keep pace with a rapidly changing industry.

Who will be able to use the new legislation?

Answer: When the new legislation is in force, it will be available to companies raising capital in BC and to dealers and advisers operating in the province. Not all market participants operating in BC will be able to take full advantage of the benefits of the new legislation because most of them must still comply with the laws of other provinces. If the new legislation meets its goals as effectively as we expect, we anticipate that other provinces will adopt similar approaches over time, as has happened in the past.

Will national issuers be asked to comply with the new BC requirements as well as the rules in other provinces?

Answer: No. The new legislation is compatible with the legislation elsewhere in Canada through the use of “harmonized interfaces” in the proposed Rules. Essentially, these are exemptions from the requirements of British Columbia legislation for issuers who are required to follow regulatory requirements elsewhere in Canada, and who comply with those requirements. As a result of these interfaces, issuers will generally avoid having to comply with two different sets of requirements.

Discussions are underway with the TSX Venture Exchange about how the new *BC Act* and Rules will interface with its requirements for listed companies.

Will national dealers and advisers be asked to comply with the new BC requirements as well as the rules in other provinces?

Answer: Yes, but compliance systems for the requirements of other provinces and of self-regulatory organizations will, with some exceptions, be sufficient for compliance with the new BC requirements. Firms will have to meet higher standards for managing conflicts of interest, disclosing fees charged to clients, and communicating with clients in plain language.

Discussions are underway with the IDA and the MFDA about how the new *BC Act* and Rules will interface with their rulebooks. The Commission’s objective is to give firms greater flexibility than SRO rules would otherwise permit for complying with the new BC legislation.

What impact will the new *BC Securities Act* have on the Mutual Reliance Review System (MRRS) and the Multi-Jurisdictional Disclosure System (MJDS)?

There is no reason why the new legislation should jeopardize either MRRS or MJDS since it is based on the same fundamental principles as existing securities legislation in British Columbia and elsewhere. The BC Rules provide that in circumstances where BC is the principal jurisdiction under MRRS, or is the review jurisdiction under MJDS, an issuer is not entitled to use the Continuous Market Access System and must instead file a prospectus and obtain a receipt.

Will the new *Securities Act* bring immediate benefits to British Columbia businesses?

Answer: The new *Act* offers the opportunity for immediate benefits for BC-based businesses. The benefits for businesses operating nationally will accrue over time as those market participants will generally have to comply with regulation in other provinces. We look forward to seeing the reforms introduced in this legislation adopted in other provinces so that they can benefit more BC businesses as well as those in other provinces.

How does outcomes-based regulation affect investors?

Answer: The new legislation protects investors better by providing better disclosure, closing loopholes by focusing market participants on outcomes, enhancing enforcement, and adding new investor remedies. The approach also lowers the cost of regulation, a cost ultimately borne by investors.

How are investors protected with fewer requirements?

Answer: The new legislation is not simply the old legislation with half of it eliminated. It is an entirely new regime logically built on the same fundamental principles as the legislation elsewhere in Canada and with the same objectives of providing strong investor protection and efficient regulation. Much of what was old did little to protect investors and yet was costly to comply with. The new *Act* focuses less on "tick-the-box" process-type requirements, and more on results-based requirements. There are four kinds of changes:

1. Obsolete or redundant requirements eliminated
2. Requirements recrafted to better achieve their purposes
3. Requirements simplified and put in plain language
4. Some new requirements added to fill existing gaps

Conflict of interest example:

Under the old legislation, the process-driven requirements dealing with registrant conflicts of interest prohibited some types of specific transactions, required other specific types to be conducted in a particular manner, and still others to be disclosed. These provisions had the effect of restricting some transactions that posed no threat to investors, while ignoring some conflict of interest situations entirely because they were not specifically mentioned in the legislation.

The new legislation handles conflicts of interest using a results-based approach. Registrants are required to resolve conflicts of interest in favour of the client, and to tell the client anything that would lead a reasonable client to question the objectivity of the advice being given. This puts the registrant in the shoes of the client to consider what conduct will be appropriate, and covers all conflict situations, whether known today or arising in the future.

Is an outcomes-based approach enforceable?

Answer: Yes. There are many specific requirements in the new legislation's results-based approach. The overall design ensures that the regulatory regime promotes a culture of compliance among market participants by being easy to understand, focused on the most important issues, and enforceable.

There are plenty of rules under the new legislation, and they are more efficient than the rules they replace.

For example: The Code of Conduct for dealers and advisers consists of 25 rules. Under these Rules, dealers and advisers must provide more relevant and clearer disclosure about their compensation. They are also required to disclose conflicts of interest to their clients. Both these provisions broaden the range of conduct covered over the current legislation.

For the Commission's analysis of the enforceability of new securities legislation in British Columbia—*Enforcement of Outcomes-Based Securities Legislation*—go to www.bccsc.bc.ca/policy and select "Regulatory Impact Analyses".

Is this an appropriate time to move away from prescriptive regulation, given the scandals of the past few years?

Answer: Scandals like Enron occurred despite the very prescriptive securities regulation regime in the United States and show that those committing fraud can thrive even in a rules-based system. The real issue is developing regulatory responses that deal adequately with the issues in the context of each market. We believe the best regulatory response is the one with the best result for investors, while placing the minimum burden necessary on market participants. Sometimes that means enforcing rules already in place; other times it means new rules. It does not necessarily mean adopting the rules or approaches of another jurisdiction for the sake of conformity, especially in the absence of any evidence that those rules will produce the desired regulatory outcome.

Won't taking a different path from Ontario and the United States fragment Canadian regulation further to the detriment of British Columbia businesses and investors?

This is not supported by past experience. Our history in Canada shows that many reforms adopted nationally were first introduced and proven in one or a few provinces. Although it is more comprehensive than previous reform efforts, the new *BC Securities Act* fits this pattern. Local initiatives are sometimes criticized for hurting harmonization and cooperation, yet they have been a source of important leaps forward in Canadian securities regulation. The shorter hold period, accredited investor exemptions, and capital pools are just three examples of local initiatives that started in one province and have now been adopted by most or all other jurisdictions.

Will different legislation in BC harm our reputation in foreign markets?

The new *BC Securities Act* and Rules are fully compliant with the Objectives and Principles of Securities Regulation established by the International Organization of Securities Commissions (IOSCO.) That said, our obligation is to regulate our markets as effectively and efficiently as we can. Ultimately, British Columbia's reputation depends on whether we achieve results, not on whether our laws look the same as those in other countries.

Will different legislation in BC weaken Canada's ability to speak coherently on international issues brought up in forums such as International Organization of Securities Commissions (IOSCO)?

The BC Securities Commission continues to work closely with regulators in other provinces both to develop national responses to regulatory issues and to deal collectively with issues that arise in international discussions. Testing new ideas and making regulation more effective in British Columbia can only help Canada's ability to deal with international challenges.

How will the new legislation promote confidence in the BC market?

Answer: The new legislation continues the regulatory improvements that have already established integrity in British Columbia markets. The issue for any jurisdiction is whether it has a regulatory system that will protect investors and support efficient markets. If it does, investors will invest because they will have confidence in the integrity of the market. Companies and intermediaries will do business in British Columbia because they can raise capital more efficiently and they can be proud to be associated with a market that investors can trust. The new legislation will meet these goals.

A recent study for the Wise Persons' Committee showed that BC leads the country in the number of securities enforcement actions. Under the new legislation, the BC Securities Commission will continue its strong enforcement record. Its study of enforcement actions over a recent two-year period showed that provisions that have been continued in the new legislation in substantially identical form account for 92% of the contraventions on which sanctions were based in that period. (The most common of these are misrepresentation, unsuitable investment advice, dealing with clients unfairly, trading without registration and offering securities illegally.)

Why has the maximum administrative penalty been increased from \$250,000 for individuals and \$500,000 for corporations to \$1,000,000 and why is it now assessable on a "per contravention" basis?

Answer: These changes bring the administrative penalties in British Columbia in line with those recently adopted in Ontario. We have seen large frauds that have cost British Columbia investors hundreds of millions of dollars. The penalties must be commensurate with the potential misconduct.

Investor Protection and Enforcement

How does this legislation help investors?

Answer: The new *BC Securities Act* represents a straightforward approach to regulation. It is a results-based model for securities regulation that provides concrete protections to investors, and immediate and long-lasting benefits to industry. For example:

- The legislation and guidance are written in plain language so that market participants will know what is expected of them. Even more important, market participants must draft the disclosure they give investors and clients in plain language so that it is understandable and achieves its intended purpose.
- Public companies must make all material information available to investors at all times. The model is designed to give investors complete and up-to-date information about the companies they invest in, whether or not the company has recently filed a prospectus.
- Registered dealers and advisers must comply with a Code of Conduct—a results-based set of rules that imposes requirements designed to ensure that their clients are treated fairly, served competently, and told all the important facts about fees and conflicts of interest.
- The Code requires firms’ dealers and advisers to hire as representatives only those who are suitable to work in the industry, to see that they are properly trained, and to supervise them properly.
- There is a statutory right of action for investors to sue companies that make misrepresentations in their disclosure.

The BC Model included a broad remedy that let investors sue persons for any material contravention of the Act. Why is this not included in the new legislation?

Answer: Not all the remedies considered were included in the new legislation, as a result of a study the BCSC conducted on that regime. Analysis showed that the remedies not included would either have added significant unquantified liability risk for potential defendants, or not have provided a meaningfully better remedy for plaintiffs than existing common law remedies. For this reason, the Commission developed a regime that created a separate right of action for a contravention of specified provisions of the legislation.

The primary purpose of these remedies is to deter contravention of the legislation. The challenge in designing a regime for this purpose is ensuring that the new remedies provide a meaningful deterrent without penalizing compliance-minded market participants by unduly increasing their liability risk or imposing unnecessary costs.

For the Commission’s analysis of investor remedies—*Investor Remedies In Securities Legislation, A Regulatory Impact Analysis*—go to www.bpsc.bc.ca/policy and select “Regulatory Impact Analyses”.

What impact will this omission have on investors?

Answer: The investor remedies regime in the new legislation is stronger than exists today and is designed to strike a balance between effective deterrence and the cost of compliance. But this regime is only one of the elements of the new legislation that improve investor protection. There are many others, including:

- Disclosure by public companies to investors must be more comprehensive, more current, and in plain language.
- Disclosure by securities firms to their clients must be more specific in the areas of fees and conflicts of interest, and must be in plain language.
- Investors have improved remedies—the right to sue for misrepresentations in continuous disclosure documents and to sue those who trade on inside information.
- Anyone who believes another person has contravened the legislation can ask the Commission to hold a hearing in the matter.
- The Commission and the courts have new powers to order wrongdoers to disgorge profits made from illegal activity; investors who have lost money as a result of the wrongdoing will have the opportunity to recover their losses from the disgorged funds.
- The Commission and the courts have stronger enforcement powers to deal with those who break the rules.

Will new investor remedies against directors and officers make it harder for companies to attract good people to serve as directors?

Answer: These new remedies (and the protections for defendants in the regime) are based on a proposal published by the Canadian Securities Administrators in November 2000 and since passed in Ontario. This proposal followed the recommendations of an industry committee established by the Toronto Stock Exchange. Both the TSX report and the CSA proposal were the subject of extensive study and consultation. Including these remedies ensures that the remedies available to British Columbia investors will be no less than those available to investors elsewhere in Canada. Including similar protections for defendants ensures that British Columbia's investor remedies do not make the province less competitive due to potential concerns of market participants relating to "strike suits".

How will the proposal to expand insider trading liability work?

Answer: The current section provides a remedy to any person who trades with the person who contravenes the insider trading prohibition. The new section provides the remedy to any person who trades between the time of the contravention and the time that the material information or significant change is disclosed under the *Act*. This is an improvement that will make the remedy more effective and allow it to operate as originally intended.

How will the new disgorgement power work?

Answer: Disgorgement can be ordered in one of three ways—by the Commission, by a civil court, or by a criminal court. Once ordered, the person to whom the order applies must pay the amount ordered to the Commission, which will then advertise for potential claimants. If someone comes forward, the Commission pays the money into court and the courts determine the claims. Any money not claimed reverts to the Commission, which can use it only for the purpose of educating market participants and investors.

What specific enforcement measures does the new legislation introduce?

Answer: There are prohibitions against misrepresentation, fraud, market manipulation, unfair practices, trading on inside information, and front running. Anyone who contravenes these prohibitions will be exposed to administrative and criminal sanctions.

- Compliance and enforcement powers are strengthened. Commission staff will have broader powers to obtain information from market participants, and the Commission will have broader powers to ban market participants from the markets and order disgorgement.
- The maximum administrative penalty that the Commission may order is increased to \$1 million per contravention of the legislation.
- The maximum fine that a court may order for an offence under the legislation is increased to \$3 million, and the court may also make restitution and disgorgement orders against a person who commits an offence. Higher penalties apply in insider trading cases.
- Anyone who believes another person has contravened the legislation can ask the Commission to hold a hearing in the matter.
- Investors under the new legislation can sue market participants on three counts under the *Act*:
 - a. Misrepresentation in offering and bid documents and the company's continuous disclosure
 - b. Illegal insider trading
 - c. Front running, wherein a firm trades ahead of its clients in the shares they oversee

Regulation of Public Companies

Will the new BC approach increase costs for public companies?

Answer: No. Those who are eligible to use the legislation to raise capital will be free to do so; those who do not wish to (whether or not eligible) will not be compelled to follow the new British Columbia Rules. The new legislation will be compatible with the legislation elsewhere in Canada through the use of “harmonized interfaces” in the Rules.

Essentially, these will provide exemptions from the requirements of British Columbia legislation for those who are required to follow regulatory requirements elsewhere in Canada, and who comply with those requirements. As a result of these interfaces, market participants will generally avoid having to comply with two different sets of requirements.

How will CMA ensure that public company information is reliable in the absence of a prospectus?

Answer: Companies going public for the first time in British Columbia will continue to file prospectuses. However, based on the strength of their continuous disclosure record, they will not have to file a prospectus to raise subsequent capital. Markets have changed beyond recognition since the prospectus regime was introduced in the 1930s and the new legislation takes this into account:

- Continuous disclosure is recognized as critical to the proper functioning of today's markets and current disclosure requirements reflect that.
- Material information about public companies is now available on a continuous basis, so prospectus disclosure for these companies is essentially redundant.

Regulation of Dealers and Advisers

Does the new legislation specifically recognize independent owner operators currently regulated by the IDA and MFDA?

Answer: The BCSC is considering the position of independent owner operators under the *Act*; however, the new legislation does not contain a specific provision for them. The Commission does not anticipate introducing a distinct registration category, but would have independent owner operators register in the "restricted dealer" category.

What impact will the Code of Conduct have on investor protection?

Answer: The Code of Conduct is a mandatory set of Rules under which registered dealers and advisers must provide more relevant and clearer disclosure about their compensation and disclose conflicts of interest to their clients. It is more comprehensive and, in some areas, demands more from dealers and advisers than the current requirements and it broadens the range of conduct covered in the current legislation.

What will the Code of Conduct do?

Answer: Investors are protected best when dealers and advisers fully understand, and are held accountable for, their broader obligations to clients and the market. The Code of Conduct replaces many intricate rules about behaviour with 25 Rules, organized under eight principles, that compel firms and their representatives to focus on the purpose of, and reasons behind, our regulatory standards. In a market that moves faster than rules can

be revised, a code of conduct provides a sound basis for regulators to hold industry to high standards of conduct.

Under the results-based requirements of the Code, market participants will be able to comply in ways that fit the size and nature of their businesses, rather than having to adapt to detailed, “one size fits all” rules. Instead of focusing on fulfilling technical requirements and hunting for loopholes, they will have to focus on what is right for investors, clients, and markets.

What happened to the Firm-Only Registration System?

The BCSC withdrew the firm-only proposal in response to a significant volume of comments from industry and to cost-benefit analysis showing that the system’s greatest benefit would be realized only if adopted by all jurisdictions. The Commission originally proposed firm-only registration to contribute to a compliance culture in the industry by making firms more accountable for their representatives. We also expected we could reduce compliance costs, while giving up little regulatory value. Although we have concluded that firm-only registration is not practical at this time, the new legislation has other provisions that focus more accountability on firms for their representatives and the Commission will be working to emphasize that accountability.

Regulatory Impact

Have you examined the regulatory impact of the new legislation?

Answer: Yes. The BC Securities Commission rigorously analyzed the impact of the most significant changes in the new legislation in five studies published between October 2002 and May 2004. These studies can be found at www.bcsc.bc.ca/policy (select “Regulatory Impact Analyses”) and are described below.

1. *Better Disclosure, Lower Costs* examines the impact of the Continuous Market Access system. It shows that it would achieve both better disclosure and lower costs for all types of companies.
2. *Strong and Efficient Investor Protection* examines the regulatory impact of the Code of Conduct for dealers and advisers. It shows that strong and efficient investor protection would result from emphasizing outcomes that help firms align their compliance focus with the interests of investors and markets.
3. *Cost Savings Under a Firm-Only Registration System* quantifies the potential savings to industry from dropping the requirement and processes for registering representatives of dealers and advisers. It shows that firm-only registration, if adopted nationally, would cut industry’s internal registration costs in half. The Commission is not proceeding with the firm-only registration system at this time because of the complexities of implementing it in only one province.)

4. *Investor Remedies in Securities Regulation* examines the impact of the Commission's earlier proposal to significantly broaden civil liability under the *Securities Act* to foster a culture of compliance among market participants. Based on the study, the Commission dropped some proposed new remedies either because they would not add to common law remedies already available or because the impact on market participants could not be quantified. The study shows that the more targeted extension of liability in the new legislation provides a meaningful deterrent without penalizing compliance-minded market participants by unduly increasing their liability risk or imposing unnecessary costs.
5. *Enforcement of Outcomes-Based Securities Regulation* compares the enforcement actions taken under the current legislation to the corresponding provisions of the new legislation. It shows that the new legislation, compared to the current legislation, would provide an equal, if not stronger, foundation for enforcement action against misconduct.