

Effective Regulation for BC's Capital Markets

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Thank you for the introduction. I am pleased to be here today at a particularly interesting and challenging time for all of us in the securities market.

When I last spoke at the Board of Trade a few years ago, we were in the throes of creating new, improved securities legislation for BC. So much has changed since then. Our regulatory reforms have taken a different direction, as we have intensified our work with other provinces. We are now on the cusp of making significant improvements to the entire Canadian regulatory system.

I will talk about the progress we are making on developing the passport system, to increase the efficiency of Canada's decentralized regulatory structure, and in bringing a more principles-based approach to regulating Canada's capital markets.

I will also outline the BCSC's new plan to deal with abusive junior market activities that are hurting BC's reputation.

Finally, I will briefly describe a few other things we are doing to protect investors, including the BCSC's leadership role in educating investors and making Canadians more financially literate.

So let me begin with the national scene.

For many years, we have been working with our colleagues in other provinces to coordinate regulation and simplify compliance. We have put much of the substance of regulation into a set of so-called national instruments, rules that have been adopted across Canada using mostly identical wording. We grant regulatory approvals on a highly coordinated basis through mutual reliance systems, in which a person or company's home province regulator conducts the analysis and makes the decision, with others then taking a short time to opt-in to the same decision. And we have a set of electronic systems through which you can make most regulatory filings with all regulators by pushing a button.

Canadian regulators are now taking coordination to a new level with the passport system. By mid-2008, our new passport system will provide single window access for public companies and investment firms across Canada, based on a full set of highly harmonized rules.

Let me give you a little background. Ministers for securities regulation in 12 provinces and territories, all except Ontario, have signed a 2004 Memorandum of Understanding committing their governments to harmonize legislation, develop a passport system, and pursue further reforms. Under the direction of the new Council of Ministers, regulators implemented Phase 1 of the passport system in September 2005. Now, armed with new legislative powers to cooperate and rely on each other, we are preparing to implement Passport 2.

Passport 2 will be simpler, faster, and cheaper. Under the new system, your company will get a single decision from your home province regulator, whether you are in Halifax, Montreal, Calgary or Vancouver, and have it apply automatically throughout the 12 provinces and territories.

It is simpler because you need only one decision from one regulator, and you need comply only, for the most part, with a set of nationally harmonized laws. You will get decisions faster, because you don't have to wait for other regulators to opt-in.

The system is also cheaper because you can eliminate many of the professional costs for dealing with multiple regulators and different laws. Your company must still pay most types of fees to all jurisdictions but the Council of Ministers has established a process to review fees once Passport 2 is implemented.

Although I know that multiple fees are an irritant, you might be interested to know that the BCSC did a cost benefit analysis in 2002, which showed that regulatory fees were a small fraction of the overall cost of an offering, compared to the companies' internal and external compliance costs. Passport will reduce those more significant costs.

In addition, if a company applies for discretionary relief, the passport system will be less costly as the company only needs to file its application with, and pay fees to, its principle regulator.

You are probably asking yourself: What about Ontario? How can this system work without the largest and most important securities commission?

The other governments and regulators want to get Ontario involved and we designed Passport 2 to work for all provinces and territories. We know that Ontario has another dream, to create a common securities regulator for all of Canada but we don't think that dream should stand in the way of progress now.

At the end of May, I, along with my colleagues from Québec, Alberta, and Manitoba, held an information session with over 100 senior industry and professional representatives, hosted by Richard Nesbitt of the TSX.

We felt it was important to go to Bay Street because it was clear that the folks in Ontario knew very little about the passport system. Neither the Ontario government nor the Ontario Securities Commission was explaining to Ontarians what the new system looks like, how it will work, or how it can improve regulation for Canada's securities markets.

The room was packed, standing room only. We heard a lot of questions and comments. Although the Toronto crowd remains focused on the ultimate objective of a common regulator, many of the participants told us they support Passport 2 as a significant improvement to the regulatory system.

We continue to invite Ontario to participate in the passport system so it can provide national coverage. However, we can't assume the Ontario government will sign on in time for us to implement Passport 2 next year. We are therefore working with our friends at the Ontario Securities Commission to design interfaces with the passport regulators that will make the system as efficient as possible for market participants.

At this point, you might ask: Why don't the other provinces and territories go along with the common regulator proposal?

First, I should emphasize that any resolution of the common regulator debate will come from governments, not regulators. The BCSC is neither for nor against the common regulator proposal. We are a creature of the provincial government and our job now is to make the current system work as well as possible.

I must say, though, that I have watched the debate about a national or common regulator for two decades now and have observed that much of the debate is founded on misconceptions about how our current system works and naïve assumptions about how an alternative might work. A lot of wishful thinking goes into the dream of replacing an existing system and its well-known flaws with a new system that is imagined to be flawless.

I could cite a variety of national initiatives that looked great on the drawing board but were less than perfect in execution, but you can all think of your own examples.

The provincial government's position, as stated publicly, is that the passport system offers the most promise for improving Canadian securities regulation. The passport system might ultimately evolve into a common regulator, but there is currently no support in provinces other than Ontario for committing to that outcome. All 12 governments think it is important to keep momentum going on the one process that will take effect in a year and could, if Ontario would join, cover the whole of Canada. No other option offers that prospect.

Last week, the Federal government, after discussions with the Provinces and Territories, announced that it would set up an expert panel to look at the two approaches – the passport system and a single national regulator. It will also look at how to improve enforcement efforts and what timelines and transition plans are required to implement either approach.

The expert panel will examine the outcomes, principles and performance measures that will best anchor securities regulation and the pursuit of a Canadian advantage in global capital markets. Most encouragingly, it will look at how Canada could best promote and advance proportionate, more principles-based regulation starting from existing harmonized legislation and national and multilateral regulatory instruments.

This last point reflects a sea change in how other Canadian governments and regulators are thinking about the best way to regulate. For several years, the BCSC has focused on

moving towards a more principles-based approach to regulation with more outcomes-based processes. We see that approach as the best way to make regulation more effective in protecting investors and less burdensome for market participants.

When we started this work, our colleagues in the Canadian Securities Administrators did not accept or agree with the changes we thought were necessary for better regulation. We found ourselves in a difficult situation – constantly forced to choose between adopting the approaches we considered best from a regulatory perspective, while at the same time trying to harmonize our requirements with those of our colleagues.

I am happy to say that has changed in today's regulatory environment. There is much more support for the principles-based approach within the Canadian and North American securities world. However, we will have to work diligently to make sure that this approach becomes embedded in Canada's regulatory culture and is not just a flavour of the month. We have learned at the BCSC that converting to a principles-based approach takes time, focus and effort. It's more about how you think about and administer the rules with regulatory outcomes in mind than about the mere drafting of the regulatory requirements.

Now onto our home territory.

What is the problem?

Well, a subculture of individuals living in this province is harming BC's capital markets. They are engaging in abusive activities involving the over-the-counter (or OTC) markets in the United States. The OTC market is composed of Over-the-Counter Bulletin Board or OTC BB and the Pink Sheets.

A short explanation of what these are: the OTC BB is a quotation service that displays quotes, last-sale prices and volume information for equity securities trading in the US. The Pink Sheets, published by Pink Sheets LLC, is an electronic system that displays bid and ask quotation prices of securities, and is used by stockbrokers trading over-the-counter in the US.

These markets are legal and are home to legitimate businesses, but they are vulnerable to abuse because the level of regulatory scrutiny is very low.

Here is the problem. Unscrupulous promoters, through deceptive means, gain control of a public company, and then promote it by making misleading disclosure. After the stock price rises, the promoters sell their shares into the market to unsuspecting investors. Since the company has no legitimate business or prospects, the stock soon becomes worthless.

Unfortunately, a disproportionate number of these promoters operate from British Columbia. Currently there are about 500 OTC BB and 200 pink sheet companies that have some BC connection.

Sometimes the head offices are here, but often the head offices are elsewhere, Nevada or Florida for example.

What are these people doing that we are so concerned about?

- BC promoters are carrying out “pump and dump” schemes, often through spam and other manipulative activities that harm investors.
- BC shell manufacturers are creating shell companies and selling them as promotional vehicles for high returns.
- Some BC dealers have been allowing anonymous offshore individuals to open accounts, deliver securities and then instruct brokers to sell those securities, no questions asked. The brokers usually have no idea who owns the securities.
- Last and definitely not least: Some BC accountants, lawyers and geologists are directly involved in facilitating these activities.

Although the victims are usually not BC investors, the visible connection to BC damages our market’s reputation.

Let me remind you what is at stake here and why we have to take action.

BC is the capital of the world for financing mineral exploration. It is also an important market for raising capital for small oil and gas companies, biotech and technology companies.

A few statistics will give you a picture of BC’s capital markets:

In 2006, we raised about \$3 billion dollars in BC as compared to \$2.6 billion in Ontario to finance mining exploration.

There are about 1,500 BC-based public companies on the Canadian markets – accounting for 13% of companies trading on the TSX; and 46% of those trading on the TSX Venture Exchange. A final important statistic -- BC based companies raised about \$42 billion dollars in the period of 2001 to 2006.

It is for the sake of the majority that we must deal with the bad apples who can spoil it for everyone. Our goal is to make BC the most transparent, toughest jurisdiction anywhere for OTC trading.

Let me emphasize that there are no silver bullets to deal with this problem.

In 2003, the BCSC set up a special group to examine the problem and coordinate our compliance and enforcement activities for OTC companies. In some instances, enforcement staff worked with the US Securities and Exchange Commission to share information and coordinate enforcement actions.

Last summer, the BCSC ordered two people out of the BC capital markets for life at the same time the SEC obtained disgorgement orders in the US. In this case, we were able to disrupt and stop the scheme early in its operation. Cases like this send a strong message that our borders will not stop regulators from assisting one another to protect our markets and investors.

As I said earlier, there are hundreds of these companies with BC connections. Many of them are legitimate businesses but too many are not. Enforcement alone cannot deal with this problem. Cases are often complex, involve cross border activity and are hard to prove.

While we will continue to enforce where we can, we have concluded that it will take a multifaceted approach, using a variety of tools, to deal with the magnitude of the problem.

We have put together a five-point plan, which we describe in a notice issued this morning.

- First, we want to improve disclosure and compliance by US OTC issuers with significant connections to British Columbia;
- Second, we want to disrupt the manufacture and sale of US OTC shell companies;
- Third, we want to disrupt abusive promotions;
- Fourth, we want to hold dealers responsible for their trading activities in the US OTC market; and
- Fifth, we want to discourage the participation by lawyers, accountants, geologists and other professionals who facilitate abusive market activities.

Here is a brief summary of some, not all of the actions. Consultation and implementation will occur over the next six months. Copies of the notice are available here today and are posted on BCSC's website.

First and most important, we propose to require BC OTC companies to comply with timely and continuous disclosure requirements. As well, we will require directors and officers to file personal information forms.

We expect that some won't want to bear the increased cost or to disclose more information about their companies. They can fold their tents and move elsewhere to do their unsavory business.

We will cease trade the issuers' securities when we find significant non-compliance with these requirements. This could be an issuer's failure to disclose management and investor relations personnel for example.

We already cease trade BC OTC mining companies that have announced mineral resources or reserves and have not filed technical reports, as required under National Instrument 43-101.

In order to disrupt the manufacture and sale of shell companies, we will be doing what we call “early” investigations and focused enforcement action.

Many of these issuers must file an SB-2 Registration form with the SEC to qualify their securities for sale in the US. We will ask BC OTC issuers who have filed SB-2s to provide shareholder lists and to identify the exemptions relied upon to issue shares in British Columbia. We will investigate all of these issuers to determine whether or not they met the requirements to use exemptions. If not, we will cease trade the issuer until it files a prospectus.

We will propose new resale restrictions on people who buy shares of a BC OTC company before it goes public. In the future, shares will only be able to be sold through a dealer, from accounts in their own name and into the public market.

In May, we announced a program called SpamWatch in which we publish information of BC OTC issuers that are part of a spam campaign. In some cases, we are imposing three-day trading halts. To date, we have imposed five halt trading orders, and surprise, surprise, the volume of spam has dropped dramatically. What this told us is that the people responsible for the spam are well aware that we are now watching and acting.

For dealers, we are going to propose new conditions of registration for those who are or may become active in trading in the US OTC market. Last fall, we began working with the IDA and its BC-based dealers to determine the most fair and effective way to deal with this problem. We have been impressed with the cooperation we have received and will be consulting with them this fall on a variety of new conditions that are outlined in the notice.

Finally, we are working with professional association and industry groups like the Law Society of British Columbia, the Institute of Chartered Accountants and the Association of Professional Engineers and Geoscientists to build awareness about the abuses of the US OTC markets conducted from British Columbia. The BCSC will make referrals to these bodies for disciplinary purposes, where appropriate.

As we continue to deal with this pernicious problem, we need to get the message out that the BCSC is taking an active role in regulating this part of the market, that staff will interfere and disrupt local participation in abusive and manipulative schemes, and that participants will be penalized.

As I said earlier, it is going to take time. We don’t expect to eliminate completely all BC-based abuses of US OTC markets, but if as a result of these initiatives, British Columbia’s share of abusive US OTC market activity is no longer disproportionate, that will be a significant success. It will also be a first step to the ultimate goal of reducing our share of this activity to a disproportionately low level.

In conclusion, I want to remind you what our mandate is: the BC Securities Commission is here to protect investors and to provide efficient regulation that supports competitive markets. What we do has huge impact.

We set standards and rules for companies so that they can be as accountable and transparent as possible to investors. But when they break the rules, it is our job to go after them, either alone or in cooperation with the police. It is something we are doing every day.

For example in the period 2001 to 2006, we processed over 7500 enquiries, opened over 2,000 cases, investigated about 165 cases. We issued 990 settlement agreements and held over 100 hearings. All this with 20 investigators and 12 lawyers in our enforcement branch.

We recognize the need to focus more on enforcement and, particularly, to work more effectively with our colleagues in the criminal justice system. This is an issue of national significance and concern. Last year, the federal-provincial-territorial ministers of justice set up a multi-disciplinary working group, involving police, prosecutors, justice policy officials, and securities regulators, to examine how we can strengthen the criminal deterrent against securities fraud. My colleague David Wilson, Chair of the OSC, is co-chairing this working group and they will be reporting in October. Also this fall, on October 31, the BCSC's annual Capital Ideas session will focus on what is happening internationally in securities enforcement. We will bring in international experts for lively debate with Canadian authorities.

Here in BC, we are also working together with Crown counsel and the RCMP to try to get more cases into the courts that result in more penalties and jail time. We need to send a stronger message to the bad actors that penalties are not just the cost of doing business, and that they really can end up in jail!

One thing we have learned, though, is that the best form of investor protection is self-protection. We have stepped up our investor education program with a new initiative called InvestRight. Its purpose is to teach individuals the necessary financial literacy skills they need to make sound investments. InvestRight combines both warnings and education. It targets those at most risk of investment fraud – seniors, faith-based groups, pre-retirement baby boomers, ethnic and immigrant communities. As well, we continue to provide a comprehensive resource to teachers of Grade 10 students to teach young people the fundamentals of managing money.

BC is playing a leadership role nationally. We are currently working with the Federal government to make these adult investment education and student financial literacy programs available across Canada in English and French.

For more immediate protection, we post RED ALERTS on our website in order to warn investors when we know something is going on in a particular community but don't have enough information to disrupt, stop or prevent it. We are looking for better ways to stop

people from losing their hard-earned money as we investigate and penalize those people who prey on vulnerable investors.

In summary, we trying to do more to disrupt, stop and prevent investment fraud. That's our job. We will continue to try harder to make sure BC is a good safe place to invest and to provide a competitive, healthy capital market for businesses to operate in BC.

Thank you.