

Another Way Forward for Securities Reform

Submission to

The Task Force to Modernize Securities Legislation in Canada

British Columbia Securities Commission

Vancouver, British Columbia

October 11, 2005

Securities Regulation at the BC Securities Commission

The British Columbia government passed a new *Securities Act* in May 2004. While the new Act is not yet in force, our Commission continues to reform regulation in ways that are consistent with the philosophy of the new legislation. We have sharpened our focus on attacking the more significant threats to investors and market integrity, so BCSC resources are used in the most cost-effective way to achieve our regulatory objectives. To minimize burden on industry and to place responsibility for compliance where it belongs, with senior management, we now aim to address regulatory issues by directing the outcome to be achieved rather than imposing detailed and inflexible requirements.

To The Task Force to Modernize Securities Legislation in Canada
From British Columbia Securities Commission
Date October 11, 2005
Subject Another Way Forward for Securities Reform

We are pleased to respond to your request for submissions on ways to modernize securities legislation in Canada.

This submission focuses on the provisions of the new BC securities legislation, which consists of the *Securities Act*, SBC 2004, c. 43, and the related rules proposed by the BCSC. The new legislation is part of a new, outcomes-based approach to regulation that the BCSC adopted several years ago and continues to implement, despite the delay in bringing the new legislation into force.

In examining how to modernize securities legislation in Canada, you should consider the following: it is very important to get the rules right; it is even more important to administer the rules the right way. As we will explain in our meeting, we are doing both.

We have structured our written submission to explain how the new BC legislation deals with the 5 key issues you raised:

- Investor Protection
- Finding a balance between cost and effectiveness of modern governance
- Access to Capital
- Regulatory Burden
- Enforcement Effectiveness.

In each area, we describe how the issues have been dealt with in the new BC legislation and explain the rationale for the decisions. We ask that you read this submission along with the remarks we will make in our oral presentation, a copy of which we will provide to you at the conclusion of our presentation.

We attach the following appendices referred to in our submission:

- Appendix A – Proposal to Redefine the Materiality Standard (June 2002)
- Appendix B – Better Disclosure: Lower Costs – A Cost-Benefit Analysis of the Continuous Market Access System (October 2002)
- Appendix C – Strong and Efficient Investor Protection – Dealers and Advisers under the BC Model – a Regulatory Impact Analysis (November 2003)
- Appendix D – Enforcement of Outcomes-Based Securities Legislation (May 2004)
- Appendix E – Analysis of Firm-Only Registration (April 2003)
- Appendix F – Cost Savings under a Firm-Only Registration System (May 2004)

We look forward to discussing our outcomes-based approach to regulation and answering any questions you may have during our presentation on Friday October 14, 2005.

Part 1– Investor Protection

The new legislation improves investor protection in four key ways:

1. The use of outcomes-based requirements
2. Its streamlined and simplified design
3. Strengthened enforcement powers
4. New investor remedies

1. Outcomes-based requirements

The new legislation is built around outcomes-based requirements. These will replace many of our detailed, prescriptive rules. We believe outcomes-based regulation better protects investors because prescriptive regulation can encourage a loophole mentality, where market participants follow the letter (but not the spirit) of the rules. Prescriptive regulation does not demand that management exercise judgment or focus on broader obligations to the market and specific requirements can quickly become outdated in the continually evolving securities industry. A regime that relies excessively on detailed and prescriptive requirements is also a symptom of a regulator that is too involved in the operations of regulated firms.

Outcomes-based requirements, on the other hand, focus market participants on what is right for investors, clients and markets. Investors are protected best when market participants fully understand, and are held accountable for, their broader obligations to clients and the market. Outcomes-based requirements are responsive and flexible, adapting to market changes as they occur. This means they lower the cost of regulation, a cost ultimately borne by investors. They provide a sound basis for regulators to hold industry to high standards of conduct. In addition, they permit market participants 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. Market participants operating in an outcomes-based environment can adapt their compliance practices in response to changing market conditions. This means better investor protection at a lower cost to investors and the market.

These are examples of the differences between prescriptive regulation and outcomes-based regulation, and how the latter better protects investors:

- **Clearer disclosure** – Current disclosure requirements are generally detailed and prescriptive. The disclosure that results is legalistic and largely impenetrable. The new legislation contains fewer detailed disclosure requirements and has an overriding outcomes-based requirement that disclosure must be understandable to ordinary clients and investors. This will lead to disclosure that is meaningful, understandable, and achieves its intended purpose.
- **More useful documents** – Since all material information about the issuer is available to investors all the time, the new legislation requires no disclosure document for offerings after the IPO (see Part 3). However, issuers are free to prepare one if they like. If they do so, there are no mandated disclosure requirements; they must only

ensure that the document does not contain a misrepresentation. This allows the issuer to craft a document it thinks will be most useful to prospective investors, yet holds it and its senior management accountable if it makes a misrepresentation. Regulatory burden is reduced, yet investor protection is improved by ensuring that any disclosure is complete and truthful.

- **More informed decision-making** – The current legislation requires registered dealers and advisers to provide prescribed disclosures to clients, who can also obtain some additional information on request. However this does not ensure clients get all the information they need to make informed investment decisions. The new legislation replaces these requirements with a requirement that registrants provide clients with the information necessary to make informed investment decisions. It also requires registrants to tell clients all important facts about fees and conflicts of interest, and indeed any information that a reasonable client would consider important in assessing the registrant’s ability to provide objective services or advice. These outcomes-based requirements will mean that investors will get more relevant and meaningful information.
- **Improved protection against conflicts** – The current legislation handles conflicts of interest by prohibiting some specific transactions, restricting others, and requiring disclosure of others. This approach restricts some transactions that pose no threat to investors, while ignoring some conflict of interest situations entirely because they are not specifically mentioned in the legislation. The new legislation replaces these provisions with a requirement that registrants resolve conflicts of interest in favour of the client, and tell the client anything that would lead a reasonable client to question the objectivity of the advice being given. This forces the registrant to consider what conduct will be appropriate, and covers all conflict situations, whether known today or arising in the future.

2. Streamlined and simplified design

Current securities legislation is complex and excessively detailed. It is often hard for market participants to understand. Complex requirements can cause them to lose sight of the underlying principles. The new legislation streamlines and simplifies the rules and writes them in plain language. We will also provide accessible guidance and comprehensive industry education programs for market participants, enabling market participants to understand more easily what is expected of them. This means we can hold them to high standards of disclosure and conduct, while providing better protection for investors and market integrity.

3. Strengthened enforcement powers

Strengthened enforcement powers and penalties will provide the Commission, and the courts, with more tools to deal with those who break the rules and to deter misconduct that threatens investors. Under the new disgorgement power, investors will be able to make claims against money recovered from wrongdoers. The increased enforcement powers are discussed in Part 5.

4. New investor remedies

Like in Ontario, there is a new remedy that permits investors in the secondary market to sue companies for misrepresentations in public disclosure documents or oral statements. Unlike in Ontario, the new remedy in BC is streamlined, as is the rest of the new legislation. This means that the liability standard for different defendants does not vary with the type of disclosure. Instead, we included a new defence that lets directors rely on management as long as the issuer has a reasonable system to ensure compliance.

Another difference is that the new remedy integrates primary market liability and secondary market liability. This puts all investors on the same footing, whether they buy from the issuer or in the secondary market. It recognizes that all investors depend in the same way on the information that a public issuer discloses.

The new legislation also includes an improved right to sue for insider trading. 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. Eliminating the requirement to prove who is on the other side of a trade in the secondary market makes the remedy more effective and will allow it to operate as originally intended.

Currently, the only way an investor can bring wrongful conduct to the Commission's attention is by making a complaint. This may or may not result in an investigation and enforcement proceeding by the Commission. The new legislation permits anyone who believes another person has contravened the legislation to seek leave from a Commissioner for the Commission to hold a hearing in the matter. Further details of this provision are in Part 5.

Part 2 – Balancing Cost and Effectiveness of Governance

The new legislation imposes governance requirements that are less costly and more effective. It requires:

- an auditor’s report on the financial statements of a public issuer, to be prepared and signed by a person subject to the requirements of the Canadian Public Accountability Board (CPAB)
- a reporting issuer to have an audit committee with a majority of independent members
- a reporting issuer to disclose its governance structure

It does not require:

- that all audit committee members be independent and financially literate
- that independence be determined using bright-line tests
- senior officer certification of financial statements and internal controls
- anything specific to internal controls on financial reporting, or that those controls be audited

Auditor oversight

The new legislation requires that an auditor’s report on the financial statements of a public issuer, be prepared and signed by a person subject to the requirements of the CPAB. Unlike the regime under National Instrument 52-108 *Auditor Oversight*, the new legislation does not include the requirement that the auditor must be in compliance with any restrictions or sanctions imposed by the CPAB. It is up to the CPAB to enforce its requirements, and to issuers to ensure their auditors are qualified to do the audit under CPAB rules.

Audit committee

The new legislation requires a reporting issuer to have an audit committee that performs specified functions and has a majority of independent members. There is an exemption from the audit committee and independence requirements for issuers who have fewer than five members on the board if the board performs the responsibilities of the audit committee. This recognizes that directors of small companies are often also officers or significant shareholders of the company.

Unlike the regime elsewhere in Canada, the new legislation does not require all audit committee members to be independent, or that they be financially literate. There was no analysis to demonstrate that independence of all members was necessary to achieve the desired outcome, and we do not believe that the financial literacy requirement is enforceable as a practical matter.

We also did not use the same test for independence. Our test is objective and considers what a reasonable person with knowledge of all the relevant circumstances would conclude. The definition of independence in the rest of Canada includes a general test that is supplemented by bright-line exclusions, which in our view defeat the purpose of

the general principle. Issuers will focus more on whether they fit a specified circumstance than whether they meet the general test.

Disclosure of governance structure

The new legislation requires reporting issuers to disclose corporate governance information.

The requirement is intended to ensure that meaningful corporate governance information is available for investors about the structures, processes and practices issuers use so investors can make informed decisions. It also leaves issuers free to choose an effective governance structure that suits their particular circumstances.

No certification requirements

Our new rules do not include certification requirements. The rest of CSA requires the CEO and CFO of a reporting issuer to certify that:

- the issuer's annual or interim filings do not contain any misrepresentations and fairly present, in all material respects, the issuer's financial position
- they are responsible for the issuer's disclosure controls and procedures and internal control over financial reporting and that those controls are effective

The new legislation does not have any similar requirements because directors and officers have a general duty under securities legislation to ensure that an issuer's disclosure is not false or misleading. Directors and officers are also directly accountable under the legislation for any violations by the issuer and are exposed to both quasi-criminal prosecution and administrative sanctions. Requiring directors and officers to confirm responsibility for disclosure, and requiring the issuer to follow specific internal governance practices, therefore adds nothing meaningful to the legal duties of directors and officers.

We were also concerned that although these requirements might have short-term benefits by focusing issuers on improving disclosure, the longer-term effect would be to undermine the effectiveness of general regulatory obligations by promoting a mentality of rote compliance.

Enforcing outcomes-based requirements, rather than specifically defining how issuers should manage their affairs to achieve the intended outcomes, provides better regulation by setting the expectation of behaviour, and then holding directors and officers accountable. It also ensures that the persons best placed to exercise judgment (the officers and directors) do so. In addition, this approach gives regulators the tools to deal immediately with emerging issues, through enforcement, compliance reviews, education or guidance, instead of constantly creating new rules after the fact to deal with each new problem that arises.

Many of the recent large corporate failures demonstrate that these requirements would not necessarily have prevented the wrongdoing. The perpetrators were already breaking existing laws and presumably would have had little compunction about signing false

certificates. It is likely that the benefits ascribed to the Sarbanes-Oxley requirements in the US and the similar “investor confidence” rules in Canada really resulted from heightened market attention to governance, disclosure, and financial reporting and auditing issues following the scandals and subsequent regulatory and criminal action, not from the actual regulatory requirements.

No internal controls rule

Although other Canadian jurisdictions have proposed a Canadian equivalent to SOX 404, the new legislation includes no requirements along these lines. We do not think that the case has been made for the rules, and we are not alone. The United Kingdom and Australia have not implemented a SOX 404-type internal control rule for the same reason. Instead, both jurisdictions require disclosure about internal controls and the United Kingdom also requires a limited auditor review.

Reliable and timely financial reporting by Canadian issuers is essential, and no doubt many issuers need to improve their internal controls over financial reporting. But is a new rule the best way to focus issuers’ attention and resources on the objective of improving financial reporting? Existing financial reporting requirements already require issuers to develop and maintain appropriate internal control over financial reporting. Even without an internal controls rule, any issuer making erroneous disclosure could defend itself only by showing that it exercised due diligence in its financial reporting processes.

This type of rule also promotes a “box-ticking” approach to controls, rather than an outcomes-based approach that focuses on both business needs and regulatory compliance.

Experience in the US has shown that SOX 404 compliance is extremely expensive. Since investors ultimately pay the costs imposed on issuers by regulatory requirements, this underlines the need for caution. We will not impose requirements unless we believe that the value to investors would exceed the costs. So far we have seen no credible evidence that any benefits arising from the proposed rule would outweigh the potentially significant costs and adverse outcomes.

Part 3 – Access to Capital

Several features of the new legislation would improve access to capital in Canada’s markets. The new legislation:

- Streamlines initial public offerings and eliminates regulatory approval for offerings after the IPO using a system we call Continuous Market Access
- Eliminates the “closed system” regime of hold periods and resale restrictions for securities of public issuers
- Eliminates mandatory escrow and looks to the market to develop other methods to achieve the intended purposes of escrow

Continuous market access

The prospectus disclosure system dates from the 1930s. Although partly modernized by the short form offering system, it is still complex and costly to use. More importantly, the disclosure it requires of companies that are already public adds little value in the modern market environment. Continuous disclosure is now the cornerstone of disclosure and modern technology enables investors to access that information quickly and easily. Interestingly, the rules surrounding the prospectus regime account for nearly 25% of the volume of securities regulation and yet less than 5% of all trading in Canadian markets occurs in the primary market.

Under Continuous Market Access, a public issuer files a prospectus only once – when it first goes public. After that, the issuer discloses material information¹ as it occurs and files the financial statements and other periodic disclosures (including an annual information form) required under the continuous disclosure rules. Because its public disclosure record therefore always contains all material information about the issuer, when the issuer wishes to raise funds it simply does so – no prospectus or other disclosure document is required (although in most cases the issuer will have to issue a news release).

We found in our cost-benefit analysis of CMA (attached as Appendix B) that CMA’s primary benefits – faster and cheaper access to capital – could be captured by issuers without eroding investor protection.

- Issuers could complete an IPO up to 19% faster and up to 51% cheaper. Offerings after the IPO would be up to 56% faster and up to 82% cheaper depending on the size of the issuer. The study showed that if CMA were available nationally, issuers would save \$170 million in net present value over five years in reduced prospectus preparation and filing costs.
- CSA plans to make the short form offering system available to almost all issuers. This would simplify the current system, but a move to CMA would still yield more significant benefits. Our cost benefit analysis showed that TSX issuers, most of

¹ The new legislation replaces the current “material fact” and “material change” disclosure triggers with a “material information” standard. The analysis of this change is in Appendix A.

which at the time of our study were already using the short form system, would be able to complete offerings 30% faster and 24% cheaper under CMA.

It is also worth remembering that most investors rely on the advice of their advisers in making investment decisions. If investors want to review documents, they can request the documents from the issuer who must send recent documents to them without charge.

No hold periods

The new legislation has no hold periods or resale restrictions for the securities of public issuers. Because material information about the issuer is required to be available at all times, there is no need for hold periods. All of a public issuer's securities – whether issued before, on, or after its IPO, and whether issued in a public offering or private placement, are free trading.

The current system of hold periods and resale restrictions for privately placed securities of public issuers is a complex and burdensome system. The new legislation reduces the regulatory burden on public issuers by eliminating this regime.

No mandatory escrow

The new legislation does not mandate escrow in IPOs. We concluded that the escrow system imposed significant disadvantages on issuers, yet provided no significant benefits to investors.

Requiring escrow has been justified as a means of tying management to the company and helping to prevent a post-offering drop in market price as a result of overselling. Some also see it as a way to help prevent market abuse. However, escrow requirements tend to restrict the sale of shares held by shareholders who are not key to carrying out the issuer's business plan. It is a "one-size-fits-all" approach that does not account for the duration of the investment or the price paid for the security, and therefore often offends investors' sense of fairness.

We do not believe it is necessary to make escrow mandatory, because the problems it is intended to solve can be solved in other ways.

- For example, an underwriter wishing to ensure management's commitment to the issuer can require things like performance-based incentives, management contracts, and non-competition agreements. Alternatively, the underwriter could impose escrow or lock-up agreements by contract, as happens in the U.S. This would also provide aftermarket price protection.
- Nor do we think an escrow rule is the right way to deal with market abuse. It imposes a burden on everyone for the abusive behaviour of a few. There are many other provisions in the new legislation that will allow us to take enforcement action against those who choose to engage in market abuse in connection with IPOs, or otherwise.

Part 4 – Regulatory burden

The new legislation provides more efficient and flexible regulation that minimizes regulatory burden for market participants in three significant ways:

1. Outcomes-based requirements
2. A risk-based approach
3. A streamlined and simplified design

1. Outcomes-based requirements

The current detailed, prescriptive rules force firms to spend time and resources on mandated processes that do not provide optimum investor protection. As discussed in Part 1, the new legislation replaces most of these with outcomes-based requirements that provide better investor protection. These outcomes based requirements also reduce regulatory burden.

Examples of Outcomes-based Requirements

Continuous market access – Under CMA no disclosure document is mandated for offerings after the IPO (although in most cases the issuer will have to issue a news release). Issuers are free to prepare a more formal disclosure document. If they do so, however, they must ensure that it does not contain a misrepresentation (which the legislation prohibits), so they must consider not only what they put in it, but also what they leave out. Any disclosure document also becomes part of their continuous disclosure record, so if there is a misrepresentation, investors will be able to sue them under the new statutory right of action.

This illustrates the difference between traditional regulation and outcomes-based regulation. Instead of mandating the content of the disclosure document, the legislation allows issuers to craft a document in a form that they think will be most useful to prospective investors. However, the legislation requires that the document contain no misrepresentations, and holds the issuer and its senior management accountable if it does. This reduces regulatory burden and yet improves investor protection by ensuring that the disclosure is complete and truthful.

Code of conduct – Another example is how the new legislation regulates dealers and advisers. The current legislation has many detailed and prescriptive requirements that have doubtful value in protecting investors or markets. Investors don't care if firms comply with detailed processes. They want to know that the firm treats them fairly, protects their interests and provides them with the information they need.

So the new legislation replaces the current detailed requirements with an outcomes-based Code of Conduct. This will allow market participants to tailor their compliance systems to suit their individual business models. For example:

- **Firms will focus on compliance problems** – Our regulatory impact analysis on the Code of Conduct (see Appendix C) showed that under the Code, firms would establish compliance systems focused on detecting compliance problems rather than

on auditing mandated processes. One of the dealers surveyed detected only 10% of compliance problems through the daily reviews that the rules require. The firm found the rest of its compliance problems using a proprietary, outcomes-based system that tracked patterns of behaviour.

- **Firms will spend less time on new rules** – The reduction in regulatory burden under the outcomes-based approach in the Code is significant, because firms spend significant resources dealing with new and complex rules. For example, one firm spent 18 person-months of senior professional time preparing a policy to respond to new NASD and IDA rules relating to analyst conflicts (see Finding 10 in Part III.B.2 in Appendix C). Under the Code, which deals with conflicts by requiring firms and their representatives to put the clients’ interests first, there is no need for a special rule to deal with analysts’ conflicts.² Although firms might have to develop new compliance processes to deal with the broader conflict of interest provisions of the Code, they would have the flexibility to do it in a more cost effective way.

Outcomes-based requirements work – The study in Appendix C shows that firms gravitate to outcomes-based approaches once they understand the benefits. We saw that, left to their own devices, firms already design compliance systems to deliver the outcomes they want. This is true even when they have to incur the cost of developing parallel systems when the mandated ones are not effective in detecting non-compliant behaviour. We have also concluded, based in part on discussions we had with experienced litigators, that litigation risk would not increase if firms could demonstrate that they have an adequate system that they follow and keep up to date.

We think that providing an outcomes-based regulatory environment inherently encourages principles-based behaviour. This has happened in the United Kingdom under the largely outcomes-based system administered by the Financial Services Authority. The BCSC’s approach to regulation (keep the rules few, simple and clear, create culture of compliance and train industry) will further encourage market participants to adjust to the new outcomes-based regime.

Outcomes-based requirements are enforceable – We prepared a regulatory impact assessment (attached as Appendix D), which focuses precisely on enforceability. It analyzed Commission decisions and settlements over a two-year period against the provisions of the new legislation that would replace those enforced under the current legislation.

We concluded that most significant enforcement actions taken under the current legislation would continue to be supported by corresponding provisions in the new legislation. This is because most of what the Commission enforces today is existing outcomes-based requirements. Indeed, 92% of alleged breaches in the two-year period covered in Appendix D are in areas where the requirements under the new legislation are

² The study in Appendix C refers to paragraph 5 under Principle 6 of the Draft Code of Conduct dealing with analyst conflicts. Paragraph 5 was later dropped from the Code because the basic conflict requirements cover the situation.

identical or substantially similar to the current legislation or have a similar test. For some types of conduct (for example involving conflicts of interest), the new legislation would provide a more specific basis for enforcement than the current legislation.

Most of the other new requirements in the new legislation would be readily enforceable because they require measurable outcomes, use objective tests that are familiar to adjudicators, or deal with areas where there is an existing understanding of what constitutes acceptable behaviour.

2. Risk-based approach

A regulator cannot prevent all risks to investors and markets (nor should it). The regulator therefore needs some framework to decide when and how to apply its resources. At the BCSC we use a risk-based approach. It is a dynamic system that seeks to identify the most serious threats to investors and markets and to then allocate resources appropriately. The cornerstone of the approach is the problem-solving methodology we will describe more fully in the presentation.

Examples of Risk-based Approach

Conditional registration – For example, in most jurisdictions brokers who transfer between firms cannot work while their transfers are being processed. We analyzed the number of serious problems we identified when processing transfer applications and found that the number was insignificant, and those would likely have been discovered through other means. We therefore concluded that there would be minimal risk to investors in allowing brokers to continue dealing with clients for the few days or weeks while their transfers were processed. As a result, we moved administratively to a conditional registration system. Under this system, we conditionally register a representative (even if the Commission has not received a termination notice from the prior firm) while the transfer is processed. (Other jurisdictions are now considering whether to implement a similar system.)

Firm-only registration – Following a risk-based approach presents opportunities for placing regulation on a sounder footing and introducing regulatory innovation. The registration requirement, for example, actually creates risks. Some firms attempt to shift responsibility for employee compliance to Commissions or SROs. Some investors also place undue reliance on the Commission’s registration. It creates a false sense of security for these investors because they regard registration as a “seal of approval”.

Applying a risk-based approach to registration requirements, we concluded that there would be no significant risk to investor protection if we did not require individual brokers and advisers to be registered. This led to our proposal for firm-only registration. Under this system, the Commission would register only the dealer and adviser firms — not the individual representatives.

This is how we analyzed the risk.

The registration requirement for individuals has these objectives:

- Prevent unsuitable individuals from becoming representatives
- Monitor representatives when they change firms and impose conditions if necessary
- Discipline or remove representatives who contravene the legislation or act contrary to the public interest
- Make information about representatives available to the public

We determined that most of these objectives could be met without the need to register individuals (see Appendix E for the full analysis).

- Using outcomes-based requirements, the Code of Conduct requires firms to hire suitable individuals and ensure they are properly supervised. It also makes firms responsible for those they hire and requires firms to share information about individuals at the time of hiring. Individual representatives must comply with virtually all requirements in the Code, including plain language disclosure and putting the client's interests first.
- As noted in the previous example, the risks associated with transfers were minimal.
- Under the new legislation the Commission can prohibit a person from being registered, or restrict a person's trading or advising activities.
- As firms are responsible for those they hire, investors should look to the firm, not the Commission, for information about their representatives.

Firm-only at work in other jurisdictions

- The SEC does not register representatives of advisers.
- The FSA does not authorize an appointed representative of a firm although they do require notification.
- Australia has a firm-only system that applies to those offering financial services. ASIC does not register representatives but requires notification of those representatives that are not directors or employees of the registered firm.

Firm-only lowers costs – Although the National Registration Database has reduced some of the regulatory burden associated with registration, we found savings in a move to firm-only registration. The study (see Appendix F) found that if firm-only registration were adopted nationally, firms would save \$12.6 million. This represented 49% of their current internal costs related to individual registrations.

Although we chose not to proceed with firm-only registration for the time being, it is a good example of applying a risk-based approach to policy-making. (We did not proceed because it would have complicated the national passport discussions. In addition, our study suggested the greatest benefits of a firm-only registration system would come about only if the system were adopted nationally.)

3. Streamlined and simplified design

Securities legislation (including much of what is currently in force in British Columbia) is not easy for industry participants to understand. They need to retain professional advisers to help with even routine compliance matters, or spend time seeking guidance from the regulator. Firms might not comply simply because they cannot understand the rules.

The new legislation is designed to address these problems.

- **Fewer detailed requirements** – It has a simpler structure and far fewer detailed requirements. In fact there are fewer than half the number of regulatory requirements under the new legislation than there are now in British Columbia. For example, the current underwriting conflict rule and related policy and flow charts take up 20 pages in the rulebook. It is very difficult to understand. The Code of Conduct in the new legislation covers the same subject matter in a rule that is 5 lines long, supported by 9 paragraphs of plain language guidance.
- **Plain language** – The legislation is written in plain language and we provide extensive written guidance, also in plain language.
- **Reduction in paper load** – The new legislation reduces paper load. This is a natural by-product of moving to an outcomes-based regime. The legislation is also designed with electronic data storage and transmission in mind. For example, dealers will no longer have to keep paper copies of documents if they have an electronic documentation system (see the study in Appendix C for other examples). Many forms have been eliminated; those that remain have been simplified, and almost all forms can be completed and filed electronically.

Overall, the new legislation reduces the regulatory burden on market participants while enhancing investor protection as discussed in Part 1.

Part 5 – Enforcement Effectiveness

An effective system of deterrence would see a balance among criminal prosecution, civil liability and regulatory enforcement.

Criminal enforcement

You ask whether expectations are unrealistic. We think that unrealistic expectations are at least part of the reason that there is a perception that enforcement is not effective. People see those who break US securities laws going to jail and wonder why it is not happening here. Part of the problem is that many people do not understand that securities commissions do not have the power to impose criminal penalties like prison sentences.

But the problem goes deeper. The fact is that there is no credible criminal deterrent in Canada for securities law violations. Generally speaking, financial crime is not a priority for police or prosecutors. When a prosecution does happen, it usually takes years to come to trial. And even when there are convictions, the courts often do not impose meaningful sentences.

The Criminal Code empowers the courts to impose meaningful sentences. There are limits to the penalties that can be imposed under provincial legislation, but the new legislation increases the maximum fine from \$1 million to \$3 million. Even higher maximum penalties continue to apply in insider trading and fraud and have been added for front running cases.

The new legislation also empowers the criminal court to make restitution and disgorgement orders (orders requiring wrongdoers to return funds equal to their profits earned or losses avoided).

However, these legislative provisions will mean little until the criminal justice system — police, prosecutors and courts — adopt a different attitude to securities fraud. As noted in the Eron Mortgage Study by Professor Neil Boyd in 2005,

. . . it is appropriate to ask whether the current penalties adequately reflect the harms created by such activity. . . . Their crimes (i.e. typical murders) are appropriately punished, but the deliberateness of their conduct and its impact on the wider community is often much less significant than the actions of those who engage in investment fraud. The principals in Eron appear to have demonstrated little remorse, though the consequences of their actions were literally devastating to hundreds of investors. And yet the civil and criminal penalties imposed are, in relative terms, quite minimal.

Civil enforcement

As discussed in Part 1, the new legislation provides a new statutory right of action for misrepresentations in continuous disclosure, and provides a better civil remedy for insider trading.

The new legislation also includes an improved disgorgement power to help to ensure that those who breach the Act cannot benefit from contravening the legislation. As mentioned in Part 1, investors will be able to make a claim against the disgorged funds. This new disgorgement power makes it more likely that investors can get their money back.

We considered whether the Commission should have the power to order restitution as well as disgorgement. We decided not to propose a restitution power. Making restitution orders would take the Commission into the area of determining rights between parties, traditionally a matter for the courts. This could jeopardize the Commission's effectiveness in dealing with public interest matters. Weighed against that risk, the potential benefit seemed small, especially with the improved disgorgement power for the Commission and the power of the criminal courts to order restitution.

The new legislation maintains the provision under which the commission can apply to the Supreme Court for restitution (and other) orders. We are in fact using this provision in a current action.

Regulatory enforcement

The current BC legislation has strong enforcement powers and the BCSC has been active in using them. A study done for the Wise Persons' Committee in 2003 showed that BC led the country in the number of securities enforcement actions from January 2000 to mid-2003.

Under its existing enforcement powers, the Commission can:

- bar those involved in misconduct from the securities markets in various ways
- prohibit wrongdoers from holding office in any issuers
- assess administrative penalties and hearing costs
- order that certain securities not be traded
- apply to court for a compliance order
- apply to court for disgorgement, restitution or damages

The new legislation broadens existing enforcement powers. It:

- increases the maximum administrative penalty the Commission can order to \$1 million per contravention of the legislation (the current maximum is \$250,000 per hearing for an individual and \$500,000 per hearing for a non-individual). The new legislation increases the maximum administrative penalty so that BC does not fall behind the maximum administrative penalties in Ontario and Québec.
- allows investors the right to claim funds disgorged (under the current legislation, disgorged funds are paid into the province's general revenue fund)
- allows anyone who believes another person has contravened the legislation to seek leave from a Commissioner for the Commission to hold a hearing in the matter.

Currently complaints are assessed in the Commission's enforcement department and then (when appropriate, using a risk-based process), proceed through the formal investigative and enforcement process. The new legislation includes this power so that market participants have an explicit process to have serious complaints heard directly, if they are able to gather the evidence and present the cases themselves. The new legislation includes the leave procedure before a single Commissioner so that the Commission can retain control over its process and resources. The leave process also protects against frivolous and pre-mature cases.