



Comments of Desjardins Group

Submitted to the

Expert Panel on Securities Regulation in Canada

July 2008

TABLE OF CONTENTS

ABOUT DESJARDINS GROUP.....	1
CONTEXT.....	1
A COMPLEX AND COSTLY TRANSITIONAL PROCESS	2
The trend to U.S.-style regulation	4
MYTHS THAT NEED TO BE DISPELLED	5
The example of Bosnia-Herzegovina	5
Securities regulation: Canada in the forefront.....	6
A regulatory system that is undeniably harmonized.....	7
An efficient and effective regulatory system	9
Other elements that contribute to the efficiency of the regulatory system	10
A FEW ACTION PRIORITIES.....	11
Modernization of legislation	12
Enforcement.....	13
International representation.....	16
The need for Ontario’s cooperation.....	17
CONCLUSION.....	18

ABOUT DESJARDINS GROUP

The largest integrated cooperative financial group in Canada, with overall assets of almost \$150 billion as at March 31, 2008, Desjardins Group comprises a network of financial service cooperatives – caisses and credit unions – in Québec and Ontario, as well as about 20 subsidiary companies in life and general insurance, securities brokerage, venture capital and asset management, several of which are active across Canada. With the expertise of 40,000 employees and the dedication of more than 6,500 elected officers, Desjardins offers its 5.8 million members and customers, including individuals and businesses, a complete range of financial products and services. Its physical distribution network is complemented by leading-edge virtual technology.

CONTEXT

In the consultation document that it made public on April 18, the Expert Panel on Securities Regulation in Canada submitted five major subjects for consideration by the Canadian public. The five subjects concern issues related to regulatory substance and approaches, compliance and enforcement as well as the structure and organization of securities regulation in Canada.

The main reason for setting up this new working group on securities regulation is more circumscribed, however. The stakeholders involved in the Canadian financial markets believe that the existing structures, based on provincial and territorial bodies, are inadequate and have to be replaced by a single regulator: a Canadian securities commission. If this assumption is not retained, the other matters raised in the consultation document can continue to be examined within the existing decentralized framework, with appropriate strategies developed and implemented by the existing bodies.

For example, it will be recalled that questions relating to the relevance of establishing for Canada a regulatory regime that is based more on principles or proportional to the size or situation of issuers are not new or specific to Canada. They have been addressed in many structured discussions between regulators, they have been considered in various public consultations and they have been the subject of initiatives in certain jurisdictions. One can logically dissociate implementation of a single regulator from principles-based regulation. These matters are important in Canada, as they are in many other countries, and they are regularly examined in international forums held by regulators. The same is true of matters related to evaluation of the performance and results of national regulatory systems that are the subject of ongoing discussion by academia and a number of international organizations. In these areas, Canada, with its existing regulatory system, is part of a global trend and, like other countries, must adapt to markets that are constantly changing.

But the same is not true for matters related to enforcement. The immediate proximity of the United States, on the one hand, and practices specific to the Canadian legal system, on the other hand, raise specific issues that far exceed the strict framework of securities regulation. We shall return to these matters later in this document.

According to many, the main securities-regulation issue that distinguishes Canada from other countries pertains to its regulatory structures. No one contests the fact that Canada has a decentralized regulatory structure. Decentralization is one type of public-management model and it presents advantages and disadvantages. The decentralized model is criticized for its supposed fragmentation – some would even say balkanization – and the resulting costs and administrative delays. Critics cite the inconvenience for regulated entities of having to deal with multiple regulators, the inconsistencies between provincial and territorial regulation, the inability of regulators to represent Canada effectively at international forums and within organizations, etc.

Canada's Minister of Finance, the Honourable James Flaherty, epitomized this perception of the Canadian system when he recently described it as:

*Too complicated. Too expensive. Too bureaucratic. Overlap. Inefficient. Ineffective. All of those things.*¹

If this perception did indeed correspond to reality, it would be difficult to argue that we should maintain a structure based on patchy regulation and inconsistent and ineffective provincial and territorial regulators. It is therefore important to take the situation into account fully and to determine whether the Canadian system is indeed fragmented and truly corresponds to the pathetic picture painted by certain observers. We must do this examination on the basis of facts – rather than perceptions alone – before embarking on paths to centralization that may themselves prove to be long, complex and costly.

A COMPLEX AND COSTLY TRANSITIONAL PROCESS

Assuming that we decide to embark on such an approach, the process required to put in place a centralized securities regulation system must take into account many constraints and respect many important deadlines.

- From the legal standpoint, implementation of such a system must be preceded by development and adoption of a *Canadian Securities Act*, which will entail significant regulation. Such work has begun and draft documents are ready – or at least we assume they are. This legislative and regulatory material will require structured consultations, as is customary in an industry that must operate on the basis of rules that are clear, explicit and well understood by the participants.

¹ Interview with the Honourable James Flaherty reported on the site *InvestorVoice.ca* on April 26, 2008. See: http://www.investorvoice.ca/CSR/CSR_index.htm.

- In addition, it should be noted that the constitutionality of such an initiative has not yet been proven, especially if one or more provinces object and contest the ability of the federal State to enforce a law that would take precedence over their existing statutes. Establishing constitutional validity is a process that may take some time, even if the federal government avails itself of its prerogative to submit the matter directly to the Supreme Court. Even so, it is essential that the possible constitutional obstacles be raised at the outset to avoid uncertainty for the capital markets.
- Moreover, even if constitutional validity poses no major difficulty, measures will have to be taken to ensure the federal act and regulations apply in a similar or coherent fashion in both civil law and common law contexts. Although the development, several years ago, of the draft *Uniform Securities Act* by the Canadian Securities Administrators (CSA) was ultimately not acted on, it has shown that such harmonization in all likelihood will not create major problems. A definitive verification remains to be done, however.
- From the administrative and organizational standpoint, the creation of a single entity under federal jurisdiction² will also require some time. Unless the provincial commissions are abolished, which would maximize potential resistance, the federal government will have to propose an opting-in formula, at least initially, whereby it will propose that the provinces transfer their resources – essentially the specialized personnel of the existing commissions – at the same time as they transfer their jurisdiction. Otherwise, the new entity will immediately be seriously lacking in expertise. Although a province such as Ontario would most likely agree to transfer the resources of its securities commission, it is far from clear that provinces such as British Columbia and Alberta would do so, without even taking Québec into consideration. With such an opting-in formula, it will be tempting to negotiate conditions for joining or harmonization mechanisms on a case-by-case basis – province by province, market by market – thus recreating the conditions for balkanization that the initial intention was to eliminate.
- In the event that provincial commissions continue to exist, for example as result of refusal by certain provinces to avail themselves of the opportunity to opt in, it will be necessary to establish between them and the new federal entity agreements on regulatory harmonization, enforcement, coordination of investigations and inspections, etc., based on the model of those that have been developed and currently apply within the CSA framework.

² These factors will also come into play if the centralized structure results from any form of cooptation and delegation by the provinces to a single organization, as certain stakeholders have suggested.

- In all these assumptions, the new centralized entity will have to maintain and operate regional offices in the participating provinces, which will limit opportunities for the savings generally associated with centralization. Still, certain high-level functions, such as the development of regulations, relations with international organizations and budgetary planning will most likely be streamlined and merged at the entity's head office. That will result in a transfer of expertise and resources toward the centre and the development of an administrative structure.

Moreover, during such changes, both the management and personnel of the organizations concerned will have to deal with such matters as administrative structure, delegation of authority, redeployment and relocation of resources, reorganization of functions and operations, redefinition of processes, renegotiation of agreements with partners and collective agreements, etc. These legitimate internal concerns often take precedence over considerations related to the external environment, market conditions and the expectations and needs of the clients or publics affected. In brief, during a transitional period such as the one we foresee, the organizations concerned will have to turn their attention and devote a large portion of their time and energy to matters of internal management and reorganization, whereas the market will continue to evolve very quickly under the impetus of technological change, new products resulting from financial engineering, new risk management models, changes in international trade, etc.

The trend to U.S.-style regulation

In addition to the foregoing, the transition process involves the real possibility that the Canadian system of regulating the capital markets will slide toward the U.S. model, without any debate on the relevance or interest of such a change for Canada and its regional markets. Ontario's regulation will in all likelihood serve as the starting point for the new centralized system. But the implicit philosophy of Ontario's regulator has often been to monitor the changes in the U.S. model, to replicate its main measures and to try to reproduce its effects. This approach is in many respects desirable, and even necessary, given the impact of the immense U.S. capital markets on the Canadian markets. The problem is that the U.S. system has been designed and has developed in a market environment that is more complex, more evolved and more liquid than the Canadian market. The need to comply with the large U.S. regulatory mass imposes requirements that are more severe than those prevailing in Canada and are adapted to organizations with resources that are generally far greater in terms of their legal staff.

Moreover, the U.S. model for securities regulation is still dominated by a rules-based and due process approach, of which it represents the most developed incarnation in the world. There is therefore a genuine possibility that, if we are not careful, the transition to a centralized system will take Canada in a direction opposite to a system that is more principles-based. Once again, there is a real danger that the direction of

Canada's regulatory philosophy will be determined above all by the transition dynamic, rather than being the outcome of a fundamental debate.

In addition, if the transition does indeed standardize market rules and enforcement practices, one may think that the Ontario approaches will ultimately prevail in all jurisdictions, notably because of the relative size of the Toronto market in Canada's financial sector. Although this scenario will suit the financial community based in Toronto, it risks placing on the shoulders of the market participants in the other provinces a disproportionate share of the administrative and financial burden required for the transition.

In brief, the transitional process will raise a spate of legal, administrative, logistical and functional issues. Moreover, for many reasons, it may be lengthy and entail substantial costs, for the regulatory bodies and the participants under their jurisdiction. It is therefore important not to take lightly the decision to impose such a drastic change on our institutions and, as necessary, to base it on facts rather than perceptions that are more or less well founded. We must establish from the outset whether this matter is really worth all the trouble and whether the resulting benefits will actually improve the existing situation.

MYTHS THAT NEED TO BE DISPELLED

The example of Bosnia-Herzegovina

One of the myths most often conveyed by critics of Canada's existing securities regulation is that Canada constitutes the only country in the world, apart from Bosnia-Herzegovina, with a decentralized, fragmented system. This distorted image, which is constantly used by proponents of centralization, is false, however. In contrast to Canada, there is indeed a securities commission in Bosnia-Herzegovina, which is a full member of the International Organization Securities Commissions (IOSCO).³ It is likely that those who cite this example do not know much about the Bosnian system, even the fact that it was set up as a result of the Dayton Accords, concluded in the United States with assistance from the U.S. government to end the war in the Balkans in the 1990s.

Regardless, this distortion is misleading in another respect. Even though Canada can no longer count on Bosnia-Herzegovina, it does not stand alone, since it is among several other well-known federations in the exclusive club of those countries that have a decentralized regulatory system. In Germany, for example, the current system gives the regulatory bodies of the *länder* (roughly the equivalent of our Canadian provinces) oversight of the stock exchanges. Thus the Hesse *länder* regulates the

³ Sceptics who understand the Bosnian language can check this at the following address:
<http://www.komvp.gov.ba/bih/>.

powerful Deutsche Börse. Closer to home, we often forget that the U.S. system is based not only on the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), but also on the 50 regulatory agencies in the States. These agencies are not bit players: for example, to the 600 or so procedures initiated each year by the SEC about 1,400 others that are initiated by the States must be added.⁴ In both cases, namely Germany and the United States, the powers and initiatives of the federated states are therefore far from negligible.

In fact, the three federations in the G7 (Canada, the United States and Germany) regulate their markets to a great extent through their federated States. Canada is therefore not quite as unusual as some people hold it to be. What does set it apart, however, is the absence of a federal regulator. Still, as we shall see later, other mechanisms have been developed in recent years to play the coordination and harmonization roles generally assigned to such an authority. Moreover, nothing indicates that these mechanisms have proved less effective than central regulators in overseeing and supporting the development of efficient and effective markets.

Securities regulation: Canada in the forefront

Distorting reality and citing myths to try to discredit the existing system are nothing new. Researchers who have tried to evaluate and to compare the real performance of the Canadian system have always had difficulty finding empirical proof to support such statements. In fact, even if the existing system is not perfect, it is a leader in the international arena.

For example, the Organization for Economic Cooperation and Development (OECD) made an extensive study in 2006 of the impact of the financial regulatory systems in 20 member countries, including Canada.⁵ The study looked at two separate subjects: regulation of the banking industry and regulation of the securities markets. The comparisons between these two markets are especially interesting, since banking regulation in Canada (like the industry) is highly centralized, whereas securities regulation is decentralized and, according to its detractors, fragmented and ineffective. We should therefore see the effects of this polarization on Canada's performance relative to the other countries in one of these sectors.

With respect to regulation of the banking sector, where Canada has strong central institutions (such as the Bank of Canada and the Office of the Superintendent of

⁴ In fact, the first steps toward legal and regulatory oversight of the securities markets in the United States were initiated by the U.S. States in the 1910s, long before the SEC was created in 1934 as part of F.D. Roosevelt's New Deal.

⁵ *Revue économique de l'OCDE*, no. 43, 2006/2 "Réglementation des systèmes financiers et croissance économique dans les pays de l'OCDE: une analyse empirique," Alain de Serres, Shuji Kobayakawa, Torsten Slok and Laura Vartia.

Financial Institutions) that are justifiably considered among the best in the world, Canada does well by ranking in the middle of the pack.⁶ As a function of the arguments conveyed by proponents of centralization, we should therefore expect Canada to do decidedly less better in the securities sector, given its so-called mediocre performance and the poor image of its 13 provincial and territorial regulators. But we find exactly the opposite according to the OECD's empirical studies, since it ranks second out of the 20 countries considered, just behind New Zealand and ahead of such countries as the United States (4th), the United Kingdom (5th) and Japan (6th).⁷ This regulatory system, which some people take pleasure in presenting as the laughingstock of the developed countries, seems nevertheless to place Canada in a highly favourable position, better in fact, if we are to believe the OECD, than the countries to which it is compared.

A regulatory system that is undeniably harmonized

We must always proceed cautiously when making such international comparisons, which have to be interpreted with considerable nuance. In fact, the decidedly negative portrait that some people paint of the existing decentralized system almost never stands up to facts and rigorous empirical analyses. Many of the most widespread perceptions of the defects of this system can therefore be discredited.

- Notably because of sustained efforts over the past 12 years, the CSA have developed and applied a set of national instruments that now cover almost all aspects of securities regulation in Canada. These pan-Canadian standards have significantly harmonized regulation in all the provinces and territories. Current oversight includes more than 70 standards, national policies and companion policies that have been generally applied in the 10 provinces and the three territories. They cover such matters as oversight of markets and trading rules, securities investment, continuous disclosure, public offerings, securities transactions outside the territory and mutual funds. Almost all of the new regulation that has come into effect in recent years has taken the form of such pan-Canadian instruments. The few instances in which local rules continue to prevail are often related to the particularities of certain markets and do not interfere with the pan-Canadian standards.
- The coming into force of the passport system negotiated between all the regulators, with the exception of the Ontario Securities Commission (OSC), now means that a publicly traded company can do business with a single regulator to

⁶ Op. cit., page 98 et seq.

⁷ Op. cit., page 104 et seq. It should be noted that this classification ranked the countries, on the basis of empirical analysis, as a function of the severely restrictive nature of their regulation, and that this characteristic favourably affected the performance of their securities markets. Unfortunately Bosnia-Herzegovina was not included in the study.

secure approval of a prospectus or to obtain certain exemptions. Once this approval has been obtained from the “local” regulator, it is automatically recognized by all the other authorities and therefore applies automatically – with no further complications – throughout Canada. The OSC, however, has decided to go it alone, refusing to join the passport system and to recognize the decisions of the other regulators. Even so, all the other provinces and territories have decided to recognize the decisions of the OSC, thereby creating a paradoxical situation: Ontario companies are guaranteed recognition throughout Canada, despite their province’s non-participation in the passport system, but companies in the other provinces that want to conduct transactions in Ontario must obtain two authorizations: the one from their province and the other from Ontario.

- The next stage of the implementation of the passport system involves registration of brokers and market participants. It should give rise in 2009 to a formula that will make it possible to harmonize the requirements and to coordinate the registration procedures, in the same spirit as that which has prevailed for issuers of securities. Once again, the outcome will be that the registration of a broker will require only the approval of the local regulator and will be automatically recognized across Canada. It is also important to point out that this process can now use the National Registration Database (NRD), which greatly facilitates and accelerates electronic submission and processing of registration applications for all Canadian jurisdictions.
- Canada’s stock exchanges and markets operate with a uniform regulatory framework (National Instruments and Companion Policies 21-101 and 23-101); moreover, the various regulatory authorities responsible for their oversight have concluded an agreement to allocate their duties and to coordinate their work. Québec, Ontario, Alberta and the British Columbia share responsibility for the derivatives, large cap and small cap markets. The stock exchanges and the alternative trading systems (ATS) can therefore do business with a single regulator.

As a function of the foregoing, it is strictly incorrect to state that issuers, market participants and marketplaces have to deal with 13 regulators and 13 sets of regulations in Canada. As for all major issues related to public policy, in financial regulation as elsewhere, progress remains to be made, but with respect to management and day-to-day operation of the markets, most of the harmonization work has been done and functions adequately.

An efficient and effective regulatory system

As for the efficiency and effectiveness of the Canadian regulatory system, it is important to consider the system's administrative efficiency and costs. These two factors are cited as examples of how the Canadian regulatory system is deficient and detracts from the competitiveness of the Canadian market.

- Generally speaking, the periods for the issuance of permits and authorizations are generally shorter in Canada than in the United States. As for adoption and implementation of regulations, the time required to adopt such rules generally depends on the periods reserved for consultation of the public or the industry. These consultations, which occasionally result in the regulators' reformulating their initial proposals, provide the guarantees necessary to establish equitable, appropriate, effective and proportionate rules. They also enable those who will be governed by such rules to obtain advance information on them. Canadian practices are in this respect similar to those of the United States. Very few participants in the Canadian securities markets would agree to eliminate these consultation periods, even to save time.
- The direct costs of regulation – which include fees and costs billed by regulatory authorities – are generally lower in Canada than in the United States, as noted by Britain's Financial Services Authority (FSA) in a comparative study published in 2003.⁸ These costs are, however, minimal in relation to the business volume of the firms that pay them, especially in respect of indirect costs, which are mainly the expenses for professional services incurred by regulated entities to meet their compliance obligations. Extensive harmonization of Canadian regulation, on the one hand, and establishment of the passport system, on the other, help to reduce these costs significantly by eliminating the need to do business with multiple regulators – for issuers and intermediaries alike.

In recent years, the CSA have also put in place mechanisms to coordinate their enforcement activities, a matter we shall return to.

⁸ See: *FSA Indicators of the costs of regulation in different jurisdictions*. The summary results of the study are given in Jean-Marc Suret and Céline Carpentier, *Réglementation des valeurs mobilières au Canada*, a discussion paper prepared for the Commission des valeurs mobilières du Québec, July 2003, pages 52-56 and 176. It should be stated that, in contrast to Canada, the direct regulatory costs in the United States are financed by the proceeds of a special tax paid to the U.S. Treasury, which returns only a portion of it to the SEC to finance its operations. In 2001, for example, this U.S. tax generated total revenues of US\$2.1 billion, whereas the SEC's total financing that year was only \$423 million.

Other elements that contribute to the efficiency of the regulatory system

To this portrait of the public regulators, we must add two other factors that affect the degree of fragmentation or centralization of the Canadian securities markets.

- Self-regulatory bodies play an important role in the oversight of the North American securities markets. Recent amendments in Canada have helped improve the cohesion of these bodies and ensure more effective management of the conflicts of interest that are unavoidable with any self-regulatory model. Today, the Investment Industry Regulatory Organization of Canada (IIROC) – which has taken over from the Investment Dealers Association of Canada (IDA) – has changed its structure and governance to divest itself of functions that involved representing the interests of the industry. Moreover, it has merged with the body that specializes in regulation – Market Regulation Services Inc. – to form a coherent, harmonized self-regulatory structure that is recognized in all Canadian jurisdictions and that applies uniform rules. The Canadian approaches to self-regulation are increasingly regarded favourably in the United States, where there are frequent calls for reforms that would go in directions similar to those developed here, to a great extent with direct assistance and encouragement from provincial regulators.
- The changes in the Canadian marketplace over the past decade have led to the TMX Group's predominant position and quasi-monopoly over Canada's stock markets. This group now comprises the markets previously shared by the Toronto, Montréal, Calgary and Vancouver stock exchanges and covers small caps, large caps and derivatives. Moreover, it is subject to integrated oversight by the regulatory authorities and the IIROC. The only exceptions to this quasi-monopoly are several Alternative Trading Systems that have been created in Canada under National Instruments 21-101 and 23-101. Although they have attractive potential, these electronic systems account for only a small fraction of their respective markets. Thus, generally speaking, Canadian stock markets are currently much less fragmented than their U.S. counterparts,⁹ although their levels of liquidity are far from comparable.

When we take the time to consider the Canadian securities market and its regulatory system on the basis of fact and empirical analysis, we arrive at a picture that is very different from that conveyed by the proponents of centralization. First, our markets are among the most centralized in the world because of the high degree of concentration in Canada's financial services industry and the quasi-monopolistic nature of our self-regulatory bodies and marketplaces. As for our regulatory system,

⁹ Despite the efforts of recent decades to ensure greater cohesion of the U.S. markets (which took the form of the National Market System), the U.S. market is based on a broader range of marketplaces, including the New York Stock Exchange, the regional stock exchanges, Nasdaq and a group of electronic markets (ECN/ATS) which have significant market shares.

it is in effect decentralized but it is not fragmented. It includes coordination mechanisms – the CSA have, for example, created a Policy Coordination Committee that meets on a weekly basis for that purpose – which have succeeded in harmonizing regulation and coordinating operations.¹⁰

It is important to recognize the progress accomplished in recent years, not only to do justice to the existing system, to avoid embarking on long, complex costly reforms that would seek to resolve non-existent problems or problems that have already been resolved. We must also avoid aiming to “catch up with” other countries by blindly imitating their regulatory systems, when comparisons with them are in reality favourable to us: should the objective not be, instead, to maintain this lead and to draw on our strengths rather than denigrating our institutions and markets? If the objective is to make the Canadian markets more competitive in the international arena, to improve integrity in respect of investors or to simplify rules and base them on principles, then we should not begin by embarking on a reform of our regulatory structures that would be needless at best and counterproductive at worst. Other matters should take priority.

A FEW ACTION PRIORITIES

Canada’s securities regulation system is not perfect. A number of significant problems persist and require rapid, if not urgent corrective measures. These problems can be resolved under the existing system, so that Canada could avoid having to embark on structural reforms that, as we have seen, would be long, complex, costly and needless.

We should like to point out four such problems that deserve the attention of regulators and markets:

- Modernization of legislation;
- Enforcement;
- International representation;
- The need for Ontario’s cooperation.

¹⁰ In fact, in certain respects, the Canadian framework can be considered more integrated than its U.S. counterpart: the United States has fragmented its regulatory system by giving separate regulators oversight of cash markets (the SEC) and certain derivatives markets (the CFTC). This sector distinction does not exist in Canada. The Autorité des marchés financiers discharges specific oversight responsibilities for the derivatives market in Montréal, but it does so under an administrative agreement with the three other commissions that share market oversight, on the basis of a delegation of powers provided by law or regulation.

Modernization of legislation

The general architecture of Canada's normative securities framework is based on three main levels: from bottom to top, these levels are (1) self-regulation, (2) "public" regulation and (3) the legislative framework. The rules of the SROs have now been largely harmonized, if not unified, in a process that was greatly facilitated by the coordination of the various public regulators that approve such rules. So-called public regulation has been subject to harmonization efforts, which, as already stated, have led to a body of regulation that is estimated to be more than 90% harmonized.

The legislative level continues to be based on separate provincial and territorial laws, but it should be noted that it has allowed harmonization of the two other levels. The efforts of the CSA, which have made possible concerted efforts to develop the imposing body of national instruments, have never come up against legislative obstacles that could have precluded the regulatory measures required for the proper functioning of the markets and effective protection of investors' and savers' interests. In fact, despite their differences, the legislative systems of the provinces and territories are generally coherent. Recent history shows that this legislative framework has in reality never constituted a serious obstacle to the implementation of the existing harmonized regulatory framework.

An interesting challenge awaits the provincial legislators, however, if they want to put in place, as suggested by the Expert Panel's consultation document, a regulatory system based more on principles. Indeed, it is often – although not exclusively – in high-level framework laws that we must strive to set out the broad principles on which we wish to base regulatory systems created with this approach. Regulation then specifies mechanisms, rules and procedures that will anchor these principles in the day-to-day functioning of the markets and validate the requirements imposed.

In this respect, the regulators and legislators in the provinces and territories will not be able to dispense with specifying the principles that in future will have to orient the development of the securities markets and the applicable oversight systems. This discussion must continue on a common basis – which must, moreover, provide for active and constant participation by the industry and consumers – and yield results that will have to be shared.

There is an interesting precedent that shows that such an initiative is possible. Early in this decade, the CSA began exhaustive work to propose a *Uniform Securities Act*, which could have been debated and adopted jointly by the 13 provincial and territorial legislative assemblies and would have permitted harmonization of Canada's legislative framework in this area. This project ultimately was not acted on in the context of that time, since the governments had decided to focus their attention on development and implementation of the passport system. But the exercise nevertheless gave rise to some interesting observations:

- It is possible to develop a legislative instrument that creates a common basis for all provinces.
- For example, this project made it possible to simplify the laws in several provinces, such as by transferring several subjects to the domain of regulation. In this way, it was possible to improve the system's ability to adapt to the rapidly changing markets, in good part because it is generally easier and faster to amend a regulation – a process that can also incorporate more flexible consultation mechanisms – than it is to make legislative changes.
- The project also showed that it is possible and useful to include in a law principles that will be used to oversee all markets and that can be specified in regulatory instruments setting out rules of application.
- It also showed that civil law and common law approaches can be reconciled in the same law, or incorporated into separate but coherent laws.

In brief, although this project did not come to fruition, it showed both the feasibility and the interest of legislative amendments, which can be effectively coordinated on the level of the provinces, to the extent that the provinces agree on common principles. Regardless, the provinces have undeniably succeeded in giving Canada a harmonized regulatory framework and establishing a uniform self-regulatory system. If they have the will to do so, they can modernize the legislative framework and introduce principles-based approaches. Moreover, the provinces where the smallest issuers are concentrated have in the past spearheaded the efforts to make regulation and enforcement more proportional to the size and situation of businesses. Once again, the need to modernize regulation should not serve as an excuse for centralization of structures, since nothing indicates that it would help resolve problems.

Enforcement

The weaknesses in enforcement of the law and the lenient sanctions imposed on offenders are often identified as the main problems of the Canadian securities regulatory system. Obviously, for some this problem stems mainly from the fact that 13 regulators have not succeeded – and cannot succeed – in combining their efforts to prevent and to control fraud.

This problem is real. It is enough to compare the penalties imposed on those who break the law in Canada and the United States to see that the U.S. is far more severe than Canada in this respect. But it is simplistic – and once again false – to argue that the situation is due mainly to our decentralized regulatory structure. As we have pointed out, a large portion of the procedures in the United States are initiated on the level of the States.

In fact, centralization is far from a guarantee of results, as the federal government recently saw with the creation of the Integrated Market Enforcement Teams (IMETs) of the Royal Canadian Mounted Police (RCMP). Announced with great fanfare in 2003, this measure created teams in four major cities (Montréal, Toronto, Calgary and Vancouver) to considerably strengthen the ability to detect and combat fraud on the financial markets, thereby compensating for the supposed deficiencies of the local regulators. Four years and almost \$100 million later, the results are so disappointing that the federal government has given Nick Le Pan, the former Superintendent of Financial Institutions, a mandate to review the operations of the IMETs. The RCMP received Mr. Le Pan's report last fall and is reviewing its operations accordingly.

The RCMP's will to strengthen its ability to investigate economic crime and financial fraud is to be commended. It is hoped that the action recently brought in Québec in the Norbourg case, which is the result of an investigation by the Integrated Team based in Montréal, indicates that the structure is indeed on the way to resolving these problems and taking its rightful place as a market watchdog. But the experience of the RCMP, like that of the other police forces that are involved in combating economic crime, shows that questions of structure are relatively secondary in such matters. Certainly there is a need for coordination and there are always tensions when different bodies try to combine their efforts in similar or related areas. But investigation of economic crimes requires specific expertise that combines investigative techniques with knowledge of accounting principles and financial market operations. To be effective, specialized police officers and forensic accountants must also have access to networks of informers and sources that enable them to pursue leads. One does not become a securities investigator overnight.

But, above all, Canada's police forces and securities commissions have to deal with a legal system that does not seem to be adapted to the increasingly sophisticated economic and financial realities. The problem is not limited to securities, but extends to a far broader range of economic crimes, including financial fraud, counterfeiting and piracy, insider trading, illegal issuance and distribution of securities, credit card fraud and identity theft. When we seek more severe penalties for these crimes, we often forget that we must not only prove the guilt of the accused, but also, in many cases, demonstrate the existence of genuine criminal intent, if not the existence of a crime within the meaning of the law, and that we must do so according to the burden-of-proof rules defined in the Criminal Code.

But when such matters have been duly proven, Canadian courts have often been more lenient than their U.S. counterparts, for example, in cases where the judges believe, rightly or wrongly, that the crimes were victimless. How can we identify individual victims precisely and measure with a degree of certainty the prejudice they have suffered in cases involving insider trading or counterfeiting of banknotes? How can we judge the harm caused when the "victim" is society as a whole and the prejudice takes the form of a loss of trust in our institutions?

These questions are not easy to answer, but the issues they raise are fundamental if we are to ensure that our financial markets can fulfill their mission in our economies and enjoy the necessary trust of local investors and savers as well as the reputation they deserve in the international arena. These questions are not limited to the capital markets, but apply to the entire financial sector, including banks and other providers of financial services and risk protection. Canada cannot afford to jeopardize its credibility and reputation because its legal system and investigative practices, including but not limited to its securities commissions, cannot ensure sufficient integrity for its markets. But nor must we sacrifice the broad principles of justice on which the equilibrium of our society is based.

It is to be hoped that the recent trend of imposing penalties that are relatively more severe than in the past, in cases of financial fraud that have received extensive media coverage, will lead to a better balance between the penalties and sentences handed down for economic crimes and those imposed for other types of infringement of the law and criminal behaviour. But, in these areas as others, the comprehensive discussion that our society has to undertake must not begin with structures, nor should it perpetuate the myths that have far too often taken centre stage.

Indeed, by blaming the securities commissions for Canada's excessively lenient response to financial fraud, we often forget that the adjudicative functions that they exercise are very specifically limited by law. The administrative tribunals that they constitute do not have the power to imprison individuals. In Québec, only since the adoption of the *Act respecting the Autorité des marchés financiers* has it been possible to impose formal fines, since the amounts in question were previously collected under agreements and penalties of an administrative nature.

All cases involving fraud or other acts of a criminal nature that are liable to imprisonment must be brought before the appropriate courts and must meet the applicable burden of proof. Among those who seek more severe penalties and who blame securities commissions and administrative tribunals with limited powers, there is – fortunately – no one who wants to give them powers that our legal system reserves for criminal courts and penal tribunals. And for good reason: we must ensure that the debate is properly targeted and is based on our principles and values, rather than being driven by myths and political agendas.

That does not mean that the administrative tribunals that the securities commissions constitute should be excluded from the debate. The creation of the *Autorité des marchés financiers* in Québec has made it possible to separate the adjudicative functions from the other activities – including investigation and regulation – carried out by the existing regulators. In so doing, we have created a mechanism that ensures greater independence for the courts (in Québec, the *Bureau de décision et révision en valeurs mobilières*) and gives the regulator greater leeway to conduct its investigations and bring legal proceedings. It is up to the provinces to consider and to adopt such a model, but it is clear that greater separation between adjudicative

functions and other responsibilities can significantly enhance the credibility of institutions as well as the integrity of the legal system of which they are an extension.

International representation

It is a fact that Canada's visibility within the major international securities organizations could be greater. But its presence and influence are significant just the same. In fact, Canada's role in these institutions continues to be disproportionate, given the limited size of its capital markets. But Canada is less visible because it is represented by regulators from Québec, Ontario, Alberta and British Columbia.

The history of the main international organization in this sector, the International Organization of Securities Commissions (IOSCO), is quite revealing. It was founded at a meeting held in Canada, on the initiative of the Commission des valeurs mobilières du Québec, whose then Chairman, Paul Guy, was at that time Chairman of an interamerican committee of securities commissions that took the initiative of accepting members from other continents. Mr. Guy was the first Secretary General of IOSCO, whose head office was in Montréal until it was transferred to Madrid a few years later at the instigation of the European members.

Since then, the Ontario and Québec securities commissions have constantly been represented on IOSCO's two main bodies: its Executive Committee and Technical Committee. David Brown, when he was Chairman of the OSC, played an important role in IOSCO and was Chairman of its Technical Committee for some time. For its part, Québec again recently assumed the chairmanship of IOSCO's Interamerican Committee and of the Council of Securities Regulators of the Americas (COSRA), another body of securities commissions in the Americas, of which it is still an active member. The two securities commissions in Western Canada are also members of these two organizations.

Although Canadian representation within these organizations is provided by the provinces and they play an important role, the name of Canada is not formally included in the list of IOSCO's members: only the four provinces are. This problem is therefore above all one of image rather than one of representation.¹¹

To resolve this matter, it would be easy to ask the CSA to ensure formal Canadian representation within these organizations. CSA's internal rules could specify the mechanisms for this representation (delegation to commissions, reporting mechanisms, coordination of positions and policies, conclusion of international

¹¹ The four main Canadian securities commissions are involved in all the main international agreements between regulators (on such matters as information sharing and mutual assistance with investigations) and have concluded a number of bilateral agreements with foreign regulators.

agreements, etc.). Since only a few large jurisdictions in Canada have the resources and expertise to play important roles in such organizations, it is difficult to see how such a formula, which would ensure the necessary visibility for Canada, could function properly without their leadership and active participation in the large organizations.

Moreover, this approach would enable Canada to improve coordination of its involvement in and policies on the large international financial forums. Major institutions, such as the Bank of Canada, the Superintendent of Financial Institutions and the four main securities regulators, already work together frequently on the executive level. It would be appropriate and desirable that this cooperation formally include matters raised by the large international financial institutions they belong to.

The need for Ontario's cooperation

Given the importance of Toronto's financial community in the Canadian economy, Ontario occupies a preponderant position on the country's financial markets. It is therefore normal that the OSC should have a determining influence over market oversight, directly in its own province, but also indirectly through the leadership that it can provide for all the other jurisdictions. In fact, several other regulators, in particular in the smallest jurisdictions, rely on the OSC's high-level expertise, the networks that converge within it and supply it, and the international connections that it has developed during a history spanning almost three-quarters of a century.¹² In fact, the considerable work carried out by the CSA over the past decade to ensure regulatory harmonization is in large part due to the efforts and expertise of the OSC's professionals, who have often drafted documents, negotiated agreements and resolved problems.

That is why the OSC's recent tendency to go it alone and its deliberate decision not to join the passport system – developed, adopted and applied by all the other securities commissions – has very significant consequences.

The OSC's refusal to take part in the passport system is due to its clear preference for a centralized regulatory model. Any reform that would improve the current system or invalidate the misperceptions of it would therefore, according to this logic, only delay or, even worse, postpone indefinitely the major reform that the OSC believes is necessary.

¹² The OSC was created in 1933 by the Ontario legislature according to a model that, at that time, was unique in relation to the agencies in the U.S. states and the Canadian provinces. This model predates by one year that of the U.S. SEC, created in 1934. The OSC was therefore the first genuine securities commission on this continent, and probably in the world.

But that is obviously not the opinion held by the other regulators, which have all agreed on the implementation of a system based on the passport. To avoid imposing on their markets the cost of the disagreement with the OSC and delaying changes that they believe are necessary, they decided by mutual agreement to give Ontario the treatment that it has refused them and to recognize the OSC's decisions as if it had joined the passport system.

Still, this situation cannot last much longer. As we have seen, it creates a clear injustice for all issuers outside Ontario, since for the time being they still need two decisions for a countrywide share issue: that of their local regulator automatically gives them access to all the other jurisdictions, except Ontario, where they still need the OSC's authorization. Issuers in Ontario, however, automatically have access to the rest of the country, without exception, on a decision from the OSC alone. In the current situation, the OSC therefore helps balkanize the Canadian system and makes issuers and brokers in the rest of the country pay the price.

It is clear that we cannot contemplate a Canadian securities regulatory system without the active, complete and unreserved participation by the province where the largest players in Canada's financial services industry are concentrated. On the other hand, the other provinces must also take into account their own markets. Ontario must rapidly rejoin the Canadian family and provide its valuable contribution to the development of a regulatory system that is decentralized but coherent, effective, efficient and inexpensive.

CONCLUSION

There was a time when we were quite right to deplore the balkanization of the Canadian market, since the lack of common rules and coordination mechanisms imposed serious and real limitations on the smooth functioning and integrity of our capital markets. But the progress made in recent years is real and, as we have seen, has rendered this criticism irrelevant, since it serves only to divert the discussion toward hypothetical structural reforms and a long and costly transitional process. Obviously, we still must improve certain practices, refine coordination mechanisms, finalize regulatory harmonization and coordinate Canada's international representation more effectively. Nothing leads us to believe that the mechanisms that have been used successfully to develop solutions over the past two decades have suddenly become unable to complete this work. Nothing, except perhaps Ontario's refusal to continue the excellent work it had contributed before changing direction.

Given that this system, despite the distorted ways in which it has been unfairly portrayed, has succeeded in making Canada one of the best-regulated countries in the world, we can look ambitiously to the future that could open up for us. Instead of being regarded as a hindrance, the system could become a model – a successful blend of effective decentralization and efficient coordination mechanisms. Moreover, such a model would also have the advantage of faithfully reflecting the diversity of the Canadian reality.