



*Public Submission to  
Expert Panel on Securities Reform*

*By*

*CARP, Canada's Association for the Fifty Plus*

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# CARP RESPONSE TO THE PUBLIC CONSULTATION PAPER ISSUED BY THE EXPERT PANEL ON SECURITIES REGULATION IN CANADA

## *Introduction*

CARP Canada's Association for the Fifty Plus is a national, non-partisan, non-profit organization with 350,000 members across the country. CARP is committed to advocating for social change that will enhance the quality of life for all Canadians as we age. One of our advocacy goals is financial and retirement security.

The state of securities regulation in Canada is fundamental to financial and retirement security and for this reason, CARP is pleased to offer our response to the Expert Panel on Securities Regulation in Canada.

CARP's focus is on protection for the individual investor and retirees who depend on the security of their private savings and public and private pension plans. There are any number of reports of smaller investors watching their retirement savings disappear. This begs the question of whether Canada's securities regulation can adequately protect them. It is small comfort to learn that even institutional investors such as pension plans were also caught up in market turmoil such as the asset-backed commercial paper (ACBP) scandal.

CARP would submit that the major challenge for securities regulatory reform is whether the changes will better protect investors, especially those who are building for retirement security or already dependent on investment of their retirement savings.

Consequently, CARP proposes that reform of Canada's securities regulation system, in addition to any other changes that improve the stability and competitiveness of our capital markets, deliver an **Investor's Bill of Rights** that provides investors with:

1. Fair dealing and transparency that supports informed decision-making and investor confidence;
2. Uniform securities regulation and independent enforcement;
3. A redress process that is timely, substantive and accessible; and
4. Financial literacy

## ***Fair dealing and transparency that supports informed decision-making and investor confidence***

Whether CARP members hold their investments indirectly through a pension fund, or directly through their own arrangements or a professional manager, they have in common that they have less time to recover from investments gone bad. As soon-to-be or current retirees, they need peace of mind regarding their financial prospects.

Their appetite for risk is not uniform, and as the Expert Panel points out, Canada's capital markets are challenging due to their polarization: 1,000 smaller publicly-traded companies comprise just 15% of the market, while 250 large ones make up the bulk, 85%. The larger companies meet the requirements of significant, complex and thorough regulations, while the smaller ones struggle to bear a regulatory burden that some want to make lighter.

The cautionary tale of the ABCP saga is instructive and unlikely to inspire consumer confidence in lighter regulation given that the current regulatory system did not prevent that debacle which ravaged the lives of 1,800 retail investors, many of whom were 50+ or seniors who were sold the ABCP as investments. In designing a new regulatory system, retail investor protection must be a priority

**In answer to the Expert Panel's first question: consumer/investor protection must be one of the objectives of securities regulation and there can be no rationale for having different standards of retail investor protection across Canada.**

It is crucial that investors have access to reliable, timely and accurate information that enables them to make decisions with confidence. It is also important, particularly for the smaller, and often more growth-oriented companies, to have access to retail investors. This can only happen when the system provides for fair dealing and transparency that supports informed decision-making and investor confidence.

The Panel suggests that enforcement could be strengthened with a set of clearly articulated principles, and this idea of clarity is key to CARP's membership. Any move towards a simplified system should extend to communication with the public and with shareholders, and companies enjoying a lighter regulatory burden should be required to provide all documentation in plain language versions understandable to the average investor.

Most investors' bills of rights we have reviewed acknowledge the importance of clarity and honesty. Investors have the right to an adviser who honestly communicates the risk involved in plain and simple language to ensure that their clients make an informed decision to invest.. There should also be a clear declaration of fees and potential losses.<sup>1</sup>

While principles-based regulation offers the advantages of streamlining procedures and leaving room for innovation and flexibility in achieving desired outcomes which must include consumer protection, the current volatility of global financial markets leads CARP to believe that Canada must consider the reduction of systemic risk as a priority for protecting the financial and retirement security of Canadians, especially those for whom we speak. Canada has succeeded to date in maintaining a stable banking environment and competitive capital markets, and any changes to the regulatory system should not sacrifice this stability. If businesses are to be granted more flexibility in achieving the objectives of such a system, then the level of transparency of the methodology used must be enhanced to ensure investor protection.

To evaluate whether securities regulation has met its objective of investor protection, platitudes are not enough. The unanswered complaints and ruined lives of retail investors caught up in the market turmoil of recent years are clear indicators that the current system of regulation is inadequate.

**CARP suggests that one criterion to evaluate securities regulation should be the drastic reduction in or absence of massive financial losses among retail investors.**

**One avenue to bring about this change in the investment climate for retail investors would be the creation of an oversight body, independent of industry with specialized expertise and comprising investor advocacy groups.**

### ***Uniform securities regulation and independent enforcement***

The current debate as to whether there should be a single national securities regulator or a continuation and improvement of the Passport system should be settled on the basis of which system would best serve and protect the interests of Canadian investors. The public discourse, however, currently revolves around international credibility, efficiency of the approvals processes and jurisdictional competition.

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<sup>1</sup> See for example the Investor's Bill of Rights in Turner, Lynn "Speech by SEC Staff: an investor's bill of rights: a commitment for the ages. <http://www.sec.gov/news/speech/spch505.htm>, consulted July 10<sup>th</sup> 2008

CARP would endorse a principles-based approach to securities regulation as a better method of responding to a rapidly changing technological and financial environment. Broadly based principles would better address regional differences as well diversity within the industry so that while a different rule might be enacted in one jurisdiction, or for one class of company, e.g. the magnitude of a fine, the principle served would be the same – deterrence or restitution.

However, the larger concern would be what principles are involved.

CARP submits that securities regulation should be based on principles that include investor protection and provide:

- enhanced protections against unfair and deceptive practices,
- industry accountability,
- strong, independent and effective enforcement ; and
- accessible remedies to obtain financial recovery for violations of the law and regulations.

With respect, the sample principles set out in the consultation document do not adequately address investor protection not least because of the vague language that would make it very difficult to draft enforceable rules.

Once again, CARP submits that there is no rationale for having different principles in different jurisdictions.

The advantage of uniformity in securities regulation across Canada is self-evident and the argument that a single national securities regulator is best suited to deliver that would seem indisputable were it not for the vocal opposition from several jurisdictions. Consequently, CARP would endorse the search for uniformity to add to market efficiency and would support the establishment of a single national securities regulator if the jurisdictional disputes can be settled in a timely manner. There is a growing concern that these disputes will delay resolution for the foreseeable future<sup>1</sup>

We see the process to achieve such a system as a difficult one, requiring political pressure and multipartite cooperation that is difficult to envisage in the current environment. The general public and their elected representatives will need to be convinced of the cost of not having a national securities regulator. It will be particularly important to engage the Quebec political milieu as the province currently controls directly a system that it sees as superior,. Since no system will work without the engagement of Ontario, which has so far stood apart, this challenge is considerable, and will be difficult to meet without much broader awareness of the downside of inaction.

The more important focus is on enforcement of any securities laws and regulations and whichever system of regulation is finally adopted, it must facilitate effective and independent enforcement of the laws and regulations. The essential elements of an effective enforcement process are independence, clear standards, capacity to investigate compliance and effective monitoring.

The principles based approach would help to set clear standards and ensure their enforceability. Independence is a non-negotiable element to promote investor confidence and expertise to investigate not ensures competent work but would inspire industry confidence and acceptance.

In this regard, CARP would endorse the recommendations offered by Professor Steven Salterio, Professor of Business and Director of the CA-Queen's Centre for Governance, for a National Securities Enforcement Agency which

- is independent of industry
- focused on enforcement
- has industry expertise
- has specialized prosecution support teams; and
- has economies of scale in enforcement.<sup>ii</sup>

The National Securities Enforcement [and/or Protection] Agency maybe a single purpose body focused on investigating complaints and allegations of fraud or it could have a broader oversight mandate which would be empowered to:

- oversee the regulatory bodies, including process audits
- establish a central registry of industry participants
- create a central database of complaints
- monitor dispute resolutions
- order/conduct independent investigations or inquiries

### *A redress process that is timely, substantive and accessible*

It is imperative that investors have a stronger ability to obtain adequate redress for violations of the law and recovery of irreplaceable assets lost through fraud, malpractice or maladministration. A key lesson to be learned from the ABCP turmoil is that it is the smaller investors who suffer irreparable damage and in that case, many were retirees or seniors who would have limited ability to replace those losses. Many of them need access to their funds immediately and as it stands, they have yet to be reimbursed. Canaccord and Credential repayments are contingent on successful restructuring, so 1,800 small investors holding \$140MM

in ABCP cannot access their money because 20 corporations are appealing the restructuring decision. The waiting period and incertitude could be ruinous for many of them; this is not an adequate restitution scenario.

The complaints handling process can re-victimize the victims. Waiting for complaints to be processed and dragging them through the justice system is extremely costly and time-consuming, particularly when it is asked of people who have just been relieved of their entire life savings. The Investment Dealers Association of Canada (IDA) offers an arbitration service to IDA member clients which it claims is timelier and less costly than the court process. One may choose to defend oneself or to be represented by a lawyer. All decisions are binding and cannot be appealed.

Many small investors who feel they have already been taken advantage of would endorse Owen Fiss's analysis of settlement: "Consent is often coerced; the bargain may be struck by someone without authority; the absence of a trial and judgment renders subsequent judicial involvement troublesome and although dockets are trimmed, justice may not be done."<sup>2</sup> It might be fair for them to ask: why should someone settle when their life savings are at stake?

At present, retail investors are obliged to collect together in class action lawsuits to protect themselves as a group. There needs to be a streamlined and accessible process with adequate legal protections to allow individual retail investors have their claims resolved.

The various arbitration/mediation processes offered by industry at present are still costly and weighted in favour of industry. The individual retail investor needs an independent publicly funded body to help level the playing field, such as the National Enforcement and/or Protection Agency suggested above.

There is also need for an adequate compensation fund accessible by investors funded by the securities industry, possibly through insurance or mandatory contributions.

CARP recommends the adoption of an adjudicative function independent of the securities regulatory agency. In the current climate, there is a need to restore investor confidence in the securities regulation system and independence of the adjudicator is a critical requirement.

The National Enforcement and/or Protection Agency would investigate and assist in bringing forward claims by individual retail investors to the Adjudicative

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<sup>2</sup> Fiss, Owen. "Against Settlement" *Yale Journal of Law*, Vol. 93, No.6 (May 1984)

Tribunal. This would strengthen enforcement of securities law and regulation by assisting the retail investors who are least able to withstand the consequences of the breach of those laws and regulations.

CARP would urge that the guiding principles of the adjudicative function be accessibility, clarity and transparency, with regular publication of rulings against offenders as powerful disincentive to abuse investor confidence.

### *Financial Literacy*

One of our central advocacy goals is financial literacy which places responsibility on the investor as well as industry. Financial literacy is essential to the ability to make informed choices, assess risk, avoid fraud and amass adequate retirement savings. Given the highly complex and decentralized nature of Canada's regulatory framework, understanding finance institutions can be daunting for the average investor.

We applaud the Canadian Government's 2007 commitment to provide the Financial Consumer Agency of Canada (FCAC) with \$3 million to address financial literacy over the next two years. However, there needs to be more collaboration on this issue. Financial institutions should be mandated by regulators to contribute pre-set amounts to existing financial literacy programs such as those operated by the Department of Finance, Industry Canada, Human Resources and Skills Development Canada (HRSDC) as well as non governmental non-profit organizations.

A 2005 Organization for Economic Cooperation and Development (OECD) Report entitled *Improving Financial Literacy* recommended that to promote, disseminate and encourage financial literacy:

- National campaigns, specific Web sites, free information services and warning systems on high-risk issues for financial consumers (such as fraud) should be promoted.
- Financial education programs should focus particularly on important life-planning aspects, such as basic savings, debt, insurance, or pensions;
- Future retirees should be made aware of the need to assess the financial adequacy of their current public and private pensions schemes;

CARP would endorse these recommendations and add the following:

- Financial literacy should be incorporated into the formal education curriculum rather than treated as a specialized program for investors only – the ability to understand the cost of debt and the need for

informed financial decision making applies to everyday living as much as it does to those with investment savings

- Special effort must be made to include groups which are marginalized whether by income status, [lack of] workplace participation, age, background or education.

The Report also included the means by which financial institutions could be required to share in the responsibility:

- Financial education should be an integral part of the good governance of financial institutions to encourage accountability and responsibility;
- Financial education should be clearly distinguished from commercial advertising and codes of conduct for the staff of financial institutions should be developed;
- Financial institutions should encourage clients to read and understand information, especially when related to long-term commitments or financial services with potentially significant financial consequences; small print should be discouraged;

## ***Conclusion***

All Canadians have a direct interest in the reform of securities regulation and CARP is pleased to contribute to the discourse with a particular focus on investor protection for those most affected by financial and retirement security concerns. The larger debates around jurisdiction, market stability and international credibility must not overshadow the primary purpose of securities regulation, that of providing a free, fair and transparent market place for investors.

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<sup>i</sup> One of the notable attempts in Canada to reduce the costs of rules and regulations and to make the rules and regulations more consistent across the country is the proposal to establish a national security and exchange commission to replace the eleven commissions that now exist. The legal basis for these provincial commissions is the allocation of power over property rights under the Canadian Constitution to the provinces. The provinces have been unwilling in the past to surrender their right to deal with security regulations to the federal government despite many attempts over the years to establish a national security commission. And if the federal government forces the issue by setting up such a federal commission, despite the objections of the provinces, the probability is that Canada will end up with twelve rather than eleven commissions, making the picture even more complicated. From **Submission to the Wise Persons Committee by the CD Howe Institute** [http://www.wise-averties.ca/submitted\\_en.asp?file=sub\\_cdh](http://www.wise-averties.ca/submitted_en.asp?file=sub_cdh)

<sup>ii</sup> Queen's Professor Counters Finance Minister's Bid for National Securities Regulator  
'Give up On National Regulator - National Securities Enforcement Agency More Achievable'  
June 04, 2008

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**Kingston, ON (June 4, 2008)** – Last week, Finance Minister Jim Flaherty with great fanfare once again attempted to muster enthusiasm for a Canada-wide national securities regulator among his provincial counterparts, with little in the way of results. “Maybe now is the time to look at more creative alternatives,” suggests Steven Salterio, Professor of Business and Director of the CA-Queen’s Centre for Governance. “If we can’t achieve the international norm of having a single national securities regulator we need to leave the various provincial regulators in place and move the enforcement part into a single national securities enforcement body,” he adds.

Professor Salterio’s proposed approach would allow all jurisdictions to keep their prized involvement in setting the regulations but the interests of investors would be put front and centre where they belong in enforcement.

What’s the difference between a regulatory and an enforcement organization? A national securities enforcement body would be a focused organization with the sole mandate to investigate and enforce the various multilateral and national securities laws and regulations that are in effect across Canada. The power to make laws and regulations would remain where it has been for the last hundred years, with the provincial government and their securities commissions. Therefore, there is no loss of sovereignty or jurisdiction at the provincial level but enforcement makes a quantum leap forward.

“After all, as we wait for the sixth committee in five years — Mr. Flaherty’s recently appointed Hockin expert panel — to weigh in on what is becoming a quest for the ‘holy grail’, the International Monetary Fund (IMF) characterizes Canada as a country where the enforcement of securities laws is ‘still in need of considerable improvement’. This can not be allowed to continue. The finance ministers’ meeting is yet another sign that there is little hope that such national securities commission is any closer to coming into being.”

Salterio lists these advantages to having a national securities enforcement body:

- **Focus:** The body would only focus on investigation and enforcement of regulations leaving day-to-day administration and adjudications of securities regulations at the provincial level. This also ends the appearance of conflict when Securities Commissioners have the combined roles as regulators, police, prosecutors and judges.
- **Expertise and capacity development:** As an elite enforcement unit with national level responsibilities, the organization would be better placed to attract the best and the brightest lawyers and accountants.
- **Specialized prosecution support teams:** Research shows that there has been relatively little success in securities law prosecution in Canada. This has been attributed in part to the need to educate judges about complex technical business and accounting matters. Crown prosecutors need support from dedicated teams of lawyers and accountants to ensure that they are able to clearly explain these matters to judges in a manner that makes sense.
- **Economies of scale in enforcement:** Research in other countries suggests that there are economies of scale from enforcement. The larger the enforcement unit, the lower the cost per investigation.

“While there are many advantages to such an enforcement agency it is certainly not a cure for what ails the Canadian securities markets,” said Salterio. “For example, it wouldn’t deal with the problem of lowest common denominator regulation that occurs in Canada due to the need to negotiate, among thirteen provincial and territorial regulators, the national and multilateral securities regulations.

“However, a well-resourced national enforcement body would be a huge step forward for the protection of investors in Canadian capital markets in both appearance and in reality. While others dream of perfection and national securities regulators, the international reputation of our capital markets require that we should be a tad more Canadian and be more realistic: let’s create an enforcement agency that has some real teeth. And let’s do it soon.”

Professor Steven Salterio is a PricewaterhouseCoopers/Tom O’Neill Faculty Research Fellow in Accounting and Director of the CA-Queen’s Centre for Governance. He is also the 2008 recipient of the Haim Falk Award for Distinguished Contribution to Accounting Thought.

