

**FIVE YEAR
REVIEW COMMITTEE
FINAL REPORT**

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**REVIEWING THE
SECURITIES ACT
(ONTARIO)**

March 21, 2003

THE COMMITTEE

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EXECUTIVE SUMMARY

INTRODUCTION

Several themes emerged in the course of our deliberations. These themes, described below, are reflected in this Report and our recommendations.

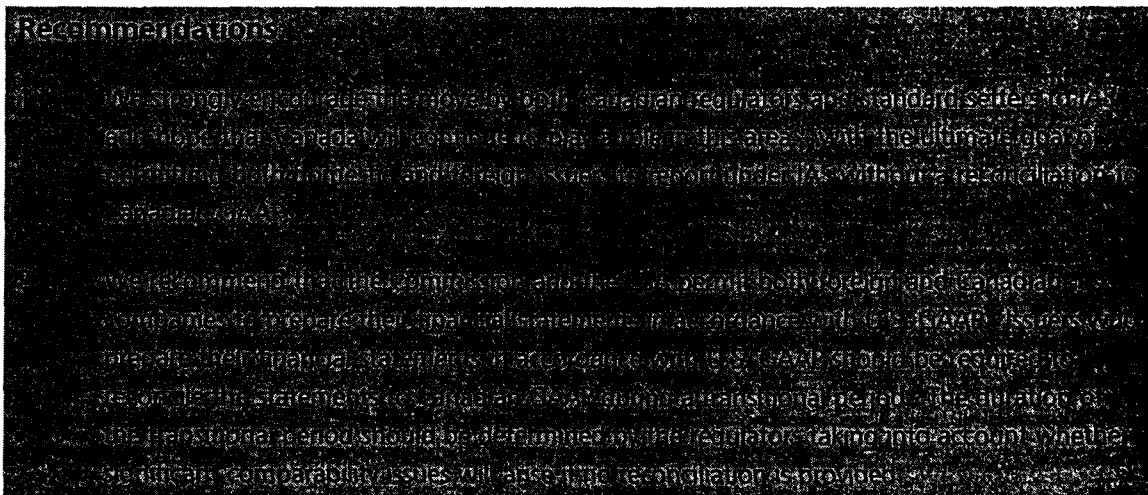
1. Regulation should support clearly identified public policy objectives and be proportionate to the objective. The benefits of regulation (and changes to regulation) must outweigh the costs imposed by it.
2. Canada competes with other jurisdictions around the world for capital and for investment opportunities. Our regulatory regime must be part of our competitive advantage. This requires that our regulators be able to operate efficiently and that our regulatory requirements not be more onerous than those existing in other jurisdictions (particularly the U.S.), except as may be required to satisfy our public policy objectives. It also requires that the markets have confidence in the enforcement powers of our regulators and that our regulators have the resources necessary to exercise those powers.
3. Increased harmonization of securities regulation nationally and internationally is imperative to ensure that Canadian capital markets are competitive with other jurisdictions.
4. Securities regulation must be flexible enough to allow regulators to react to changing circumstances on a timely basis.
5. Securities regulation in Canada must be sensitive to the nature of our capital markets and the participants who inhabit it, the large proportion of small cap issuers, and the significant number of public companies with controlling shareholders. In other words, a “one size fits all” approach may not work in all instances in Canada.

The recommendations resulting from our deliberations are set out below, along with a reference to the page of the Report on which the particular recommendation can be found. You will find it helpful also to consider the reasons for each recommendation, which are set out in the part of the Report accompanying the recommendation.

RECOMMENDATIONS**PAGE****PART 1 – THE ROLE OF THE COMMISSION IN CAPITAL MARKETS
REGULATION**

1. We recommend that the provinces, territories and federal government work towards the creation of a single securities regulator with responsibility for the capital markets across Canada. To this end, we strongly encourage the Government of Ontario to actively support the Wise Persons' Committee recently established by the Federal Finance Minister. 41
2. In the meantime, we recommend that certain steps be undertaken by securities regulators to simplify the current regulatory regime in Canada:
(i) We recommend that securities regulators continue to harmonize securities regulation across Canada; (ii) We recommend that securities regulators be given the authority to delegate any power, duty, function or responsibility conferred on them to another securities regulatory authority within Canada, and that they actively engage in delegation among themselves. We therefore recommend the Act be amended to give the Commission this delegation authority, and that the necessary consequential amendments to the immunity provisions in the Act be made; (iii) We recommend that securities legislation across the country be amended to provide for "mutual recognition" so that the rules of the jurisdiction having the closest connection to a transaction or market participant will govern that transaction or market participant, and other affected jurisdictions will recognize and allow those rules to be applied in place of their own. 41
3. We strongly encourage the move by both Canadian regulators and standard setters to International Accounting Standards and hope that Canada will continue to play a role in this area – with the ultimate goal of permitting both domestic and foreign issuers to report under IAS without a reconciliation to Canadian GAAP. 48
4. We recommend that the Commission and the CSA permit both foreign and Canadian companies to prepare their financial statements in accordance with U.S. GAAP. Issuers who prepare their financial statements in accordance with U.S. GAAP should be required to reconcile the statements to Canadian GAAP during a transitional period. The duration of the transitional period should be determined by the regulators taking into account whether significant comparability issues will arise if no reconciliation is provided. 48
5. We strongly encourage the Commission and the CSA to continue developing securities transfer legislation modelled on revised Article 8 of the Uniform Commercial Code in the U.S. and we urge governments across Canada to ensure that such legislation is adopted on a uniform basis as soon as possible. 50

studied by various groups in the U.S. and are being followed closely in Canada.⁷⁰ Notwithstanding these legitimate concerns, we believe that it continues to be important for Canadian issuers to be able to stay in step with requirements imposed by U.S. regulations without duplicating efforts for Canadian reporting purposes. Also, despite recent corporate failures in the U.S. we continue to have faith generally in the robustness of U.S. accounting standards.



2.3 Book-Based Settlement and the Indirect Holding System

Legislation in Canada dealing with the holding, transfer and pledging of securities and interests in securities was developed at a time when securities were held under what is referred to as the *direct holding system*. In such a system, owners of securities had a direct legal relationship with the issuer. That is, owners would either be recorded on the issuer's register or be in physical possession of negotiable security certificates. If a holder of a registered certificate wished to transfer or pledge its interest in securities, it endorsed the certificate, usually in blank, to the purchaser or the pledgee. The purchaser might, in turn, surrender it to the issuer for a new certificate, whereupon the issuer would amend its records to show the purchaser as the registered holder of the certificate. In the case of a pledge of securities, the pledgee either held the certificate to prevent the pledgor from selling or pledging the security to someone else or required that the pledgee be shown as the registered holder on the issuer's register and that a new certificate be issued to it.

Today, securities held by Canadian investors and by investors in other parts of the world are most commonly held through the *indirect holding system*, sometimes also referred to as the

⁷⁰ For example, the *Sarbanes-Oxley Act of 2002* requires the SEC to conduct a study on the adoption by the U.S. financial reporting system of a principles-based accounting system, including an examination of the feasibility of and proposed methods by which a more principles-based accounting system may be implemented in the U.S.

book-based system. Under the *indirect holding system*, a security is not registered in the name of the person who owns that security. Instead, investors' interests in securities are recorded on the books of an intermediary – typically a securities dealer, bank or custodian. The intermediary, in turn, has its interests recorded on the books of another intermediary, and so on up the chain of intermediaries until some intermediary – usually a central securities depository – is either recorded on the issuer's register or is in physical possession of negotiable security certificates.

Most commercial transactions in the securities markets are effected by book entries in securities accounts maintained by intermediaries for their customers. Issues may arise in those transactions concerning the nature of the property interest acquired or the validity of a transfer or pledge. If a purchaser/pledgee is not certain which laws apply to the transaction, or whether those laws clearly and inarguably recognize its property interest, then the purchaser/pledgee will attribute legal risk to the transaction. This legal risk may increase transaction costs or, if the legal risk is deemed unacceptable, cause market participants to avoid the jurisdiction altogether. Also, lack of harmonization of substantive laws and conflicts-of-law can make the transferring and pledging of indirectly held securities between jurisdictions inconvenient and, in some cases, altogether unmanageable.

There is a need for a nationally harmonized (and ultimately globally harmonized) commercial-property law framework to oversee the holding, transferring and pledging of securities and interests in securities. Action has been taken in this regard in many parts of the world, including the U.S. In the U.S., Article 8 of the *Uniform Commercial Code (UCC)*, which governs transfers and pledges of securities, was revised in 1994 to deal with securities held through the indirect holding system as well as both certificated and uncertificated securities in the direct holding system. No such changes have been made to legislation in Ontario⁷¹ or elsewhere in Canada. This creates legal uncertainty particularly for Canadian market participants active in cross-border securities trading and pledging transactions. It places them at a competitive disadvantage vis-à-vis market participants in the U.S., the European Union and certain other jurisdictions that have reformed, or are in the process of reforming, their substantive laws and conflict-of-laws rules in this area.⁷²

After the enactment of revised Article 8 of the UCC, the Uniform Law Conference of Canada established a committee to study the issue of law reform in Canada. It proposed the adoption of a uniform provincial *Securities Transfer Act (USTA)* in Canada, substantially modelled on UCC revised Article 8. This project has been ongoing for a number of years in Canada. In recent

⁷¹ The relevant legislation is the *Business Corporations Act*, R.S.O. 1990, c. B-16 and the *Personal Property Securities Act*, R.S.O. 1990, c. P-10.

⁷² The conflicts-of-law problem for the indirect holding system is currently being addressed internationally by the *Hague Conference on Private International Law*, which is developing a proposed multilateral choice-of-law Convention. The CSA has been involved in the Hague Conference project, through the Federal Department of Justice, as part of the Canadian delegation to the Hague Conference, and through IOSCO, which is an interested observer to the project.

years, a CSA Task Force has become involved in this project, and is overseeing the drafting of the USTA legislation with the help of a consortium of provincial legislative counsel.⁷³ The need to update the legislation in Canada is clear and compelling. Canadian legislation in this area is currently out of step with legislation in the U.S. and certain other countries. The legal foundation for the holding transfer and pledging of securities is of fundamental importance to the clearing and settlement process, and to efficient and safe capital markets.

Recommendation

We strongly encourage the Government and the CSA to continue developing securities transfer legislation modeled on Article 8 of the U.S. and to encourage other jurisdictions to adopt similar legislation to provide for a uniform cross-border approach.

2.4 Participation in IOSCO

Securities regulators from around the world have sought to harmonize their approach to regulation through IOSCO.⁷⁴ Established in 1975, IOSCO promotes mutual co-operation among members through discussion of matters such as market regulation policies and the development of international standards in securities regulation. Over the years, the Commission has been an active participant in IOSCO.

IOSCO has completed or has work in progress on a range of matters, including:

- ◆ a multilateral memorandum of understanding for securities regulators regarding information sharing and co-operation in enforcement matters;
- ◆ statements of principles to guide securities regulators in dealing with critical areas necessary for auditor oversight;
- ◆ recommendations for securities settlement systems intended to promote the implementation of measures that can enhance international financial stability, reduce risks, increase efficiency and provide adequate safeguards for investors; and
- ◆ disclosure standards for cross-border initial public offerings and listing of equity securities.

⁷³ The Committee has been advised that the Task Force released for comment in June 2002 to a limited number of government and other key stakeholders a draft of the USTA and working drafts of conforming amendments to Ontario and Alberta personal property security legislation ("PPSA"). The stakeholders included the Uniform Law Conference of Canada PPSA Working Group and the Canadian Conference on Personal Property Security Law. The Task Force's next step is to publish in provincial securities commission bulletins a consultative draft USTA, together with consequential amendments to PPSA legislation and provincial business corporation acts, extensive explanatory material and a CSA Position Paper. The tentative target date to publish the materials is the middle of 2003.

⁷⁴ IOSCO is a worldwide association of regulatory bodies with responsibility for securities regulation and the administration of securities laws. IOSCO aims to foster co-operation among its members, promote high standards of securities regulation, facilitate the exchange of information and encourage the establishment of standards and effective surveillance of international securities transactions. For more information, see the IOSCO website at www.iosco.org.