IIACACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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SENT BY EMAIL

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RE: Consultation Drafts of the Provincial Capital Markets Act ("PCMA") and the Capital Markets Stability Act ("CMSA")

The Investment Industry Association of Canada (the "IIAC" or the "Association") welcomes the opportunity to comment on the consultation drafts of the PCMA and the CMSA. The IIAC commends the Governments of Canada, British Columbia, New Brunswick, Ontario, Prince Edward Island and Saskatchewan (the "Participating Governments") for moving forward to establish the Cooperative Capital Markets Regulatory System (the "CCMRS") and the Capital Markets Regulatory Authority (the "Authority") that oversees it. We continue to hope that other jurisdictions join this initiative, and urge them to engage in discussions with the Participating Governments.

The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 160 IIROC-regulated investment dealer Member firms. These firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations.

The IIAC supports the underlying objectives of this initiative, including fostering more efficient and globally competitive markets, providing for one voice on the international stage, and enhancing efficiencies by strategic priority settings. The CCMRS will also protect regional interests and provide a more streamlined process for small regional businesses to raise and grow capital. Furthermore, the CCMRS will reduce the fragmentation and duplications that currently exist within the provincial securities system. It will provide a better balance between financial stability/investor protection and market efficiency. Finally, it will enhance the ability of law enforcement and prosecutors to achieve better criminal enforcement outcomes across Canada.

We fully support the federal government's role in regulating systemic risk. The IIAC believes the CMSA will help achieve this objective however, its implementation must not result in undue regulatory burdens on capital market participants.

In providing our comments we would like to emphasize the difficulty in fully assessing and commenting on the consultations drafts of the PCMA and CMSA in the absence of the detailed regulations and the complete draft legislation (including the still-to-be drafted aspects of the PCMA in respect of transition

and making regulations).[1] The IIAC reserves the right to comment on all aspects of the CCMRS, including the PCMA and CMSA once the entire regime has been proposed.

In order for the CCMRS to function effectively, it is critical that:

- The transition to the PCMA be seamless and not result in additional costs for market participants.
- During the transition to the PCMA no material changes are made to existing securities laws and practices, including the discretionary relief that market participants currently rely upon in the participating provinces.
- The CMSA not impose undue regulatory burdens on capital market participants and the power to regulate systemic risk be used judiciously and in a manner that reflects coordination and cooperation with other prudential regulators such as the Office of the Superintendent of Financial Institutions and the Bank of Canada.
- A simplified, common set of fees be developed to streamline and harmonize the currently duplicative and cumbersome system. A transparent, fair and simple fee structure promotes efficiency and is an advantage for both large and small dealers and market participants more generally.
- The policy and regulation-making process is open and transparent, and will hear and consider the perspectives, interests and concerns of market participants and investors from all regions of Canada.
- The governance structure accords with best corporate governance practices, including clearly articulated guidelines and procedures for the selection and appointment of the Authority's board members and senior officials, on the basis of merit and expertise.

To achieve these above objectives, the Participating Governments may wish to consider a minimum one-year transition period for the PCMA and CMSA to minimize market impact and to allow the Authority and its staff to work towards harmonized practices.

While the IIAC fully supports the implementation of a cooperative securities regulator for the country, we wish to highlight the importance that proposed legislation parallel existing securities law to the extent possible to avoid disruptions in market activity, confusion, and unnecessary costs to market participants. To this end, the proposed legislation should adhere to principles of securities law embedded in the existing legislation that have been developed over time through extensive consultation and debate.

It is imperative that, while certain substantive changes in the law are necessary to achieve harmonization of legal requirements across the participating regions, these changes should be highlighted and explicitly identified in conjunction with an explanation of the anticipated reasons and consequences of the change. First, the PCMA is silent on many requirements. While we recognize that the intention is to have most of these requirements addressed in the regulations to avoid confusion and certainty, these changes should have been clearly outlined in the commentary. Second, the IIAC is concerned to note a number of proposed wording and concept changes between existing securities law

[1] The consultation draft of the PCMA states that certain parts of the draft PCMA relating to transitional provisions and regulation-making powers are still being developed.

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requirements and those proposed in the PCMA. These new requirements have not been identified in the accompanying background material and have not been the subject of robust dialogue and consultation on the implications of these proposed revisions. We have identified some of these changes below, but there are no doubt other proposed revisions which, in the context of this comment period, have been difficult to identify and study.

The overriding principle in the development of new securities legislation should be to ensure such legislation is as consistent with existing requirements as possible, and the temptation to make amendments to existing draft legislation, no matter how subtle, should be avoided until the Authority is established. These amendments can then be proposed, considered, examined and debated within the open policy-making approach promised by the proposed governance model.

The IIAC believes it is inappropriate to make amendments to existing legislation without a full, open and transparent process and as such, we hope the points identified are reviewed carefully and be given due consideration in future consultations.

1. Concerns with the PCMA Consultation Draft

(A) The Form and Substance of the Legislation and Regulations

(i) Organization and form

The IIAC supports the structural simplification of the PCMA and agrees that the platform approach to capital markets regulations will ensure sufficient flexibility to allow the Authority to respond to market developments in a timely manner. In adopting the regulations under the PCMA, we feel strongly that existing regulations, in the form of national instruments, multilateral instruments and provincial rules, should be adopted as they exist currently and only minimal amendments should be made to achieve harmonization. Introducing changes to the existing regulations while trying to transition to a new securities regulation regime will result in potential market disruption. There will also be a significant cost to market participants in assessing any substantive changes to existing regulations.

The IIAC urges the Participating Governments, where possible, to adopt existing regulations in their entirety, using the same numbering and wording (including applicable definitions). Where this is not possible, Participating Governments should explicitly detail how and why the proposed regulations differ. For market participants comparing the existing regulations and rules, it will be helpful if the Participating Governments could provide backline comparisons showing the proposed changes at the time of publication for comment, with particular attention given to substantive and significant changes (including commentary explaining the intention behind such changes). Given the expected large volume of regulations that will be released for public comment, we request that a minimum 120 day comment period be provided, as well as an opportunity for direct briefings by relevant policy advisors to the CCMRS.

(ii) Exemptive relief

The IIAC's members are very concerned about the availability of existing exemptions and the corresponding exemptive relief currently provided for under provincial securities laws and national instruments ("NI") after the transition to the CCMRS. Many IIAC members have received discretionary exemptive relief in respect of their business operations.

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For example, IIAC members may rely upon exemptive relief to trade OTC derivatives under blanket exemptive relief currently available in British Columbia, Saskatchewan and New Brunswick. Reporting issuers commonly rely on discretionary exemptive relief from continuous disclosure requirements. It is also very common for investment funds in Canada to rely on discretionary exemptive relief from investment restrictions in NI 81-102. Exchanged-traded funds in Canada rely on discretionary exemptive relief from certain prospectus delivery requirements. Several non-Canadian exchanges, clearing agencies and derivatives trading facilities rely on exemptive relief from recognition requirements under provincial securities laws. In addition, exemptive relief has been granted from the prospectus and registration exemptions in the *Securities Act* (Ontario) (the "OSA") and the Fund Facts delivery requirement for pre-authorized purchase plans.

The IIAC requests that the Participating Governments consider, not only additional guidance on transitional provisions in order to maintain these exemptions, but the need to examine the related sunset provisions which may result in the termination of the relief upon the coming into force of the PCMA. The relief should be permitted to continue notwithstanding the introduction of the PCMA or CMSA and the inadvertent triggering of any sunset clauses. Similarly, IIAC members are concerned with any inadvertent conflicts with respect to existing relief and how it relates to non-participating jurisdictions going forward; for example, if a "passport" decision was granted by Ontario to apply in each of the provinces and territories of Canada. If the OSA no longer exists but the operative provision is still in force in a non-participating jurisdiction, does the exemptive relief still apply in the non-participating jurisdiction?

(iii) Derivatives regulation

The IIAC is supportive of the approach to include derivatives in the relevant provisions in the PCMA rather than propose separate derivatives legislation. Our members would like to understand, for instance, how any proposed repeal of the Ontario *Commodity Futures Act* will occur and whether the CCMRS will preserve existing regulations relating to futures or propose new regulations. As with securities regulation, the Participating Governments should seek to minimize undue disruptions to market participants during the transition. Where possible, existing regulations should be adopted under the PCMA.

If new regulations are proposed the market will require sufficient time to review and prepare for any changes.

(B) Omissions and Material Changes in the PCMA

As stated above the IIAC was surprised and concerned by the number of substantive items contained in the provincial securities acts that do not appear in the PCMA. We assume these items will be included in the proposed regulations, but for certainty and to ensure there were no oversights, we wish to highlight some key provisions. The Association would also like to point out some additions and revisions which give rise to material differences in the PCMA. It should be noted that the items listed below are by no means exhaustive, but simply illustrative of important variations from current legislation. As stated, we are concerned that our analysis of the PCMA is incomplete without being able to assess the entire regime, including the regulations and reserve the right to provide further comments on the PCMA once the regulations are published for comment.

(i) **Statutory Duty to Assist** – Section 105 of the PCMA creates a new duty for persons subject to a review under section 103, or an investigation under section 104, to give all assistance that is reasonably required to enable a review or an investigation. The IIAC has grave concerns with this new requirement. The duty to assist should only apply when the Authority is exercising powers of compulsion contained in the PCMA. As presently drafted, it is unclear if all of section 105 is limited to giving assistance when a place is entered under subsections 103(4), 104(7) or 104(8) of the PCMA, or if that limitation only applies to control persons and the owner of an entity who is in charge of a place that is entered under the powers in those subsections.[2]

(ii) **Two Day Right of Withdrawal** – Currently, under subsection 71(2) of the OSA, when the prospectus delivery requirement applies in respect of a sale of securities, the purchaser has a right of withdrawal by informing the dealer of its withdrawal within two business days. This provision protects investors and as such, we believe the intention is for its inclusion in the registration regulations, but would request confirmation of this assumption. We also query how differences in provincial legislation with respect to rescission and withdrawal rights will be resolved.

(iii) **Self-Dealing** – The PCMA does not include rules similar to Part XXI of the OSA. These rules address conflicts of interest and investment restrictions for mutual funds. As such, we believe the intention is to have these provisions included in the registration regulations.

(iv) **Unfair Practices** – Section 70 in the PCMA includes several requirements to protect vulnerable persons. While the IIAC has no objection to such a provision being included, it is a change from the OSA. We request the Participating Governments provide clarity and guidance on the expectations relating to compliance with such a requirement, over and above compliance with NI 31-103.

(v) **Dealer Exemption for Banks** – The exemption for banks under section 35.1 of the OSA is not included in the proposed PCMA. This exemption provides that banks are exempted from the requirements to be registered as a dealer, underwriter, adviser or investment fund manager. Given this important exemption, we believe the intention is to have it included in the registration regulations, but would like confirmation from the Participating Governments.

(vi) **Designations** – Subsection 95(2) of the PCMA provides that the Authority may make designation orders. While the PCMA permits opportunities to make representations before the Authority issues an order under subsection 95(3), the IIAC believes interested/affected parties should also be given the right to make representations before the Authority makes an order designating a security to be a derivative or designating a derivative to be a designated derivative.

Subsection 95(2) of PCMA permits the designation of an entity as a market participant. While this is not a new provision, we note that the definition of market participant is broader in scope and may include entities that were previously excluded from this designation. The obligations and requirements for market participants are significant, including the market conduct requirements in Part 9 of the PCMA, the enforcement powers in Part 11, and the disclosure requirements in Part 14. Given the scope of these requirements for newly designated entities,

[2] Note that the duty to assist is also contained in the CMSA.

we recommend that the Participating Governments revert to the OSA or, at the very least, permit a longer transition period for these entities to comply.

(vii) **Burden of Proof for Reasonable Investigation Defence** – Part 12 of the PCMA shifts the burden of proof for the reasonable investigation defence in a primary market right of action from the plaintiff to the defendant (including defendant directors, officers and experts). Under Part XXIII of the OSA, the plaintiff bears the burden of proving that a defendant other than the issuer/offeror failed to conduct a reasonable investigation or believed there had been a misrepresentation. Under sections 119, 121 and 123 of the PCMA, the defendant has the burden to prove that, after conducting a reasonable investigation, the defendant had no reasonable grounds to believe and did not believe that there was a misrepresentation. There is a concern that this shift would have a chilling effect on, for example, the willingness of experts to give fairness opinions as it makes it easier for plaintiffs to bring actions against experts and may also lead to an increase in frivolous litigation, which will be burdensome on directors and officers.

(viii) **Liability Caps** – Part 13 of the PCMA has the potential to penalize issuers and other defendants who face parallel proceedings in a participating jurisdiction and a non-participating jurisdiction because the liability limit in section 165 does not incorporate damages and amounts paid in settlement in the non-participating jurisdiction. This is a departure from section 138.7 of the OSA, which incorporates damages and amounts paid in settlement in any other proceedings in Canada. There is a concern that this change would lead to plaintiffs proceeding in both participating and non-participating jurisdictions in an attempt to, effectively, double the liability limits.

(ix) **Definition of "Misrepresentation"** – The definition of "misrepresentation in the PCMA has been revised from the current definition in both the OSA and the British Columbia Act. What had been an "untrue" statement has been changed to a "false or misleading statement". A similar concept is reflected in the obligations a person has to investors in section 72. This is a significant change and should be submitted for broader consideration and discussion.

(x) **Obstruction** – Subsection 76(1) of the PCMA prohibits "obstruction" which includes "withholding" information. The inclusion of the word "withholding" is troubling, if interpreted as a diminishment of rights of a respondent (or potential respondent) to a regulatory proceedings. Again, this is a significant change requiring more fulsome consideration and consultation.

(C) <u>Interaction with Non-Participating Jurisdictions</u>

A critical aspect in determining whether the CCMRS can function effectively and efficiently is whether and how the participating jurisdictions will interact with the non-participating jurisdictions. It is vital that this interaction not increase the costs to market participants or result in disruption of their activities in the non-participating jurisdictions. The IIAC urges the Participating Governments to provide guidance on how it expects this interaction to work, and whether there will be an enhanced and revised "passport" regime.

The IIAC also suggests some consideration be given to providing guidance on the role that a newly formed Authority would play with the non-participating jurisdictions. In addition, as our members' primary regulator is IIROC, we are concerned about how the existing oversight of Self-Regulatory Organizations will be maintained and what the interplay will be with the oversight and recognition provided by the non-participating jurisdictions.

(D) Introduction of a CAO or COO into the Regulatory Division

Given the monumental duties that the Chief Regulator will be responsible for at the outset of the formation and development of the Authority and the need for the Authority to operate as a high performing entity to achieve its significant objectives, the IIAC suggests that consideration be given to establishing an additional senior position to ease the Chief Regulator's heavy demands. The IIAC is concerned the Chief Regulator would find it difficult to implement a strategy to achieve cost-effective regulation while also focusing on his/her primary responsibility of establishing the vision and direction of the Regulatory Division, warranting the need for a Chief Administrative Officer ("CAO") or Chief Operating Officer ("COO").

The Regulatory Division will be responsible for the policy, regulatory operations, advisory services and enforcement functions of the Authority. In addition, the Chief Regulator will be accountable to the Board of Directors and serve as the CEO responsible for the business and operations of the Regulatory Division, working with an Executive Committee and overseeing the Deputy Chief Regulators who are based in regulatory offices across Canada. There will also be significant responsibilities relating to overseeing the operations and staff of these offices. These are, we believe, too many important responsibilities for a single individual to undertake while the Authority is in its infancy.

Establishing the position of a CAO or COO will help ensure that the Chief Regulator can focus on the overall direction of the Regulatory Division, while the CAO or COO can lead the administrative and operational functions that will be critical to the organization.

2. Concerns with the CMSA Consultation Draft

(A) Designation and Systemic Risk

Part 2 of the draft CMSA provides a broad discretion to designate market entities as being systemically important and products and practices as systemically risky. The IIAC believes it is critically important to provide guidance on these aspects of the CMSA. We are specifically concerned with the manner in which discretion will be exercised, the right of affected parties to make representations before such a designation is made, rights of appeal from such a designation, the mechanism for varying orders and regulations, and the circumstances and manner in which the Authority can revoke such a designation. Such guidance is necessary to better understand when a determination of systemically important will be made and how it will be administered. We are of the view that the proposed approach and the apparently broad discretion subjects the CMSA to wide and unnecessary criticism in the absence of clarity on how and under what circumstances the discretion will be exercised and what procedural rights will be accorded.

This guidance could take a similar form to the rule and interpretative guidance published by the U.S. Financial Stability Oversight Council in respect of its considerations, processes and procedures for

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evaluating whether non-bank financial companies pose a threat to the financial stability of the United States pursuant to the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.[3] This rule provides, in part, for an opportunity for entities to challenge the "systemically important" designation. While subsection 27(3) of the CMSA allows an entity to make representations, we believe that the ability to challenge the designation should also exist, given the significant implications of such designation being assigned.

(B) Data Collection and Protection

The IIAC generally supports the stated goal of centralizing and streamlining data collection activities to monitor capital markets activity or detecting, identifying or mitigating system risk. The IIAC agrees with the statement in the commentary that "the Authority must coordinate, to the extent practicable, its information collection requirements with other domestic and foreign financial sector regulatory authorities to avoid imposing an undue regulatory burden." The IIAC requests guidance be provided to ensure this will be the result, including guidance on the manner in which the Authority will minimize the data collection burden on market participants, ensure full consultation on proposals to collect market data, and coordinate with other regulatory authorities. IIAC members are concerned that they will ultimately have to incur the costs and time of providing the same information to multiple authorities.

The IIAC is also concerned about safeguards to protect the confidentiality of the information collected. The draft PCMA and CMSA give the Authority discretion in deciding whether to treat information as confidential, including compelled evidence obtained in a regulatory investigation. The IIAC urges the Participating Governments to provide guidance on the manner in which this discretion will be exercised.

(C) New Powers and Clarification Sought in the CMSA

Similar to the proposed PCMA, we note some issues in the proposed CMSA that require clarification. Clarification as to whether these changes were intentional departures from current legislation and/or matters that will be addressed within the regulations will be helpful to our assessment. In addition, the IIAC is concerned with some of the new powers under the CMSA and how they will be exercised. While by no means exhaustive, the IIAC would like to highlight the following:

(i) **Notice of Violation Without Hearing or Review** – The IIAC has grave concerns with Section 44 of the CMSA which provides the Chief Regulator with the right to issue a notice of violation. A violation notice and the fine should not be issued without a full opportunity to be heard in advance. As currently drafted, this section will result in a denial of natural justice for the recipient of the notice of violation. It would be a denial of natural justice for a person served with a notice by the Chief Regulator to appear and make representations to the same decision maker to set aside the notice. An independent tribunal should determine whether the Chief Regulator's allegations have been established. Rights of appeal to a court of competent jurisdiction should also be set out.

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[3] Financial Stability Oversight Council - Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies, Rule (12 CFR Part 1310) and Interpretative Guidance (76 FR 64264).
See **http://www.treasury.gov/initiatives/fsoc/Documents/Nonbank%20Designations%20-%20Final%20Rule%20and%20Guidance.pdf**

(ii) Foreign Capital Markets and Intermediaries – The Association asks for clarification with respect to section 3 of the CMSA. Section 3 states that systemic risk means a threat to the stability or integrity of Canada's financial system that, in part, is transmitted through or impairs capital markets. We query whether the intention is to capture *foreign* capital market intermediaries. The IIAC suggests that these provisions be clarified regarding the extra-territorial implications when, for example, foreign investment dealers are trading in Canada. The scope of section 3 as it pertains to foreign domiciled entities should be outlined clearly in a companion policy or regulation.

(iii) Interaction with SROs – The items listed in section 31 of the CMSA, such as the transparency of trades, clearing and settlement, margin, capital and leverage, liquidity, etc. appear to overlap with IIROC's jurisdiction. If requirements may be prescribed in the regulations in relation to these items to address systemic risk, how will these provisions interact with current IIROC requirements? The Participating Governments must ensure that they coordinate efforts with IIROC to mitigate the burden on market participants.

(iv) Due Diligence Defence – Section 47 of the CMSA provides that if a person other than an individual commits a violation, any of the person's directors or officers could also be liable for the violation. With such a heavy burden placed upon these directors or officers, we suggest that these provisions should include a corresponding due diligence defence consistent with corporate law.

In closing, we welcome the opportunity for a continued dialogue with the Participating Governments regarding the draft legislation, and would be pleased to discuss this submission should you have any questions.

Yours sincerely,

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