



Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

July 18, 2016

The Honourable William Francis Morneau
Minister of Finance
Department of Finance Canada
90 Elgin Street
Ottawa, Ontario K1A 0G5

Sent by email to: comment@ccmr-ocrmc.ca

Re: CSA Notice and Request for Comment on Proposed Amendments to Multilateral Instrument 62-104 Take-Over Bids and Issuer Bids, Proposed Changes to National Policy 62-202 Take-Over Bids and Issuer Bids and Proposed Consequential Amendments

FAIR Canada is pleased to offer comments on the revised draft federal Capital Markets Stability Act (“CMSA”) that is proposed to be administered by the cooperative regulator known as the Capital Markets Regulatory Authority (the “CMRA”).

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. Executive Summary

- 1.1. Overall, FAIR Canada is satisfied with the revisions made to the CMSA.
- 1.2. FAIR Canada is particularly pleased to see that protection of investors has been added to the purposes section of the CMSA. FAIR Canada continues to stress the importance of investor protection in all aspects of the CMSA and believes the Minister should expressly refer to this important principle in other specific provisions of the CMSA, in particular section 6(2). FAIR Canada therefore is pleased to see investor protection included in the CMSA’s mandate.
- 1.3. With respect to enforcement matters, FAIR Canada urges the Minister to ensure that the federal authority hires staff with the appropriate expertise to carry out a robust enforcement regime. We also encourage the Minister to enter into MOUs with other Canadian financial services regulators, and criminal enforcement bodies, in order to bolster the federal authority’s enforcement capabilities. FAIR Canada also asks that the Minister develop a more fulsome whistleblower program which provides for confidentiality and financial incentives. We also urge the Minister to revise the CMSA so that whistleblower protections will extend to independent contractors under section 63 of the CMSA.

- 1.4. With respect to the CMSA's provisions on data collection (section 9 of the CMSA), FAIR Canada asks that the Minister include additional wording in order to ensure that the practical realities of the proposed data collection regime lead to effective and valuable data collection. We are concerned that the current language used in the CSMA will not make it easy for the federal authority to obtain data that can be easily used in a timely manner. We stress that the data must be easy for the federal authority to obtain and must be available in a format that allows for searching as well as data mining. The Minister should not only consider the burden placed on participants in providing disclosure, but also the burden placed on regulators that are mandated to obtain data from secondary sources, especially when that data may not be in a usable format. We urge the Minister to address these issues directly in the CMSA.
- 1.5. Finally, FAIR Canada asks the Minister to reconsider the proposed definition of "security" in the CMSA. We are concerned that the definition, as currently drafted, will lead to the carve-out of certain investment products, and this will erode and undermine the mandate of investor protection. FAIR Canada supports a definition of "security" that would allow for the regulation of products that the average retail investor views as investments, such as deposit and insurance based products like principal protected notes, and segregated funds. We are opposed to definitions which permit for the carve-out of these products and believe that such carve-outs will lead to gaps in investor protection.

2. General Comments

- 2.1. Purposes of the Act: FAIR Canada is pleased to see that the purpose of the CMSA has been amended to say that "[t]he purposes of the Act are....to protect capital markets, *investors* and others from financial crimes"¹ (emphasis added). As stated in FAIR Canada's previous comments on the draft CMSA², we strongly believe that investor protection must be at the core of any securities regulations. We commend the Minister for including investor protection in the CMSA's purpose.
- 2.2. Fulfilling the mandate: FAIR Canada believes that section 6(2) of the CSMA should be amended to say that "[i]n fulfilling that mandate, the Authority must coordinate...its regulatory activities with those of other...financial authorities... to promote efficient capital markets, *to achieve adequate protection of investors*, to achieve effective regulation and to avoid imposing an undue regulatory burden" (proposed additions italicized). Again, FAIR Canada strongly believes that investor protection must be at the core of securities regulators' fulfillment of their mandate and we urge the Minister to make this amendment.
- 2.3. 5-year review: FAIR Canada is pleased to see that provisions requiring the Minister and Council of Ministers to conduct a five-year review of the CMSA and its administration and operation have been added to the CMSA. FAIR Canada believes that ongoing reviews of legislation are important and necessary to ensure effective securities regulation is being delivered. In conjunction with the mandated 5-year review we ask that the report which is to be produced and delivered to the Council of Ministers be made publicly available. We also encourage the Minister to propose and expeditiously implement any changes or revisions that come to light

¹ Revised Capital Markets Stability Act - Draft for Consultation s. 4

² FAIR Canada's comments on the Cooperative Capital Markets Regulatory System Legislation (December 8, 2014), available online at: <http://faircanada.ca/submissions/fair-canada-comments-on-cooperative-capital-markets-regulatory-system-legislation/>

in the course of this review and that would further the purpose of the Act, specifically the protection of investors.

3. Enforcement

- 3.1. Fraud and Enforcement: FAIR Canada urges the Minister to ensure the enforcement teams responsible for enforcement of the CMSA are staffed with individuals who possess the skills necessary to guarantee that a robust enforcement regime will be established. This includes lawyers with relevant expertise to investigate and prosecute wrongdoing, individuals trained in computer forensics, and specialized data analysts who are able to both survey and mine the data collected.
- 3.2. FAIR Canada notes that entering into enforcement related MOUs with securities regulators in international jurisdictions is positive and we support such cooperative initiatives. However, we remind the Minister that it is equally important to build relationships and coordinate with criminal enforcement bodies within Canada. This should include the Government of Canada's Integrated Market Enforcement Teams (IMET), and provincial police units that detect, investigate and deter investment fraud. FAIR Canada believes that developing strong relationships with criminal enforcement divisions and units across the country will help to ensure a strong, effective enforcement regime is established as part of the CMSA.
- 3.3. The Minister should look to examples from Quebec and Ontario in order to build a collaborative enforcement network. The Autorité des marchés financiers (AMF), for example, uses a joint committee model that has formal relationships with relevant police authorities and is thereby able to evaluate incoming fraud cases and determine the best unit to handle each case. Similarly, the Ontario Securities Commission (OSC) has established the Joint Serious Offences Team (JSOT), an enforcement partnership between the OSC, RCMP Financial Crime program and Ontario Provincial Police Anti-Rackets Branch. JSOT combines law enforcement policing skills with the OSC's expertise in forensic accounting and capital markets to investigate and prosecute serious violations. FAIR Canada believes both the Quebec and Ontario models are exemplary models. We urge the Minister to follow their lead and create an integrated approach at the federal level for the criminal prosecution of serious offences.
- 3.4. In addition, FAIR Canada believes it is crucial that the Minister build relationships with insurance regulators and other domestic financial services regulators to ensure there are no gaps to combating fraud. Securities regulation does not occur in a vacuum but instead occurs alongside the regulation of other things that may be viewed as "investments" (for example, syndicated mortgages). A strong enforcement regime will be one that collaborates with other regulators and has a holistic view of our markets as well as the skill to drill down in specialized areas, and we encourage the Minister to formalize such collaborative partnerships.
- 3.5. Whistleblowers: FAIR Canada urges the Minister to expand the language in section 63 regarding threats and retaliation against employees to also include protection for independent contractors. Outside professionals, such as accountants and consultants, are often in the best position to report fraud or wrongdoing. However, it is reasonable to believe they would fear retaliation, similar to an employee, should they come forward.³ Moreover, the section should

³ http://www.bressler.com/uploads/1348/doc/Independent_Contractors_Whistleblowers.pdf at p 2

consider the economic realities of today's employment arrangements, where an increasing number of individuals are hired on a contract basis. Also, in the investment world, many individuals operate through separate incorporated companies, despite the fact that for practical purposes they work as employees. As the purpose of anti-retaliation provisions is to encourage individuals with knowledge of wrongdoings to come forward, the section should be amended to include everyone who is likely to have such information. If employees are the only parties covered by the CMSA, then investment firms would be permitted to 'punish' independent contractors if they were caught being a whistleblower by withholding payment or bringing baseless legal claims. The Minister should therefore expand the scope of section 63 so that independent contractors are also protected.

- 3.6. FAIR Canada also urges the Minister to include provisions in this section that will guarantee confidentiality for those who come forward to report wrongdoing. FAIR Canada believes that confidentiality is a key requirement needed to encourage individuals to come forward with valuable information. Confidentiality should be extended to all individuals who come forward in good faith with information regarding a possible securities violation. While we recognize that absolute confidentiality may not be able to be maintained, efforts should be made as far as possible to maintain the confidentiality of everyone who brings forward information.⁴
- 3.7. FAIR Canada believes that financial incentives are critical to obtaining valuable information. We are strongly supportive of the payment of financial incentives to those who qualify. We therefore recommend that the Minister revise this section of the CMSA in order to include provisions which set out the terms for financial incentives. We refer you to our comments on the OSC's proposed whistleblower program for more information on how to build a framework for financial incentives.⁵

4. Data Collection and Disclosure

- 4.1. FAIR Canada is pleased to see that the Minister has considered data collection methods in the CMSA. However, FAIR Canada believes that further attention must be paid to the realities of what has been proposed in order to ensure that effective data collection is accomplished.
- 4.2. FAIR Canada believes that in order for data to be useful it must be presented in a format that is searchable and that will allow for data mining to take place. We also believe that regulators should not be burdened with a cumbersome data collection process. FAIR Canada is therefore concerned by the amendments made to section 10(b) of the CMSA which states that "before making a request [for disclosure], the Chief Regulator must consider the extent to which it is practicable to obtain the records and information in a timely manner from another source."
- 4.3. Firstly, if the requested data has already been provided to another regulator and the federal authority is expected to therefore obtain the data from that source, it is crucial that the data already be in a format that allows for easy searching and data mining (if it could be so provided by the market participant). Requiring the federal authority to rely on data which can neither be easily nor efficiently used is not helpful to the federal authority when it comes to enforcement

⁴ FAIR Canada's comments on OSC Staff Consultation Paper 15-401: Propose Framework for an OSC Whistleblower Program, (May 4, 2015), at section 3E, available online at: <http://faircanada.ca/submissions/12473/>

⁵ FAIR Canada's comments on OSC Staff Consultation Paper 15-401: Propose Framework for an OSC Whistleblower Program, (May 4, 2015), at section 3B, available online at: <http://faircanada.ca/submissions/12473/>

and compliance reviews. Moreover, the federal authority may be unfairly burdened and unlikely to work as efficiently as it otherwise could because of the procedural requirement to use the data that has already been provided, regardless of how that data has been presented. If the data is not in the desired format, the federal authority must be granted the power to compel the party in question to expeditiously provide the necessary data in a prescribed format.

- 4.4. Secondly, FAIR Canada is concerned that the requirements in section 10(b) of the CMSA, which say that the federal authority must first see if the data has been provided to another regulator before looking to the party in question to obtain that data, may cause delays to data collection processes. For example, if the federal authority is required to approach several regulators in order to obtain the data needed, or go back and forth between other regulators and the party in question in order to successfully obtain what is needed, it is likely that this process will often result in unnecessary delays. The additional time it takes to obtain data will also use up personnel resources at the federal authority, further adding to this burdensome requirement.
- 4.5. FAIR Canada asks that the Minister consider how this requirement will work in practice, and we encourage the addition of specific regulations which take into account burden on the CMRA and explain how this mechanism would work. The CMRA may wish to consider the imposition of a prescribed format in which data is to be provided to any regulator.
- 4.6. FAIR Canada is also concerned about the revisions made to section 14 regarding the disclosure of the data obtained by the federal authority. The revised section 14 says “[i]nformation obtained by the Authority under this Act may be disclosed if *the disclosure is consistent with the purposes for which the information was obtained*” (italics added to show amendments). We are specifically concerned as to how this section would be applied in practice, and we are worried that data provided to the federal authority pursuant to a request in the normal course of business would not be permitted to be disclosed in the context of an investigation pursuant to other parts of the CMSA. FAIR Canada asks the Minister to consider the practical consequences of this section and provide further guidance to resolve any uncertainty in that regard.

5. Definition of “Security”

- 5.1. FAIR Canada is concerned that the amendments to the definition of “security” in the revised CMSA will permit for the carve-out of certain investment products. The CMSA states that “‘security’ includes any contract, instrument or unit commonly known as a security *but does not include a contract, instrument or unit that is within a prescribed class*” (amendments to the definition are italicized). FAIR Canada supports a definition of “security” that would allow for the regulation of products that the average retail investor views as investments. This includes deposit and insurance based products, such as principal protected notes, and segregated funds. Such products are generally caught by the definition of security but have been defined out of the term “security”.
- 5.2. FAIR Canada believes that segregated funds should be included in this definition and we are opposed to language that will facilitate such products being carved out of securities regulation. Including such products within the definition of security would simplify oversight by firms and regulators of financial service providers who sell segregated funds. We refer you to the

comments previously made on this subject in our December 23, 2015 letter to the Cooperative Capital Markets Regulatory Authority⁶ and our comments on the inadequate regulation of market conduct with respect to segregated funds.⁷

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Should you have further questions, please contact Neil Gross at neil.gross@faircanada.ca / 416-214-3408 or Marian Passmore at marian.passmore@faircanada.ca / 416-214-3441.

Sincerely,



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⁶ FAIR Canada's comment on the Cooperative Capital Markets Regulatory System, (December 23, 2015), available online at: <http://faircanada.ca/submissions/the-cooperative-capital-markets-regulatory-system-revised-consultation-draft-of-provincialterritorial-capital-markets-act-and-draft-initial-regulations/>

⁷ See FAIR Canada's letters to FSCO on their draft Statement of Priorities: <http://faircanada.ca/wp-content/uploads/2011/06/110606-FSCO-Draft-Statement-of-Priorities.pdf> and <http://faircanada.ca/submissions/osc-draft-2012-2013-statement-of-priorities/> and our letter to the Expert Panel regarding Reviewing the Mandate of FSCO, where we address the inadequate regulation of segregated funds: http://faircanada.ca/wp-content/uploads/2011/01/150821-Letter-to-Expert-Advisory-Panel-re-FSCO-Mandate-Review_Final.pdf which includes two letters written to FSCO about the inadequacy of the regulation of segregated funds.

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