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Dear Mr. Crawford:

In response to the notice dated April 28, 2000, announcing the formation of the Securities Review Advisory Committee (the "Committee") and inviting the comments of market participants, please find below our written submissions on some of the matters raised in the Issues List set out in the notice. Specifically, we have chosen to address issues 11-13, 30, 32-37 and 39. We would be pleased to discuss our submissions on any or all of these issues with the Committee or its staff. Thank you for taking the time to review our comments.

REGULATION OF REGISTRANTS

11. Jurisdictional Application of the Registration Requirement

At present, Section 25 of the *Securities Act* (Ontario) (the "Act") prohibits persons and companies from trading in securities or acting as an adviser unless they are registered to do so.

Should the Requirement to be Registered to Trade in Securities be more Focused?

The definitions of "trade", "trading" and "security" set forth in Section 1 of the Act are extremely broad with the result that the requirement to be registered under the Act in order to trade in securities is very far reaching, especially when one considers that the definition of "trade" includes any act in furtherance of a trade. Accordingly, Sections 35(1), 35(2) and various sections of the Regulation and certain Rules made under the Act contain numerous exemptions from the requirement to be registered under the Act in order to trade in securities. While certain of the exemptions are purposive in nature and speak to situations where, given the size of the trade, the nature of the parties to the trade or the nature of the securities which are the subject of the trade, the intermediation of a registered dealer would not be meaningful (for example, trades in excess of $150,000, trades with institutional purchasers or trades in sovereign debt), there are a large number of other exemptions which appear to be remedial in nature and which address situations where the breadth of the trading registration requirement has captured situations where such requirement should not apply. For example:

- the exemption provided at Section 35(1)(12)(iii) of the Act which is required in order to permit the exercise of conversion rights attached to convertible securities;
- the exemption provided at Section 35(1)(17) of the Act which allows a holder to tender securities to a take-over bid; or
- the exemption provided at Section 35(1)(19) of the Act which permits a company to issue stock options to its employees.

However, the best example of how the breadth of the trading registration requirement requires a comprehensive series of exemptions in order to carve back its application, is the exemption provided at Section 35(1)(10) of the Act. This exemption allows a person or company to sell a security through a registered dealer acting as agent without the seller having to be registered in its own right. Absent such exemption, any investor selling a portfolio security would have to be registered to effect such a transaction even when selling through a registered dealer.

It is interesting to compare the operation of the requirement to be registered to trade in securities against the requirement to be registered in order to act as an adviser in securities. Unlike the broad definitions ascribed to "trade" and "security", an "adviser" is defined in the Act as being "a person or company engaging in, or holding himself, herself or itself out as engaging in, the business of advising others as to the investing in or buying or selling of securities". The restriction of the requirement to be registered as an adviser to persons actually engaged in or holding themselves out as being engaged in the business of advising in securities (the "targeted approach"), as opposed to requiring the registration of anyone who provides securities advice in any context (the "blanket approach"), provides for a more focused application than the trading registration requirement where the blanket approach has been employed. The benefit of the targeted approach is that it does not result in persons being subject to the adviser registration requirement in situations which were not intended to be caught by such requirement. As a result, there is no need to prescribe a comprehensive list of exemptions to the adviser registration requirement, and indeed, there are a very small number of exemptions from such requirement in the Act and its related instruments.

We are of the view that there is substantial merit to applying a targeted approach to the dealer registration requirement and limiting the application of such requirement to persons or companies who engage in, or hold themselves out as engaging in, the business of trading in securities, and we are of the view that incorporating such an approach would improve the efficiency of the capital markets without diminishing the investor protections provided by the Act. Indeed, such approach has already been adopted in Ontario in connection with the universal registration requirements prescribed by Part XI of the Regulation ("Universal Registration") which generally requires the registration of all "market intermediaries". Market intermediaries are defined as being persons or companies engaging in, or holding themselves out as engaging in, the business of trading securities in Ontario.

Adopting the targeted approach to the dealer registration requirement would allow for the deletion of many of the statutory exemptions from such requirement which are sprinkled through out the Act and its related instruments and would materially reduce the number of applications to

the Ontario Securities Commission (the "Commission") for exemptive relief from the application of such requirement.

Should the Dealer Registration Requirement extend to Persons Advising with respect to Securities?

It is acknowledged that at present, there is an advisory component to the services provided by registered dealers (other than discount dealers). However, registered dealers do not have to separately register as advisers where the provision of advice is "solely incidental to their principal business or occupation" (Section 34(c) of the Act). The exemption provided by Section 34(c) is generally thought to be available where the registered dealer is compensated through trading commissions and is not compensated separately for providing advice.

However, given the emergence of discount dealers in the Canadian capital markets (being dealers who offer execution services but who do not provide advice, and accordingly, charge smaller trading commissions then those charged by full service dealers), it is difficult to make the case that full service dealers are not, in some respects, being paid for the advice that they provide through the ability to charge non-discounted trading commissions. Further, in a market where the principal distinction between discount dealers and full service dealers is that full service dealers provide advice and are subject to the trade suitability obligations of the Act, it is also difficult to argue that the provision of such advice is "solely incidental" to their principal business.

In recognizing that there is an advisory component to the services provided by full service dealers, which is an important part of their business and for which they are being compensated, one might also conclude that the safe harbour from the advisory registration requirement provided by Section 34(c) of the Act may not be available on such facts. If the Committee concluded that Section 34(c) of the Act was not available to full service dealers who provide advice as a component of the services which they provide, the Committee should then consider how the dealer registration requirement could be reconciled with the adviser registration requirement. Two options would appear to be available:

(i) Require full service dealers to also register as advisers. This proposal would be very disruptive to the markets and is, in our view, unnecessary.

(ii) Provide an exemption from the adviser registration requirement beyond what is presently provided by Section 34(c) for full service dealers who provide advice as a component of the services which they provide, and who are subject to the trade suitability obligations of the Act. In our view, while this approach is preferable, it will require a thoughtful examination of the ambit or form of advice which could be given by a full service dealer on a registration exempt basis.

The Committee may wish to give this issue special attention given the announcement of certain US full service dealers to move away from a per transaction commission structure in favour of a fee structure based on the performance of a client's portfolio, notwithstanding that the account is

not managed on a discretionary basis. It is interesting to note that such change in fee structure is generally felt to be an attempt by the full service dealers to reverse the migration of market share from full service dealers to discount dealers, and appears to be a recognition that the distinguishing feature between full service dealers and discount dealers is the advisory component of services offered by full service dealers.

Should the Definition of "Adviser" be Amended?

We encourage the Committee to review the definition of "adviser" to ensure that it includes individuals who provide securities advice over the internet. There are numerous websites on the internet operated by persons who provide advice and recommendations with respect to securities. Arguably, webmasters who operate websites on a for profit basis would fit within the present definition of "adviser"[1]. However, as many individuals who operate such websites do not charge or receive any form of compensation in connection therewith, it is arguable that such persons are not caught by the current definition of "adviser" as they are not engaged in the business of advising in securities. Perhaps the definition of "adviser" could include persons or companies who publish or broadcast securities advice, regardless of the media of transmission, in circumstances where it is reasonable to conclude that the persons receiving such advice will rely upon it, notwithstanding that the recipient does not pay the provider for the advice.

We also recommend that the Committee consider whether the Act presently addresses the situation where persons intentionally disseminate information or recommend securities with a view to increasing or decreasing the market price of such security. There has been considerable publicity of late regarding the manipulation of "chat rooms" and internet "bulletin boards" by persons who seek to influence the price of a security by participating in "chat room" discussions or by posting information on bulletin boards. While the dissemination of material non-public information by insiders or tipees would be subject to the insider trading prohibitions of the Act, very often, false or misleading information is circulated by persons who are not in a special relationship with an issuer. Such persons are arguably not engaged in the business of advising in securities and would therefore not meet the current definition of "adviser". Again, amending the definition of adviser to include a reliance based test would capture this situation. Alternatively, it might be more practical to make such practice an offence in its own right under the Act.

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[1] It is arguable that operation of a website which charged a fee to persons who were allowed access could fall within the exemption from the adviser registration requirement provided by Section 34(d). Section 34(d) provides an exemption from such requirement to:

a publisher of or any writer for any newspaper, news magazine or business or financial publication of general and regular paid circulation distributed only to subscribers thereto for value or to purchasers thereof, who gives advice as an adviser only through such publication and has no interest either directly or indirectly in any of the securities upon which the advice is given and receives no commission or other consideration for giving the advice, where the performance of the service as an adviser is solely incidental to their principal business,

However as Section 34(d) predates the use of the internet as a medium for the delivery of advisory services, it is questionable whether all of the pre-conditions that would allow a person to take advantage of such exemption are met in such circumstances.

Another issue presented by the increased use of the internet by dealers and advisers to deliver services to clients, is the application of the registration requirements of the Act to entities who are not physically present in the Province and whose only nexus to Ontario is through the internet. For example, it has been widely reported that a number of unregistered US based online brokers have been opening accounts for and dealing with Ontario residents. Where such dealers actively solicit potential customers in Ontario, it is clear that they are subject to the registration requirements of Ontario legislation as they have engaged in acts in furtherance of a trade in Ontario. However, in the situation where the unregistered dealer does not solicit Ontario persons or otherwise conduct business in the Province but merely maintains a website that can be accessed by persons resident in the Province, and such persons access the website and place orders which are filled by the dealer outside of Ontario, it is not clear that a sufficient connection with Ontario has been established such that the requirements of the Act are triggered.

Case law on the jurisdictional application of provincial securities laws has held that there must be some activities by a person within a province before such person will be considered to be trading in the province. However, the relevant case law largely predates the widespread use of internet and does not provide sufficient guidance on this point.

Instead, the Committee may wish to consider whether an "end-user" approach should be used in connection with the registration requirements of the Act such that if end users of a service are resident in Ontario, the providers of such service are subject to the provisions of the Act. In this regard, it is interesting to note that an end user approach has been employed in OSC Policy 4.8 – Non Resident Advisers which states that:

> The Commission considers a person or a company to be acting as an adviser in Ontario if it, directly or indirectly or through a third party, acts as an adviser for a person or a company in Ontario, notwithstanding that (i) the advice may be given from a place outside of Ontario or (ii) the advice may be unsolicited.

12. Impact of Technology on Access to Markets

For the reasons set forth below, we do not believe that a disintermediated market has developed in Canada (other than through unlawful conduct) which permits investors to participate directly in organized securities markets without the interposition of a regulated intermediary. Further, given the manner in which the Canadian securities regulatory authorities propose to regulate new and emerging securities markets, we do not believe that a disintermediated market is likely to develop in the near future. However, even if a disintermediated market were to develop, we are of the view that there would be a significant role for regulated intermediaries in such an environment.

The Role of Regulated Intermediaries in a Disintermediated Market

The ability of investors to communicate directly with a securities market for the purposes of placing orders is only one of many functions which must be undertaken in connection with most securities transactions. Accordingly, in a disintermediated market, there would be numerous

functions which retail investors would not be able to undertake which would likely have to be discharged by regulated intermediaries. For example:

- Clearance and Settlement – Regulated intermediaries would continue to play a significant role in connection with the clearance and settlement of trades in a disintermediated market. Presently, dealers are responsible for the trades they execute on behalf of their clients and are required to make "good delivery" even if their client's fail to do so. In connection with this obligation, the solvency of dealers is closely monitored by requiring dealers to submit regular financial reports to their principal regulator. As such, the "credit ring" involved in the clearance and settlement of trades in securities is fundamentally sound and there is considerable confidence in it. It is difficult to envision a system in which individual investors were responsible for ensuring the clearance and settlement of their own trades that would be as efficient as the present system or which would have the full confidence of the capital markets.

- Custody, Valuation and Reporting – Another function which would have to be discharged in a disintermediated market is the custodial function. The storage, valuation and reporting function presently played by regulated intermediaries is an important element of secondary market trading and is one that requires specialized expertise (for example, monitoring the holdings of registered accounts to ensure that they hold only permissible investments and dealing with restricted or legended stock). Regulated intermediaries also generate confirmations of transactions, monthly reports showing the value and composition of an investor's portfolio and year-end reports which are necessary for tax reporting purposes. It is unlikely that retail investors could discharge these functions themselves without considerable expense and effort.

- Research and Analysis – The research and analysis function historically played by certain regulated intermediaries in providing independent information and opinions regarding issuers to the market would arguably become more important in a disintermediated market. At present many retail investors rely on the regulated intermediaries with whom they deal (other than in the case of discount dealers) to review the available research with a view to recommending securities and providing information about issuers in which clients have expressed an interest. In a disintermediated market, investors themselves would have to seek out such information; however in such an environment, investors might choose to contract for this service on an unbundled basis.

We also note that absent the intermediation of registered dealers, it is unlikely that retail investors would be able to trade on margin as the financial institutions which provide credit to the retail market would not have the specialized securities knowledge which would allow them to properly assess their risk, nor the ability to easily monitor and close out margined positions. Lastly, certain complex products, such as, futures, options and other forms of derivatives require the expertise of regulated intermediaries in order to be properly employed for hedging purposes or to be fully understood from a risk perspective in connection with speculative transactions.

Permissible Disintermediated Transactions

If there is any ambit to permit transactions in the retail markets which can be undertaken by market participants without the interposition of a regulated intermediary, it would be the communication of orders to organized securities markets. The downside of allowing retail investors to discharge this function directly is that choices made by such investors would not be vetted by a dealer with better access to market information than the investor. However, in granting discount dealers an exemption from the trade suitability requirements of the Act (discussed in greater detail below), the Canadian securities regulators have agreed that informed investors should be able to contract for execution services only and forego the function played by full service dealers in recommending securities and reviewing client choices.

However, allowing retail investors to place orders directly would require that retail investors have the ability to see the bid and the ask on a particular market in real time and be able to transmit orders to that market's electronic book. Achieving such transparency and access would require a common technological platform which may be difficult to achieve. Further, in such a scenario, a regulated intermediary would likely still be required in order to effect the clearance and settlement of any such trade.

Proposed Regulation of Alternative Trading Systems

As set forth above, we do not think that a disintermediated market will develop in Canada in the near future. While the advent of internet enabled electronic trading systems[2] has created disintermediated markets in many jurisdictions, such trading systems (generally referred to in Canada as alternative trading systems, or ATS's) have not penetrated the Canadian market to any significant degree[3]. To date, the Canadian securities regulatory authorities have required that ATSs register in Canada as dealers and execute or report transactions in listed securities on or to recognized Canadian exchanges. However, the Canadian Securities Administrators (the "CSA") last year released for comment a draft National Instrument (the "National Instrument") regarding the regulation of ATSs in Canada which recommended for the first time that ATSs be allowed to compete against the traditional Canadian securities exchanges. Under the draft National Instrument, ATSs have three regulatory options:

- An ATS can choose to be recognized as an exchange rather than as an ATS, and be regulated as such;

[2] It is important to distinguish between technologies which facilitate improved communication between a customer and a dealer (i.e. email, internet enabled cellular phones and pagers, etc.) and those systems which actually operate as a market matching buyers and sellers. It is only the latter which would be considered an ATS.

[3] It is acknowledge that access to the internet cannot easily be restricted on a country by country basis and that investors in Canada, can, through the internet, access disintermediated trading systems which are operated from other jurisdictions. However such systems are not registered to operate in Canada and their extension to Canadian investors is unlawful.

- An ATS may register as a broker-dealer and become a member of a stock exchange and thereby be exempt from the requirements of the National Instrument applicable to ATSs; or

- An ATS may register as a dealer, become a member of a non-exchange SRO and be subject to the requirements of the National Instrument applicable to ATSs.

In the event that the National Instrument became effective, ATSs operating in Canada would become regulated intermediaries regardless of the regulatory option chosen by them. Accordingly, even if ATSs were to permit direct access to retail investors, a proposition which is far from clear, the situation would not be materially different from that which exists at present, as ATSs, as recognized exchanges, registered dealers and IDA or exchange members, would be subject to the comprehensive rules governing the manner in which registrants and SRO members deal with their own clients. Accordingly, we do not think that the emergence of ATSs in the Canadian markets require changes to the existing securities legislation beyond what is contemplated in the draft National Instrument.

Registrant Obligations

In light of the fact that a disintermediated market has not developed in Canada and that electronic trading will likely be provided by ATSs who are themselves regulated intermediaries (please see the discussion above titled – "Proposed Regulation of Alternative Trading Systems"), we think the issue would be better framed as whether all registered dealers should be subject to the trade suitability and know-your-client ("KYC") obligations imposed by the Act on registered dealers in an environment where traditional brokerage services are being "unbundled".

Canadian discount dealers (dealers who provide trade execution services for their clients but who do not provide advice, and accordingly, charge a discounted per transaction commission) have been lobbying the Canadian securities authorities for relief from the trade suitability obligations of the Act, and on April 10, 2000, the CSA announced that such relief would be available upon application provided certain preconditions are met.

We agree with the CSA's positions that investors who wish only execution services should have the ability, through the use of a discount dealer, to purchase such services separately. As the discount dealer is being compensated only for providing execution services, and is precluded from providing advice, it is appropriate that it not be subject to the trade suitability obligations of the Act.

However, where a dealer, recommends securities or provides advice, such registrant should still be subject to the trade suitably obligations. In addition, dealers who manage client assets on a discretionary basis should, in all cases, be subject to such obligations.

In light of the CSA's position set forth above, it would also be appropriate to exempt ATSs from the trade suitability obligation where it was clear that the only services that the ATS was providing directly to investors was the provision of real time market data and access to an organized securities market.

Universal Registration

As the Commission has stated in the past, the purpose of the registration requirements of the Act, in general terms, is to provide some assurances to investors as to the reliability and the quality of the services of the securities market actors with whom they are dealing. Those who argue against the merits of Universal Registration do so on the basis that such assurances are unnecessary with respect to trades in certain securities or with certain counterparties who are sufficiently sophisticated and are able to withstand the full loss of their investment. It is argued, therefore, that registration as a dealer should not be required in order to engage in such trades. Prior to the introduction of Universal Registration, it was possible for market participants to trade securities in Ontario pursuant to exemptions from the registration requirements of the Act with the result that such participants were effectively permitted to engage in the business of trading securities without being subject to regulatory oversight.

In our view, the concerns raised by dealers carrying on trading activities on an unregistered basis which led to the introduction of Universal Registration continue to be applicable in today's capital markets. In fact, given the increase in the number of investors and other market participants which have entered the markets since 1987, the reasons for maintaining Universal Registration may be more compelling today. Of these reasons, we are of the view that two are especially significant:

- First, the solvency of a dealer is a matter which affects both retail and sophisticated investors, irrespective of the nature of the security they purchase. While it is reasonable to assume that a sophisticated investor does not require the protection afforded by the prospectus requirements of the Act in certain circumstances, we do not agree that such an investor does not require protection from the financial failure of the securities firms with which it deals. While detractors of Universal Registration may argue that sophisticated investors, by virtue of their financial status and clout, are in a position to require that the securities firms with which they deal maintain adequate capital and insurance and have other control procedures in place, we are of the view that it would be inappropriate for these matters to be left to investors to monitor. Furthermore, the failures during the past few years of other financial institutions, both regulated and unregulated, suggest that the insolvency or other failure of a sizeable unregulated institution could have significant adverse consequences on market participants and the capital markets as a whole.

- Second, unregistered dealers which are not subject to regulatory oversight but which are permitted to carry on trading activities pursuant to exemptions from the Act would have a significant competitive advantage over registered dealers who also engage in exempt-market activities and we do not believe that permitting such a competitive advantage is justifiable.

While we are of the view that the public interest concerns with respect to the carrying on of securities trading activities on an unregistered basis continue to apply today, we acknowledge that Universal Registration is not without its own problems. For instance, the creation of the

limited market dealer category of registration has offered investors little protection of any kind, since limited market dealers are not subject to the full registration requirements of the Act, such as those requirements relating to capital and insurance. The benefits of allowing the Commission to maintain minimal regulatory oversight over dealers in this category of registration do not, in our view, outweigh the burdens of registration. For this reason, we support the abolition of the limited market dealer category of registration.

As well, from a drafting perspective, the registration provisions of the Act are cumbersome as a result of the manner in which the Universal Registration provisions of the Act were "overlaid" on the pre-Universal Registration regime of dealer registration exemptions.

In light of the foregoing, we believe that the policy objectives underlying Universal Registration could be achieved by following the more targeted approach to dealer registration which is discussed in our response to Question 11, while at the same time eliminating the majority of the exemptions from such requirement. In other words, a firm should be required to be registered as a dealer under the Act if it is engaged in, or is holding itself out as being engaged in, the business of buying or selling securities, on the basis that firms which are so engaged should meet minimum standards of reliability. With such a change in the dealer registration requirement, the Universal Registration provisions of Part XI of the Regulation would become unnecessary.

There are presently ten categories of dealer registration under the Act[4]. We are of the view that the number of categories of dealer registration under the Act could be narrowed considerably.

Generally, we are of the view that what is required is a registration category for dealers that provide the full range of brokerage services (full service dealers) and a category for dealers that provide only execution services (discount dealers). The present registration categories of "broker" and "investment dealer" could be combined into a single category of registration for full service dealers which are members of a recognized stock exchange or another recognized SRO. Discount dealers could be defined as dealers who provide execution services but who do not provide advice, and who do not trade client accounts on a discretionary basis. The category of discount dealer would be of assistance in terms of identifying those dealers which are not subject to the trade suitability obligations of the Act which are discussed above.

Whether or not discount dealers would have to be a member of a recognized exchange or SRO in order to become registered turns on whether the Committee is of the view that the Commission should devote resources to monitoring the conduct of registrants on a day to day basis. We think that recognized exchanges like the TSE and recognized SRO's like the IDA, are better suited to discharge this function, and if this view were adopted, the category of "securities dealer" (being dealers that are registered under the Act but that are not a member of a recognized exchange or SRO) could also be deleted.

Further, in the event that Universal Registration were to be repealed, the categories of "financial intermediary dealer", "foreign dealer", "international dealer", "limited market dealer" and

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[4] Broker, financial intermediary dealer, foreign dealer, international dealer, investment dealer, limited market dealer, mutual fund dealer, scholarship plan dealer, securities dealer and securities issuer.

"securities issuers" could be abolished. In such event, it might make sense to add a further category of dealer registration for non-resident dealers who are registered under the securities laws of another jurisdiction recognized by the Commission (such as the United States or the United Kingdom) who wish to register in Ontario in order to deal with a limited group of customers beyond those with which it could deal with in reliance on the existing registration exemptions.

ENFORCEMENT

30. Insider Trading

The Committee has asked whether the current detection and disclosure provisions with respect to insider trading are sufficient. The Committee specifically requests comment on whether the use of structured products by insiders to trade synthetically in the securities of the companies for whom they act should be regulated.

In our view, the insider trading provisions of the Act and the rules and regulations are in need of review and, at least in some respects, revision. In particular, there have been significant shortcomings with the requirements for disclosure of insiders' trading activities. In responding to the concerns in this area, the CSA have recently initiated two changes that will significantly improve disclosure of insider trading activity in Canada. First, in the larger jurisdictions that had not previously done so, such as Ontario, the CSA have amended or resolved to amend the provincial securities legislation to require insiders to report their trades within 10 days. Second, and perhaps more importantly, the CSA is proposing to require electronic filing and dissemination of insider reports by the end of the calendar year.

While these developments, assuming they are properly implemented and enforced, will represent significant improvements from a detection and disclosure perspective, there are other reasons to look at updating the insider reporting provisions of the Act. In particular, as the Committee has indicated, structured financial products have been developed in recent years which enable insiders to trade in securities of their companies synthetically without triggering a trade reporting requirement under the existing provisions of the Act. In most cases, these synthetic trading activities require the seller of the structured product to hedge its financial position by actually trading the issuer's securities in the market. In the circumstances, there is every reason to require disclosure of the insider's activities and to prohibit the insider from engaging in these activities when the insider has material undisclosed information.

In the U.S., the SEC has used its rulemaking powers to extend insider reporting requirements to require disclosure of synthetic trading activities by insiders. Several years ago, the British Columbia Securities Commission issued a notice indicating that the purchase and sale of third party options by insiders, including private over-the-counter options, must be reported. However, in Ontario, the Commission struggled in the *Albino* case with the question whether cash-settled or "phantom" stock options are securities that should be reported. In our view, the existing provisions of the Ontario Act do not require insiders to report transactions in structured products with third parties in all circumstances where such reporting should be required. For example, the purchase and sale of non-transferrable cash-settled derivative instruments such as

options or forwards do not appear to be reportable under the Act. In particular, the provision indicating that the purchase or sale of a put or call is deemed to be a change in beneficial ownership of the underlying securities is limited in its scope and should be replaced with a more expansive provision.

We are not in any way advocating that there be restrictions on the use of structured products by insiders in appropriate circumstances. These products can and do serve useful purposes for holders of large stock positions. What is needed, however, are clear rules concerning the application of insider trading restrictions and reporting requirements in the context of hedging transactions and synthetic trading activities.

Consideration should also be given to the application of other provisions of the Act to these activities hedging transactions and synthetic trading activities.

IMPACT OF REGULATORY HARMONIZATION AND GLOBALIZATION TRENDS

32. Regulatory Harmonization

The mutual reliance review system ("MRRS") has procedurally simplified the prospectus review process and the process of applying for discretionary relief, and is to be applauded as a significant step forward in achieving inter-provincial cooperation. However, the system does not purport to be, nor can it be, anything more than a procedural simplification. National issuers are still required to consider, and comply with, the separate securities laws of thirteen jurisdictions across Canada, including rules, regulations, policies, notices and, in some cases, unpublished positions of staff. In the case of exemptive relief applications, it is often the case that the nature of the relief sought in one province may be substantively different than the relief sought in another, leading to the necessity of identifying the differences among these laws in order to ensure that the Decision Document that is issued will ultimately be technically sufficient. Each jurisdiction retains the right (and obligation) to apply its own laws to whatever issues come before it, and to "opt out" of MRRS in circumstances where it disagrees with the decision reached by the principal regulator.

We suggest that the next most pressing need for harmonization lies in the area of underwriter, broker-dealer and adviser registration requirements. Currently, except to the extent permitted by available exemptions, it is necessary for a firm wishing to act in these capacities to become registered in each province and territory, and to comply with the requirements of each jurisdiction in which they are registered on an ongoing basis. In some cases it is not possible to obtain registration in a particular jurisdiction without establishing a place of business there. Although in many jurisdictions it is possible to rely upon exemptions from the registered dealer requirements when dealing with certain institutional clients or when trading in large blocks of securities, the availability of these exemptions varies significantly from province to province. The universal registration regime in the Province of Ontario effectively requires foreign dealers to register as International Dealers in order to be able to deal in securities in the Province of Ontario, creating yet another system of rules. The effect of the universal registration regime in the Province of Newfoundland has been to preclude foreign dealers from engaging in any private

placement transactions in that province, as the limited number of prospective institutional purchasers there generally does not justify the cost of registration.

We submit that it would be in the best interests of the Canadian capital markets if the registration procedures and rules regarding exemptions from the registration requirements were harmonized. A foreign dealer should be able to effect a single registration that would permit it to engage in transactions in any security, with institutional and other sophisticated purchasers meeting a single set of prescribed criteria, in any province or territory of Canada. Likewise, a domestic Canadian dealer should be able to effect a single registration that would permit it to deal with any prospective Canadian purchaser of securities, without regard to the purchaser's province or territory of residence.

We believe that, as long as securities laws remain a matter of provincial jurisdiction, true harmonization can only be achieved in one of two ways. The first would be to harmonize the laws themselves through the adoption of a uniform statute in each jurisdiction (along the lines of the Uniform Commercial Code adopted by many jurisdictions in the United States). The second would be to introduce a concept of true mutual reliance, where each jurisdiction would be required to abide by the substantive decisions reached by the principal regulator, without any power, or obligation, to conduct an independent review. The express power of each Canadian securities regulatory authority to delegate certain functions to other securities regulators in Canada would be necessary to achieve this objective.

We draw to the Committee's attention the fact that, since 1991, each province of Canada has effectively delegated certain of its prospectus review powers to the U.S. Securities and Exchange Commission in the case of offerings by U.S. issuers eligible to use the Canada-U.S. Multijurisdictional Disclosure System ("MJDS"). Although this system has been virtually unused for "northbound" offerings, it does serve as an example of a true substantive mutual reliance system, rather than the more procedurally-based current MRRS system.

33. Globalization Trends

On a substantive level, we submit that Ontario securities laws should adopt a concept similar to the "qualified institutional buyer" concept adopted in the United States, with similar eligibility requirements. Sophisticated institutions should not need the benefit of the protections afforded by the prospectus and registered dealer requirements of the Ontario Securities Act, and should have access to the same investment opportunities as their U.S. counterparts if they are to become globally competitive. The existing patchwork of prospectus and registered dealer exemptions, and the overlaying requirements of the universal registration regime, make it unnecessarily difficult, if not impossible, for the international securities markets to embrace prospective Canadian institutional investors, to the prejudice of the Canadian institutions.

On a more theoretic level, we submit that the key to avoid compromising Ontario's global competitiveness is to acknowledge clearly that the securities laws of the Province of Ontario are a form of consumer protection legislation intended for the benefit of residents of Ontario. The Province should refrain from attempting to extend the reach of its jurisdiction in the way that the Provinces of Alberta and British Columbia appear to have done. As a matter of principle, a

purchaser of securities should look only to the rules of his or her jurisdiction of residence for protection from the potential abuses that securities legislation is intended to address.

There is a rather pressing need for the securities legislation in Ontario to recognize expressly the existence of the securities laws of the other provinces and territories of Canada, and those of the U.S. and other countries, and to provide guidance on the principles to be applied in addressing the interaction of those laws with the laws of Ontario. The Interpretation Note replacing OSC Policy 1.5 (the "Interpretation Note") is no longer adequate to provide guidance in determining the circumstances in which Ontario securities laws are applicable to a transaction, and it does not address many of the more complicated issues raised by the interaction of various laws.

By way of example, consider the case of an issuer resident in Ontario that completes a private placement of securities to a purchaser resident in the United States pursuant to an available U.S. private placement exemption. The Interpretation Note suggests that Ontario law would not apply to this private placement provided that there are no other connecting factors to Ontario and that the securities "come to rest" outside of Ontario. There is a fairly widespread view among members of the Ontario securities bar that this requirement can be satisfied by having the purchaser covenant not to resell the securities into Ontario for a period of 90 days. If the U.S. holder resells to an Ontario resident after that 90 day period (which it generally would be permitted to do under U.S. law in reliance on Regulation S), what resale restrictions apply to the new Ontario holder? At present, section 72(4) would not deem the resale to be a distribution, because the securities were not "previously acquired" pursuant to one of the specified Ontario exemptions in that section (but rather in circumstances where Ontario law did not apply).

Consider further the situation if the issuer were resident in Alberta, rather than Ontario (and is also a "seasoned issuer" entitled to the benefit of the abbreviated four-month hold period available in Alberta). We understand that, in contrast to the policy expressed in the Interpretation Note, the Alberta Securities Commission would view Alberta law as applicable to the initial private placement because the issuer is resident there, notwithstanding that the purchaser is resident in the United States and there are no other connecting factors to Alberta. In this case, the issuer complies with the applicable Alberta private placement rules as well as the applicable U.S. rules. The U.S. holder then immediately resells the securities to an Ontario purchaser. Under Ontario law it would appear that this trade is not a distribution as it is not a trade by the issuer or a control block holder, and it is not deemed to be a trade by section 72(4), as the securities were previously acquired pursuant to an exemption from *Alberta* law, not Ontario law. Should these securities now be freely tradeable in Ontario? From a policy perspective, should they be subject to the four month hold period applicable under Alberta law, the six, twelve or eighteen-month hold period that would have applied under Ontario law, or the two year hold period that applies under U.S. law?

If the closed system is to be preserved in its existing form, there might be some merit to the introduction of the concept of a "privately placed security", being one that was previously issued or traded pursuant to a prospectus or registration exemption under the applicable laws of the jurisdiction of the initial purchaser's residence. It would be most logically consistent with the premise of the current closed system to provide that a further trade in any "privately placed

security" will be deemed to be a distribution until the date that such security would have become freely tradeable under Ontario securities law, if the initial exempt trade had occurred in Ontario.

IMPACT OF TECHNOLOGY

34. Electronic Media

It is clear that the Act was drafted in the context of a paper-based environment. In some cases this has created difficulties as the use of electronic media has evolved and securities disclosure documents have been mandated for filing in electronic format. In our view, the Committee should consider amending the Act where existing provisions create a paper bias which adversely affects the use of electronic media and electronic delivery systems.

One example of a key set of provisions in the Act that bears a paper bias is the set of civil liability provisions for misrepresentations contained in a prospectus or take-over bid circular. In certain cases, liability is based on the responsible individual having "signed" the prospectus or other document. This is to be contrasted with securities legislation in Quebec and in the United States where civil liability is imposed on certain responsible individuals based on their capacity as a director, senior officer, promoter or other responsible position. As such, there is no requirement for signatures and no need to prove that, in an electronic filing environment, the responsible individual has "signed" the prospectus or other document. Under Ontario's existing electronic filing requirements, additional paper procedures are required to ensure that the statutory rights of investors are not undermined by the signature requirements in the Act. While this provides some evidentiary support for investors seeking to exercise their statutory rights, there remains some uncertainty as to whether electronic versions of disclosure documents have actually been "signed" within the meaning of the Act. In our view, this uncertainty should be addressed by amendment to the Act, in which case the additional paper procedures could be eliminated.

Rights of Withdrawal

Another part of the Act where the evolution from paper to electronic media has an impact is in the context of rights of withdrawal. In the last 15 years, we have seen paper security certificates all but disappear as electronic book-entry based systems have evolved. This has facilitated acceleration of the settlement process from T+5 to T+3 with the prospect of overnight settlement looming in the future. With these accelerated settlement timeframes, it has become virtually impossible for underwriters to issue trade confirmations and deliver final prospectuses sufficiently in advance of closing a public offering of securities to ensure that rights of withdrawal have expired. As a result, the underwriters are now forced to take full liability should investors decide to exercise their rights of withdrawal and walk away from the transaction. Under the Act as currently drafted, it is not clear whether underwriters could, in turn, exercise these rights of withdrawal against the issuer. In any event, the exercise of rights of withdrawal by underwriters against the issuer after a transaction is closed would adversely impact other investors who have not exercised rights of withdrawal on a timely basis. This raises the prospect of having to unwind a public financing transaction after closing because significant

numbers of investors are able to exercise rights of withdrawal. In our view, this raises significant public interest concerns that should be addressed by the Committee in its review of the Act.

These rights of withdrawal were introduced many years ago as a consumer protection concept and may no longer be appropriate remedies in the context of today's securities markets. As far as we are aware, they have rarely if ever been used by investors and, as such, are arguably unnecessary. As well, there does not seem to be precedent for these withdrawal rights in the U.S. or other securities legislation. In today's securities markets, where significant trading occurs on a "when issued" basis immediately following the pricing of an offering and where investors are looking to take delivery of underwritten securities as quickly as possible following pricing, we are concerned that the uncertainty introduced by the possible exercise of rights of withdrawal, however theoretical, no longer serves the public interest.

35. Shareholder Communications

The Committee has specifically requested comment as to whether new regulation is required to address the use of the Internet as a means for issuers to communicate with their shareholders. In our view, consideration should be given to the need to amend the Act to ensure that electronic communications and electronic delivery systems are permitted under appropriate circumstances. In most cases, the Commission has been able to make rules to address technological developments in the communications and document delivery context. In certain cases, the legislation has been an impediment to rulemaking that would embrace new technological developments. For example, a requirement for a written proxy would appear to be an impediment to introducing on-line voting for securityholders. In our view, the Act and other related legislation should be amended to broadly facilitate technological development. The detailed requirements concerning acceptable electronic communications and delivery systems should be left to Commission rulemaking. In a similar vein, it would be inappropriate to refer to the Internet in the Act or related legislation since there are alternative communication and delivery networks which currently exist or may be developed in future.

36. Direct Dealing in Securities

As the use of electronic means in the securities industry has increased in recent years, there has been a significant trend to eliminate brokers, dealers, underwriters and other intermediaries in certain types of securities transactions. The Committee refers to the increasing popularity of direct purchase plans offered by public companies as one example. Direct access trading systems where investors are able to interact directly with a stock exchange or other form of organized securities market is another example. In our view, the Act should be updated to remove impediments to these developments rather than rely on Commission rulemaking and/or applications for exemptive relief to facilitate these industry trends.

37. Document Delivery Requirements

The Commission has asked whether the requirement in the Act that a reporting issuer "deliver" corporate information to securityholders is still an appropriate communication model in light of

technology-related developments. In our view, reporting issuers should have the obligation to provide disclosure documents or information to their securityholders using an appropriate delivery system, electronic or otherwise. However, consideration should be given to amending the Act to ensure that the Commission is in a position to sanction alternative information communication requirements. For example, the Act should not impose a paper delivery obligation on reporting issuers in respect of any particular communication or disclosure document. Rather, the Commission should be given the authority to make rules prescribing the types of delivery systems that will be acceptable in the public interest. The Commission may conclude that paper delivery should be mandated for securityholders who expressly request this form of delivery, at least for the foreseeable future. Absent a specific request, the Commission could sanction electronic delivery simply by e-mail communication informing a securityholder of the availability of the disclosure documents on the SEDAR website. Ultimately, the provisions of the Act should not constrain the evolution of acceptable delivery systems.

MANDATE AND RULE OF THE COMMISSION

39. Rule-Making Authority

In our view, the implementation of the rule-making power has been largely successful. In spite of this, there have been occasional instances in which Staff has, in our opinion, failed to observe appropriate procedures in implementing the Commission's rule-making authority. These instances are cause for concern: their proliferation would subvert the very principles that informed the creation of a rule-making power for the Commission in the first place. A brief review of the 1994 Daniels Task Force Report (the "Task Force Report") should prove helpful in recalling those principles. Against this backdrop, it will then be easier to see how Staff's current practice has on occasion violated their spirit.

The Rule of Law: Openness, Public Participation and Certainty in Regulation

From the outset, the mandate of the Task Force in issuing its report was structured by the need to respond effectively to the administrative law issues raised by *Ainsley Financial Corporation et al.* v. *OSC et al.*[5] and *Re Pezim and Superintendent of Brokers et al. and two other appeals*[6]. In both of these cases, the use of policy statements by provincial securities regulators to promulgate mandatory requirements of the securities regime was declared to be invalid by the courts.[7] The Task Force noted that the administrative law issues raised by these decisions were not confined

[5] (1993), 14 O.R. (3d) 280 (General Division) [hereinafter *Ainsley*].

[6] (1992), 96 D.L.R. (4th) 137 (B.C.C.A.) [hereinafter *Pezim*].

[7] It is important to note that although the decision in *Pezim* was overturned by the Supreme Court on appeal, it was reversed on other grounds. Indeed, the Task Force Report pointed out that in rendering his judgement Mr. Justice Iacobucci stated that "…policies cannot be elevated to the status of law; they are not to be treated as legal pronouncements absent legal authority mandating such treatment." The *Task Force Report* at 1, citing *Pezim* [1994] S.C.J. No. 58 at para. 75.

to policy statements alone: "concerns respecting the legal status of policy statements [also] applied to some degree to other regulatory instruments used by the OSC".[8]

In setting out specific recommendations aimed partially at dealing with these administrative law issues, the Task Force made explicit the foundational principles upon which its recommendations were predicated. Among these was "[t]he need to promote openness, public participation and certainty in regulation."[9] The Task Force remarked upon the close connection of the values of openness, public participation and certainty in regulation with the Rule of Law and expressed the view that an "important characteristic of a legitimate regulatory system is its congruence with the Rule of Law."[10] Citing a submission to the Task Force by Professor Jeffrey Macintosh, the Task Force further noted that "the Rule of Law amounts at bottom to a statement about how law in a representative democracy differs from the arbitrary law of potentates. In a representative democracy, law derives legitimacy…only insofar as those who exercise authority are acting within the sphere of authority properly delegated to them by the legislature."[11]

In order to bring the Commission's regulatory practices into harmony with the Rule of Law and the associated values of openness, public participation and certainty in regulation, the Task Force Report recommended the adoption of a rule-making power for the Commission. While it was generally recognised that such a power would greatly expand the Commission's sphere of authority, the Task Force did not intend the rule-making power to be limitless. Indeed, the Task Force Report expressed "strong agreement" with the view that it would not be a "positive development if the policy-making function of the Commission was… replaced by a rule-making function where all of the pronouncements of the Commission ha[d] the same legal status as statutes and regulations."[12] In a similar vein, the Task Force Report stated that "[t]he magnitude of the rule-making power recommended for the Commission requires considerable attention to the checks and balances that will accompany its exercise. We regard an effective notice and comment procedure as the central mechanism for ensuring the accountability and transparency of Commission rule-making."[13]

This appeal to principles of accountability and transparency was echoed throughout the Task Force Report.[14] In addition to undergirding the Task Force's recommendation of a notice and

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[8] The *Task Force Report* at 2.

[9] The *Task Force Report* at 10 (emphasis added).

[10] *Ibid* (emphasis added).

[11] *Ibid.*

[12] *Ibid.* at 27, citing the submission to the Task Force of the law firm of Stikeman, Elliott.

[13] *Ibid.* at 35 (emphasis added).

[14] See, for example, at 37 where the Task Force identified a lack of sufficient supporting material accompanying a request for comments on a proposed rule as potentially impairing "the goals of transparency, accountability and participation in public decision-making"; see also, at 38 where transparency and broad participation were referred to as "foundational principles"; see, finally, at 49 where the Task Force Report stated that "[t]ransparency and participation are, undoubtedly, important components of a legitimate regulatory regime.

comment procedure accompanying the rule-making power, these principles were at the heart of the Task Force's refusal to recommend a transitional grace period from the notice and comment process in order to elevate then-existing policy statements into rules: "In our view, market participants should not have to be subject to binding rules unless, at the time they were proposed and reviewed, the public well understood their mandatory character and was afforded the benefit of the appropriate procedural protections."[15]

Unfortunately, in our experience Staff has not always displayed proper regard for these principles in implementing the rule-making process. This has been particularly evident in Staff's occasional tendency to treat proposed rules, which have not yet satisfied the notice and comment procedure, as if they represented rules that were in force.

One recent example relates to the Commission's position on material acquisition disclosure in a prospectus. Until recently, the sole requirements for such disclosure were set out in Regulation 1015:56(1)(a), as supplemented by OSC Policy 5.1. These instruments authorised the Director to require that a prospectus contain financial statements of an acquired business only in cases where the proceeds of the securities offered by the prospectus were being applied to finance the acquisition of that business. More stringent requirements were set out in Proposed Rule 45-501, which contemplates the inclusion in a prospectus of financial statements of an acquired business, dating as far back as the three most recently completed financial years, whether or not the proceeds of the prospectus distribution are being used to finance the acquisition. While we do not question the soundness of the policy concerns underlying these more stringent requirements, we are deeply troubled by the manner in which Staff proceeded in implementing Proposed Rule 45-501. On a number of occasions, our dealings with Staff in connection with the process of obtaining a receipt for a prospectus resulted in staff insistence upon compliance with the disclosure requirements of Proposed Rule 45-501 prior to the expiry of the notice and comment period.

In our view the enforcement of Commission policy in this way prior to a Proposed Rule's having achieved binding legal effect both violates the spirit of the principles which animated the Daniels Task Force Report and raises the same administrative difficulties which were addressed by the *Ainsley* and *Pezim* decisions. Moreover, concerns about this practice can rarely be properly addressed at the time it occurs, when serving our clients often requires sacrificing principle to pragmatic considerations relating to the need to get a transaction done. In view of this, we urge the Advisory Committee to consider ways of ensuring that adequate constraints are put in place to avoid the occurrence of these practices and to ensure proper implementation in the future of existing rule-making procedures.

Indeed, in our recommendations, we have sought at several points to devise arrangements that heighten the realization of these values in the securities context."

[15] *Ibid*. at 40.

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Yours very truly,

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