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October 3, 2002

DELIVERED

Mr. Purdy Crawford
Chair
Five Year Review Committee
c/o Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Box 51 First Canadian Place
Toronto, Ontario
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Dear Mr. Crawford:

**Re: Five Year Review Committee–
Comments on the Committee's Draft Report**

We are enclosing our firm's comment letter on the May 29, 2002 Draft Report of the Five Year Review Committee. As we state in the letter, we found the Draft Report to be exceptionally clear and well-written and comprehensive in scope. All of us believe that it makes an important and timely contribution.

Obviously our comment letter is being submitted well past the due date, and for that we apologize. Susan Wolburgh-Jenah kindly advised me that we could submit the comment letter now, but has also indicated that it may not be possible to officially show Torys LLP as a commenter or for the

Committee to revisit aspects of the Report that the Committee has already dealt with. We accept those conditions fully and appeciate the opportunity to make a submission on that basis.

Yours truly,

Torys LLP
per: Robert H. Karp
Partner

RHK/sp

cc Susan Wolburgh Jenah
General Counsel
Ontario Securities Commission

Peter Jewett
Patricia Koval
James Turner

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Dear Mr. Crawford:

**Re: Five Year Review Committee–
Comments on the Committee's Draft Report**

We appreciate the opportunity to make this submission on the May 29, 2002 Draft Report of the Five Year Review Committee. We found the Draft Report to be exceptionally clear and well-written and comprehensive in scope. All of us believe that it makes an important and timely contribution.

We make both general and specific comments in this submission, the latter by referring to the recommendation number shown in the Executive Summary of the Draft Report. With one exception[1], you may assume that we either support or are neutral with respect to those recommendations that we have not specifically commented on in this submission.

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[1] The exception is that we make no comments in this submission on recommendions 56 through 60 relating to mutual fund governance matters, because members of our firm are participating directly in other forums created by the OSC to focus specifically on these matters.

Part 1. The Role of the Commission in Capital Markets Regulation

We agree with the Committee's view that "[the creation of a single securities regulator for Canada] is the most pressing securities law issue in Ontario and across Canada" at this time. We agree with those who believe that Canadian securities regulators must speak with a single voice on the international stage and to the SEC, and that Canadian regulators should not be seen to be overly pre-occupied in the resolution of regional disputes on pressing issues. As an example, the regionally divergent views that have recently appeared in the press[2] on the question of corporate governance reform in Canada may not reflect well on the regulation of Canadian capital markets. Canada lags behind other federal countries that have adopted national-level securities regulation.

The various initiatives that have been put in place in Canada to create a "virtual" national securities regulator, such as the development of national or multilateral instruments by the Canadian Securities Administrators and the various Mutual Reliance Review Systems ("MRRSs"), are helpful but are not panaceas.

The national instruments take too long to develop and are sometimes so peppered with local exceptions that they are difficult to use and cannot fairly be described as harmonization successes. And multilateral instruments are problematic in that they do not apply across Canada.

The MRRSs do not achieve the desired results in any transaction that involves some complexity or novelty (and transactions are increasingly more complex and novel). In these transactions, the time periods stipulated by the MRRSs are often exceeded, and the principal regulator is often reluctant to enforce the time periods in the relevant MRRS if another jurisdiction has not yet considered the issue or has a question or problem with some aspect of the transaction.

The MRRSs would be substantially improved if a mutual recognition model were implemented though your Committee's recommendation to amend provincial securities legislation. In such a model, the applicant or filer would be required to deal with only the principal regulator, who has the power to issue decision documents on behalf of the other regulators, without consultation.

We are concerned, however, that the time and energy needed to adopt a true mutual recognition model of regulation might better be spent in achieving the goal of establishing a national or pan-Canadian commission. We have similar concerns about attempting to harmonize securities laws across Canada. We believe that this exercise is unlikely to succeed absent the establishment of a national or pan-Canadian commission. Specifically, we think that uniform legislation is only achievable after political decisions have been made to have a single regulator, constitutional issues have been resolved, there has been "buy-in" from staffs of the commissions, and the national or pan-Canadian body has been given appropriate legal authority to issue and enforce rules.

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[2] "Securities reform a must, ministers say. Rock, Manley warn regulatory framework risks alienating international investors." National Post, Thursday, September 26, 2002.

We agree fully with recommendation 3, which would permit Canadian companies to prepare financial statements in accordance with U.S. GAAP. Any impediments to this approach in the *Business Corporations Act* (Ontario) and the *Canada Business Corporations Act* ("CBCA") should also be removed.

Part 2. Flexible Regulation

We agree that rule-making needs to be streamlined through shorter time periods and fewer publications and republications. At the moment, passing a new rule is too slow.

A related point is that, in our view, rule-making has not achieved the transparency and clarity that it was hoped rule-making would achieve. We do not believe that this is solely because the rules are new. Rather, many of the rules are too lengthy and needlessly complex. Sometimes the length and complexity is to reflect regional differences. Other times, overly complex SEC rules are used as models but are subsequently tailored for the Canadian marketplace: this retains the over-complexity but renders SEC jurisprudence less relevant or not relevant.[3] In addition to streamlining the process of rule-making, rule-makers should commit to strive for greater simplicity, brevity and clarity in the drafting of the rules, even if some degree of precision or scope is lost.

The Commission should have the basket rule-making power in recommendation 11. But the linkages between a basket-rule making power and the recommended ability of the Commission to impose administrative fines of up to $1 million causes us some concern (see Part 6 below).

We believe that the OSC should be able to issue 'no action' letters. We also think that the Commission should be able to issue blanket rulings, provided that the rulings are not used to establish new regimes, and are limited to furthering the objectives in the rules they address.

Unwritten rules or policies still exist and, on occasion, new ones continue to be made without adherence to the formal processes mandated by the *Securities Act* (Ontario) (the "Act"). One of these unwritten and unacceptable policies is that no exemptions will be granted from a rule in the first year following its adoption. Such a policy is typically not consistent with the exemption power in the rule, and is not, we suggest, a desirable approach. The reality of rule-making is that problems with new rules are often not apparent until they are applied in real life circumstances. The identification of these problems should be expected (and not viewed as a criticism), and fixing them quickly should be a priority. If a regime of blanket rulings or 'no action' letters is adopted, these could be deployed quickly to correct problems in new rules.

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[3] In contrast, in 1993, the OSC adopted essentially verbatim the SEC's rules on executive compensation disclosure. Although this was a sea change for executives and their advisors, the transition was eased because years of SEC pronouncements and other interpretive resources were available to Canadians. On the other hand, the current significant acquisition disclosure rules were adopted from SEC Rule 3-02, but modified in important ways that made existing U.S. interpretation resources less helpful. Market participants in Canada continue to struggle with these acquisition disclosure rules.

We agree with recommendation 18 that the Commission should publish the granting of exemptions from rules. However, if the Commission decides to publish exemption requests that were not granted, this should only be done on a no-names basis, perhaps in the form of periodic summaries (similar to the summaries that used to be published in respect of exemptions from OSC Policy 9.1, although they should be published more frequently than those summaries were published).

3. Regulation of Market Participants

We agree with recommendation 24, "that the registration requirement relating to trading should be moved to a model requiring the person or company to be "in the business" of trading." We do not understand, however, why this change should only be made if it were adopted across the country (because moving to a less onerous standard in Ontario can be done unilaterally).

We agree with recommendation 31, that "SROs be required to report to the Commission any breaches or possible breaches of securities law that they believe have occurred or may have occurred." However, we think that such an obligation should apply only to "material" breaches or possible breaches.

4. The Closed System and Secondary Markets

We agree with recommendation 35, which would see us move forward to create a statutory civil liability regime for continuous disclosure. We think that, in today's environment, this should move forward as a priority. It should also move forward as a priority if it is a pre-requisite to the elimination of the unnecessarily complex "closed system" of hold periods, restricted periods and seasoning periods (we strongly agree with recommendation 37). We also strongly agree with recommendation 42 that the Act's timely disclosure provisions not be amended to require disclosure of "material information", and we agree with recommendation 43 that the existing materiality standard should be changed for all purposes under securities legislation to a "reasonable investor standard".

We note that the definition of "material fact" has been used in the Act for two basic but different purposes. It has been used on the one hand in the insider trading restrictions in section 76 and, on the other hand, as a standard of disclosure in the definition of "misrepresentation" and in the various Forms to the Act. We believe that the existing definition, focused as it is on the market effect of information, continues to be appropriate for insider trading purposes but not for purposes of determining if the appropriate disclosure standard has been met. With respect to the latter, the Commission has adopted in its decisions the test articulated in *Northway* which focuses on whether or not there is a substantial likelihood that a reasonable person would consider the fact important in making its decision. We therefore recommend that for purposes of determining if a "misrepresentation" has occurred and if disclosure is adequate in a document, such as a prospectus, which requires disclosure of all material facts, a fact would be a "material fact" if "there is a substantial likelihood that a reasonable person or company would consider it to be important in making a decision to purchase or sell securities of the issuer".

We have two concerns with the existing proposals for civil liability for continuous disclosure. The first is that the proposed regime is too complex and serious attempts should be made to simplify it, on the theory that simplicity will lead to greater understanding by market participants and therefore greater adoption and compliance by them. The second concern is that the existing proposal will result in extensive litigation over "when" a particular fact should have been disclosed. The question of "when" to disclose is one of the most difficult questions faced by directors, and it involves the exercise of difficult judgments. Capital markets are not always best served by second-guessing these real time judgments with the benefit of hindsight. Accordingly, we would limit civil liability for continuous disclosure, particularly in the beginning, to the making of misleading statements; we would not impose civil liability for the failure to make timely disclosure, although that would continue to be an offence under the Act.

Subject to those concerns, we agree with all the other recommendation in Part 4.

5. Enhancing Fundamental Shareholder Rights

We agree with recommendations 52 through 55. With respect to recommendation 52 to relax the proxy solicitation rules to facilitate shareholder communication, we support the concept fully. The CBCA amendments are an improvement over the previous regime, but they do not go as far as SEC reforms (which in our view are desirable).

6. Enforcement

There is a concern about the recommendation to amend section 127 to give the Commission power to levy administrative fines of up to $1 million for contraventions of Ontario securities law where it is in the public interest to do so. The linkage of this recommendation to recommendation 11—that the Commission have be given basket rule-making power—is of particular concern to some of us. We recognize that the Commission's expertise should be deferred to in the levying of these fines, but we would also like to see the introduction of some element of independence between those who make and enforce the rules and those who levy the fines. Perhaps we should have a system similar to the administrative law hearing judges regime in the United States. That system, however, suffers from a conceptual flaw–we understand that the judges, who are supposed to be independent of the SEC, are employees of and paid by the SEC. A Canadian version should strive to correct this conceptual flaw.)

With respect to recommendation 81, we do not think that the provision prohibiting a person or company from making a misrepresentation should be limited to statement made "with the intent of effecting a trade" in a security. Misrepresentations can cause serious harm even if they are not made with the intent of trading, and should be an offence, whether or not it was made with the intent of trading.

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Again, we appreciate the opportunity of commenting on these matters to the Committee.

While this submission is made on behalf of our firm, it does not necessarily reflect the views of all of our partners. We would be pleased to discuss any aspect of this submission with you at your convenience.

Yours truly,

Torys LLP
per: Robert H. Karp
Partner

RHK/sp

cc: Peter E. S. Jewett
Patricia A. Koval
James E. A. Turner