June 5, 2000

Dear Purdy:

Thank you for your letter of April 28. I am glad you are heading the Securities Review Advisory Committee; apart from your superb qualifications for the role, it is good to see the Secretary of the Kimber Committee now taking responsibility for chairing a successor to that Committee.

As directed in the Request for Comments, I am enclosing a diskette with the contents of this letter.

I believe my colleagues at Torys will be preparing a detailed submission to your Committee. By way of personal reply to your letter, I wish only to comment on the importance of an agreed analytical approach to the host of issues confronting you. My suggestion is that you will find your time well spent if, early in your work, you arrive at a series of criteria or tests for application to specific issues.

What follows is my preliminary attempt at the list I would adopt if I were in your shoes. I am sure that you and your Committee will have reservations about some of these items, will have additional items, and will differ as to the priorities among the items. That is important, but not critical. What is critical, in my view, is that some time be taken to reflect on these basic underlying concepts that will be relevant to most or all of the issues before you.

1. **Regulate only to the minimum extent needed to respond to an identified policy concern**

   This might seem so obvious as not to require a statement, but I am constantly amazed at the extent to which regulatory initiatives are adopted in various aspects of our society without articulating this criterion or using it as a test to determine the appropriate scope of the regulation. In consequence, we sometimes see a legitimate policy concern addressed through a regulatory intervention that goes far beyond what is necessary. Accordingly, my candidate for the pre-eminent criterion that your Committee should apply in assessing regulatory proposals is that there be a clear identification of the

policy concern being addressed, followed by a focus on what is the minimum degree of regulatory intervention which will adequately respond to the concern.

The regulation of mutual funds is an illustration, in my view, of areas where the existing structure might be very different if this precept had been borne in mind as regulations evolved.

2. **Be careful of "made in Canada" solutions**

I almost included in this list the physicians' rubric "do no harm". The principal application of that rubric, would, in my view, be in the context of regulations that affect the competitive position of Canada's capital market vis-à-vis that of the United States. I haven't studied the statistics in preparation of this letter, but my experience tells me, and the literature I have seen confirms this, that both the primary and the secondary markets for Canadian securities are moving to the United States to a disturbing extent.

I recognize that this movement is attributable in large part to underlying economic considerations that are beyond the scope of your Committee. However, concern with a different regulatory structure in Canada has some influence: most importantly, it sometimes persuades an entrepreneur or public corporation that has decided to have recourse to the primary or secondary markets in the United States to make this recourse exclusive, staying away from the Canadian marketplace because of additional compliance costs.

The Ontario Securities Commission has recognized this concern and attempted to respond to it in various ways. My suggestion is that your Committee should be cognizant of this in all your deliberations. Every care should be taken to minimize differential regulatory costs that might discourage capital market participants in the United States from including Canada in their range of activities.

3. **Be willing to rely on capital market participants to enforce their legal rights**

Historically, Canadian regulators and legislators have been cognizant that Canada, by comparison with the United States, is a "non-litigious" society. This has encouraged regulatory interventions (for example, important aspects of our regime for related party transactions) that would, in the United States, be left for the courts to resolve in the context of litigation brought by aggrieved shareholders or other constituencies. However, in recent years Canadian participants in the capital markets have demonstrated a much-

increased willingness to litigate when they feel aggrieved. The opportunity to do so has been increased through the availability of new class action remedies.

We are, then, in danger of developing a regime that involves a higher degree of regulatory intervention on a before-the-event basis, supplemented by active litigiousness on an after-the-event basis. Cumulatively, these might well prove to be overkill. My suggestion is, then, that your Committee be on the alert to identify situations where before-the-event regulatory intervention can be reduced or eliminated in reliance on the increasing awareness of market participants that what they do could well be the subject of after-the-event litigation.

4. **Don't unnecessarily protect market participants who need no protection**

This consideration is already recognized in private placement rules which define categories of investors for whom the prospectus and related requirements are less necessary, or are not necessary. Without commenting on the details of those rules, my point is that the underlying principle is one which should be capable of more far-reaching application.

Federally, it is likely that the new banking legislation will adopt the concept of "wholesale banks", which will be freed from some regulatory inhibitions on the basis that they deal entirely with non-retail customers. Perhaps a similar innovation would be appropriate in the securities markets. Whether or not that is the case, it seems to me very probable that the flexibility and competitiveness of Canada's marketplace would be enhanced if your Committee, when you decide that a particular regulation is needed, also separately consider whether the regulation need apply to all market participants. This consideration might probably be regarded as simply one application of my first principle above, that regulation should not go beyond the minimum that is necessary for effective response to an identified policy concern.

It would be easy to expand this list. I hope the Committee will emerge with recommendations that encourage reliance on electronic communication and reduce the paper-based orientation that dominates existing securities law. I hope that, where feasible, there will be reliance on private sector solutions. I share the belief that there should be an attempt to analyze what activities require regulation, rather than focussing on sterile definitions: the prime example of this being, of course, the emphasis on regulation of the advisory activity. But all of these and other

substantive points seem to me to flow from the principles I have set out above. They are in the category of implementation rather than of analysis.

I hope the above comments will be helpful and would be glad to discuss them with you or your colleagues if you have comments concerning them.

Please accept my best wishes for the success of your work. It is important to all participants in our marketplace and to Canada's economic position as a trading nation.

Yours very truly,

James C. Baillie

JCB/cp

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