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Five Year Review Committee Reviewing the *Securities Act* (Ontario)
c/o Purdy Crawford, Q.C.
Osler, Hoskin & Harcourt LLP
Barristers and Solicitors
Box 50, 1 First Canadian Place
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Dear Mr. Crawford,

BMO Nesbitt Burns Inc. ("BMO Nesbitt Burns") appreciates being provided with the opportunity to comment to the Five Year Review Committee Reviewing the *Securities Act* (Ontario) (the "Committee") on its Draft Report. This is a period of potential significant change in securities regulation in Canada, from the British Columbia Securities Commission's ("B.C.S.C.") *New Proposals for Securities Regulation* ("*New Proposals*"), to new and proposed legislation in Manitoba and Québec. Our views on the draft report cover two general concepts: (i) the need for Canada to remain competitive through efficient and effective capital markets; and (ii) the importance of responsive securities regulation that is fair to all participants in Canada's capital markets.

National View Towards Securities Regulation

Ontario and Canada need healthy, competitive capital markets in order to prosper. BMO Nesbitt Burns is of the view that, at a minimum, a uniform national approach to securities regulation is one of the prerequisites. Capital market participants in Canada compete not only amongst themselves, but also internationally. Inter-provincial harmonization of securities regulation would reduce the regulatory burden in Canada, and would increase Ontario's ability to compete in increasingly global capital markets.

Since the discussion surrounding a national securities regulatory authority and the CSA Uniform Securities Legislation Project began, certain provinces appear to be stepping away from harmonization.

Separate provincial approaches to securities regulation, or approaches which maintain duplicative provincial bureaucracy in securities regulation, will only result in higher costs to both the investors and the firms that participate in Canada's capital markets. This is a time when the provinces must work together for a solution, as disharmony will ultimately cost the consumers of capital market products and services.

System of Functional Regulation

Participants in the capital markets of Ontario and Canada are generally involved in more than one financial product and service: the large securities dealers in Canada are owned by the banks, who may offer trust and insurance services through affiliates; insurance companies are launching banks and starting securities dealers. As vendors of financial products and services change how they do business, so, too, should the regulatory regime. Regulatory costs impact a participant's ability to compete with other substitute, or similar, financial products from the other pillars of the financial industry.

Although major financial institutions now regularly offer many types of financial products, these financial entities often have considerable focus in only one or two of the four pillars: banking, insurance, trust services or securities. Unequal regulation of the different financial products and services available can result in regulatory favouritism of one financial product over another; this would be unfair to other competitors in similar, competing industries. More importantly, it may also lead to unequal protection for the consumer.

We consider a national approach to securities regulation as more important than implementing a functional regulatory system. We believe the provinces should move to a harmonized national system for securities regulation first, should a functional regulation system prove to be an impediment to a harmonized national system. In other words, if we cannot have both, we favour a national system for securities regulation.

Although BMO Nesbitt Burns supports the proposals of the Committee towards functional regulation among all of the four pillars, it is our opinion that market conduct should be included in any functional regulatory system. Market conduct, although at times highly technical and specialised, is an important part of prudential regulation as it often impacts prudential issues. It is our view that any

system of functional regulation should also have the authority and the ability to govern market conduct in the capital markets of Canada.

International Issues and Globalization

In recognizing the globalization of capital markets, Ontario should consider the direction other G8 nations are taking with respect to capital markets' regulation and, where appropriate, take similar action to foster reciprocal recognition arrangements with such nations. We are strongly supportive of the comments of the Committee to encourage Canada's regulators to move to a national system of harmonized regulation and to parallel those of other well developed capital markets by further implementing IOSCO initiatives and a harmonized functional system.

Self-Regulation

It is important that any capital market's self-regulatory organization ("SRO") be credible and accountable to foster the trust and confidence of the consumers of the financial products and services that the SRO regulates. By recognizing and regulating a SRO, the credibility of the SRO would be increased. Mandatory recognition of any SRO would give the Commission the appropriate statutory authority to review the decisions and orders of the SRO and could result in a decreased regulatory burden since duplication would be minimized.

The decision to recognize a SRO should be done at a national level, either by the CSA, or by any national regulator or harmonized national system that emerges. It is our opinion that the statutory requirement to recognize a SRO should not be made until some national approach to securities regulation is adopted.

Discussion of the future of the I.D.A. and other financial self-regulatory organizations has been the topic of some debate recently. In addition to the recommendations made by the Committee in its Draft Report, the potential for regulatory consolidation has been raised, with the suggestion that streamlining requirements, impacts and costs to members could be achieved. Such assertions need to be examined closely with appropriate considerations of not only perceived, but real effectiveness and efficiency. As part of the consolidation debate, the trade association role would need to be developed in such a manner so as to ensure that industry member interests are properly aligned and represented.

BMO Nesbitt Burns looks forward to the discussion on this important issue and welcomes the opportunity to comment.

A Protective Approach to Regulation

BMO Nesbitt Burns is of the view that providing the OSC with the power to make restitution orders would represent a fundamental change to the intended and proper focus of the Act which should continue to be protective rather than remedial.

In this regard, the capital markets industry has made significant progress to ensure that relatively inexpensive formal systems, such as the IDA Arbitration Program, are in place to facilitate the advancement of proper claims and redress. To the extent that these existing systems are deemed insufficient, our opinion is that the focus should be on fixing such systems, not creating another layer of systems for redress.

Civil Liability for Continuous Disclosure

Securities regulation should foster proactive compliance by setting out reasonable, fair, and practical rules. With this objective in mind, BMO Nesbitt Burns recognizes the benefits to be derived from creating a statutory civil liability regime for continuous disclosure. However, we are concerned with the broad scope of the current proposal, and are of the view that the range of persons who are intended to be included as "other responsible parties" should be specifically defined.

As has already been contemplated in the Draft Report, we are also of the opinion that any statutory provisions in this regard should be carefully drafted so as to minimize the potential costs to the industry that may be associated with unmeritorious strike suits. In addition, BMO Nesbitt Burns is of the view that any such civil liability provisions should not be drafted as "strict liability" offences.

Disgorgement and the Imposition of Fines

While BMO Nesbitt Burns supports strong penal sanctions for those who improperly take advantage of the capital markets in Canada, the penal and disgorgement provisions recommended by the Committee in chapter 19 of the Draft Report may not be constitutionally appropriate for provincial

implementation. Amendments to federal legislation may therefore be required to make the proposed penal sanctions effective. If the Act is in fact to be amended to allow the OSC to impose such penalties, it is our opinion that a tiered system of fines should be implemented which tie the severity of the sanction imposed to the specific regulatory breach.

Market Manipulation and Misrepresentations

BMO Nesbitt Burns agrees in principle with the express inclusion of anti-fraud and market manipulation provisions in the Act. We would however recommend against making such provisions "strict liability" offences.

Similarly, BMO Nesbitt Burns agrees in principle that the Act should be amended to include a provision prohibiting a person or company from making a statement that the person ought reasonably to know is a misrepresentation. In this regard we are also of the view that the limitation existing in the securities legislation of B.C., Alberta, Saskatchewan and Manitoba (i.e., "with the intent of effecting a trade") should also be incorporated into the proposed amendment.

Appropriate Standard for Materiality

The 'reasonable investor' test presented in the Draft Report appears too subjective to be effective and properly administered. It is our opinion that a precise and non-subjective approach to the disclosure standards should be adopted. In this regard, we refer to Appendix F of the B.C.S.C.'s *New Proposals*, where a non-subjective approach to the materiality standard is considered. We are of the view that the approach taken by the B.C.S.C. is readily usable and practical, as it is substantially similar to the system already in use, and less costly to implement.

Cost-Benefit Analyses

With capital markets regulation comes costs to the consumers and investors in Canada's capital markets. These same consumers and investors, in turn, should benefit from the increased protection of the regulatory regime. It is important that the costs be considered against the benefits and, in this regard, we strongly agree with the Committee's recommendation that the Commission should be required to undertake cost-benefit analyses to assess the effectiveness of proposed regulations against

the cost of implementing such regulations. It is important to make such cost-benefit analyses public to ensure transparency and accountability in the regulatory system.

Responsiveness of the Regulatory System

The responsiveness of a regulatory system is very important to protect consumers; however, a rush to implement regulation may result in a less than perfect implementation of such regulation. The implementation of new regulations can require capital market participants to undergo major operational changes. These changes may be technical, such as computer programming or new systems, or may be functional, such as training and procedures for employees. Regulation is only effective if it is properly implemented, and it is best to implement a change after proper planning and consultation. Otherwise, it may be necessary to constantly amend policies and procedures to remain in compliance. In this regard, we believe that the shortened timeline recommendations of the Committee contained in Chapter 6 of the Draft Report are unrealistic. We further oppose the recommendation contained in Chapter 6.3(b) of the Draft Report, that the Commission should only be required to republish for comment a proposed rule if the proposed changes are considered material by the Commission. We believe there is a need for transparency in the implementation of regulation, so that concerns and views that might not otherwise be apparent can be raised.

Conclusion

BMO Nesbitt Burns believes that a public discussion of the improvements required to the securities regulatory system is essential in order to keep our capital markets healthy and competitive. We appreciate the opportunity to comment. We hope that our comments are well received.

Yours very truly,

Michael S. McGrann
Executive Managing Director & General Counsel