FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

December 8, 2014

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Dear Honourable Ministers:

RE: The Cooperative Capital Markets Regulatory System – Governance and Legislative Framework

FAIR Canada is pleased to offer comments on the proposed governance and legislative framework for the cooperative capital markets regulatory system ("CCMR") and, in particular, on the Memorandum of Agreement ("MOA") signed by the above-noted governments and the two pieces of draft legislation – the draft provincial Capital Markets Act ("PCMA") and the draft federal Capital Markets Stability Act ("CMSA") – that are proposed to be administered by the cooperative regulator known as the Capital Markets Regulatory Authority (the "CMRA").

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

I. Introduction

FAIR Canada welcomes efforts made by governments and regulators to improve and enhance cooperation with respect to securities regulation and capital markets in Canada. In its December 2011 constitutional reference decision, the Supreme Court of Canada decided that each level of government has jurisdiction over some aspects of securities regulation and can work in collaboration with the others to carry out its responsibilities.

FAIR Canada sets out below some key points that it encourages both current and future governments and regulators to incorporate as essential components of any cooperative regulatory scheme designed to provide adequate investor protection while at the same time ensuring that the Canadian securities markets operate as efficiently as possible.

FAIR Canada also urges governments and regulators not to lose focus on several important investor-focused initiatives that are currently underway. In particular, FAIR Canada encourages continued regulatory concentration on the mutual fund fees initiative (including the banning of third-party embedded commissions), the implementation of a statutory best interest standard and the point of sale initiative for investment funds (including mutual funds, exchange traded funds and other investment funds).

Given the significance of the proposed governance and legislative framework to any cooperative security regulatory scheme, FAIR Canada urges governments and regulators to ensure that a fulsome and thorough consultation with stakeholders is conducted and that adequate time is allotted. This should include a period to review and reflect on the comments received regarding the draft legislation, and stakeholders should be provided ample time to consider the draft regulations expected to be published in the early spring of 2015 that will be lengthy. Recognizing the desire to quickly move forward with this initiative, we believe it is unrealistic to expect the CMRA operational by the fall of 2015. More realistic timelines might comfort some stakeholders that the process is not being unduly rushed and that the result will be a careful, considered system.

The CCMR notice published on December 5, 2014 states that "…In order to maintain continuity and minimize disruption for market participants, the participating provinces plan to propose initial regulations that substantially maintain the harmonization achieved under the current structure…. accordingly, the draft initial regulations under the PCMA will be based on the existing rules of the

participating provinces, including the existing national and multilateral instruments. Generally the draft initial regulations will propose changes to the existing rules only as necessary to fit them under the PCMA and to eliminate differences in requirements in order to create a single set of regulations that will apply across the participating jurisdictions…"[1]. FAIR Canada urges regulators and governments to approach harmonization with the goal of furthering the key mandate of investor protection and to not engage in a harmonization process at the expense of adequate investor protection.

II. Investor Protection Measures That Need to be Included in Any Framework

1. Independent Statutory Investor Panel

FAIR Canada strongly supports provisions for an independent statutory investor advisory panel that is appropriately funded and afforded a broad mandate to represent the interests of Canadian financial consumers in securities regulation. The 2009 Expert Panel on Securities Regulation Final Report and Recommendations ("Expert Panel Report") commented on the lack of engagement of retail investors in the regulatory process, and recommended the establishment of a national, statutory, independent investor panel.[2]

In January 2010 and April 2011 the Canadian Securities Transition Office and FAIR Canada jointly hosted symposia on retail investor engagement in securities regulation. The panelists discussed the mandate, composition, and funding for an independent statutory investor panel, and stressed the importance of retail investor input early on in policy development. The final PCMA (or final CMSA) should provide for the creation of an independent, statutory investor advisory panel to ensure that the views of the retail investing public are captured in the CMRA policy-making process, including proactive identification of investor protection concerns. FAIR Canada recommends that the panel be modeled on the UK's highly-regarded statutory Financial Services Consumer Panel (the "UK Panel") and that its composition and mandate be consistent with the recommendations made in the Expert Panel Report.

The importance of such a panel to the development of regulatory policy that fosters fair and efficient capital markets and adequately protects investors cannot be overstated. Such a panel would provide for an effective, transparent and credible mechanism for investor consultation and feedback. The UK Panel and the Ontario Securities Commission's Investor Advisory Panel have had a significant, positive influence on the regulatory policy-making process which has greatly assisted those regulators in fulfilling their statutory mandates. We encourage the statutory inclusion of such a panel within the CMRA and also within other securities regulators not participating in the CMRA.

2. Investor Representation on the Board of Directors

The board of directors of the CMRA is proposed to have the responsibility, among other things, to set the policy priorities and strategy for the CMRA and to make regulations under both the PCMA and the CMSA. Accordingly, FAIR Canada recommends the inclusion of directors who will represent the interests of retail investors. One of the key criteria to be considered by the Nominating Committee

[1] See online at http://ccmr-ocrmc.ca/cooperative-capital-markets-regulatory-system-update-draft-initial-regulations/

[2] This was a recommendation set forward in the Hockin Report (Thomas Hockin *et al.*, "Expert Panel on Securities Regulation Final Report and Recommendations" (June 2009), online: <http://www.expertpanel.ca/eng/documents/Expert_Panel_Final_Report_And_Recommendations.pdf >).

should be experience in investor-related issues, given the purpose of the cooperative system to "provide increased protection for investors"[3]. The Nominating Committee should actively seek out individuals who have securities regulatory experience from the retail investor perspective. Such nominees should also satisfy other necessary criteria (namely, members who are independent of the governments represented by the Council of Ministers and possess appropriate qualifications and capital markets-related experience[4]). The appointment of qualified people whose body of work is known to reflect and foster the interests of retail investors would be in the public interest.

3. Mandatory, Statutory, Independent, Binding Dispute Resolution Service

FAIR Canada recommends that governments and regulators mandate participation by all securities registrants in a single, independent, not-for-profit investment dispute resolution service that has the power to make binding decisions.

As acknowledged in the G20 High-Level Principles on Financial Consumer Protection (the "G20 High-Level Principles"), which were endorsed by the G20 Finance Ministers, including Minister Flaherty, at their meetings on October 14-15, 2011: "[c]onsumer confidence and trust in a well-functioning market for financial services promotes financial stability, growth, efficiency and innovation over the long term."[5] It is generally recognized that key components of consumer confidence are accessible and user-friendly arrangements to resolve disputes.[6] Principle 9 of the G20 High-Level Principles is 'Complaints Handling and Redress' which provides that:

> "Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient. Such mechanisms should not impose unreasonable cost, delays or burdens on consumers… Recourse to an independent redress process should be available to address complaints that are not efficiently resolved via the financial services providers and authorised agents internal dispute resolution mechanisms."[7]

We believe that the fair, accessible, accountable, timely, and independent resolution of investment disputes is an essential element of consumer protection and encourage governments and regulators to provide such a system for investors to resolve their complaints. Retail investors need a dispute resolution provider that will help them understand the process and their individual complaint, and they need a process that does not necessitate the expense of hiring a lawyer or other representative to seek redress.

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[3] See Section 1(a)(ii) of the MOA.
[4] See Section 6.2 of the MOA.
[5] Organisation for Economic Co-operation and Development, "G20 High-Level Principles on Consumer Financial Protection" (October 2011), available online at: http://www.oecd.org/regreform/sectors/48892010.pdf at page 4.
[6] See World Bank Report "Resolving disputes between consumers and financial businesses: Fundamentals for a financial ombudsman" (January 2012) at page 9.
[7] *Supra* note 5, at page 7.

Further, and fundamentally, retail investors need a dispute resolution process that will deliver a resolution of each dispute as is the case in other leading jurisdictions[8]. It is for this reason that FAIR Canada urges the adoption of binding decision-making authority as a key element of the process.

FAIR Canada believes that the CMRA provides an opportunity to legislate the mandatory participation of all dealers and advisers in a single, statutory, not-for-profit, dispute resolution service with power to make binding decisions. There is a strong need for such a requirement.

4. An Independent Adjudicative Tribunal

FAIR Canada recommends that governments consider imbuing the adjudicative tribunal with complete independence from the policy and regulatory division of the securities regulator by making it a separate entity. This would allow the independent adjudicative tribunal to function, and to be perceived, as fully independent of the regulatory agency and its investigative arm.

5. Combating Financial Fraud

It is essential that securities regulators have the necessary responsibilities and tools to combat investment fraud. In our view, a more coordinated regulatory system will improve investor protection as compared with the current system.

With respect to the CMRA, it is essential to ensure that Canada-wide enforcement of securities-related fraudulent conduct and other wrongdoing is strengthened, through appropriate staffing (including leading securities litigators, forensic financial professionals, investigators, and others) and prioritization based on complaints and market trends.

In addition, at present there is a dearth of data collected on investment or financial fraud in Canada (for example, the amount of losses suffered by victims of investment fraud, the number of known incidences of investment fraud in Canada per year, the number of fraud related complaints made per year). There is also no central collection and clearing agency to coordinate efforts to combat fraud. To this end, FAIR Canada recommends the CMRA, other securities regulators and self regulatory organizations (the Investment Industry Regulatory Organization of Canada ("IIROC") and the Mutual Fund Dealers Association of Canada ("MFDA")) collect, maintain and make publically available data on fraud complaints, investigations, proceedings and subsequent outcomes and coordinate their efforts to the greatest extent possible and practicable. Having empirical data will allow for the prioritization of efforts to combat fraud and other wrongdoing based on complaints and market trends.

FAIR Canada made a number of recommendations to improve Canada's ability to combat investment fraud in its recent report. We urge governments and securities regulators to give serious consideration to those recommendations.[9]

[8] In the UK, Australia and New Zealand, the system provides for binding decision-making. We see no reason for a less consumer-friendly dispute resolution system in Canada.

[9] FAIR Canada's "A Report on a Canadian Strategy to Combat Investment Fraud", August 2014, available online at http://faircanada.ca/wp-content/uploads/2014/08/FINAL-A-Canadian-Strategy-to-Combat-Investment-Fraud-August-2014-0810.pdf.

6. Misrepresentation in Sales Literature or Verbal Misrepresentations

Given the need for real repercussions for misleading information in marketing and sales documents and misrepresentations by market participants and registrants, FAIR Canada recommends that investors be given a specific statutory right of action for misrepresentations in such materials or for verbal misrepresentations. A right of action currently exists in Saskatchewan and New Brunswick in their securities legislation and such a right should not be lost. Rather, it should be strengthened and extended to all Canadian investors in the interests of investor protection through its adoption in the PCMA and in the governing statutes and rules of other securities regulators throughout Canada.

7. Mandatory Periodic Review of Legislation and Securities Regulators' Operations

FAIR Canada recommends that securities legislation and the securities regulatory regime, including operations of all securities regulators, should be reviewed by legislatures on a periodic basis (every three to five years). Stakeholder input should be sought on such review, and a resulting public report should be issued.[10]

III. Comments on the Two Draft Pieces of Legislation, the PCMA and CMSA

FAIR Canada sets out below comments on some specific aspects of the proposed PCMA and CMSA that have been issued for comment.

1. The Core of the Securities Regulators Mandate Must Be Investor Protection

(a) Purposes Section of PCMA

In Canada's capital markets, investor protection is at the core of a securities regulator's mandate. The proposed draft PCMA provides that "The purposes of the Act are, as part of the Canadian capital markets regulatory framework, to provide protection to investors from unfair, improper or fraudulent practices, to foster fair, efficient and competitive capital markets in which the public has confidence and to contribute to the stability and integrity of the Canadian financial system."

FAIR Canada is concerned about the addition of a new purpose, namely "to contribute to the stability and integrity of the Canadian financial system", to the existing mandate of securities regulators. We are not clear as to what exactly is meant by "stability" and how this purpose may be addressed in relation to the investor protection mandate in the event of a market or financial crisis. We would not want to see the availability of an argument from market participants that enforcement action against them should not be pursued in the interests of "stability of the financial system" and allow investor harm to occur with no real consequences. Real consequences must follow investor harm. In addition, we are concerned with the breadth of the concept of "stability and integrity of the Canadian financial system" which goes well beyond the integrity of our capital markets. The core mandate of the CMRA, as with provincial securities commissions, must be the protection of investors.[11] We believe that adding this

[10] FAIR Canada believes that a review of the CMRA and other securities regulators should occur as recommended in our submission to Ontario's Standing Committee on Government Agencies dated February 23, 2009. See our submission online at http://faircanada.ca/wp-content/uploads/2008/12/Final-Submission-to-Standing-Committee-july-30-FINAL.pdf

[11] See Pezim v. British Columbia (Superintendent of Brokers), [1994] 2 S.C.R. 557 at page 589 wherein the Supreme Court stated "It is important to note from the outset that the Act is regulatory in nature. In fact, it is part of a much larger framework which

additional purpose may have unintended consequences and lessen the principal mandate of securities regulation, which is investor protection. We therefore suggest that this purpose be omitted from the Purposes section of the PCMA.

(b) Purposes Section of CMSA

The proposed draft CMSA's purposes are "… as part of the Canadian capital markets regulatory framework, (a) to promote and protect the stability and integrity of Canada's financial system through the management of systemic risk related to capital markets; and (b) to protect capital markets against the commission of financial crimes."

FAIR Canada proposes that the wording of purpose (b) be amended to read: "to protect *investors* and capital markets against the commission of financial crimes." We make this recommendation on the assumption that it does not create jurisdictional issues with respect to constitutional law or, if it does, such issues can be resolved through the legislative architecture being used to vest the CMRA with powers derived from provincial jurisdiction.

2. The Platform Approach to the PCMA

The PCMA takes a so-called "platform approach" to capital markets regulation in that it sets out the fundamental provisions of securities legislation while leaving many requirements, including some requirements that are currently contained in some provinces' securities legislation, to be addressed in regulations. For example, the take-over bid trigger of 20% of outstanding shares is not contained in the PCMA whereas it is found in section 89 of the Ontario *Securities Act*. A commentary provided on the official CCMR website[12] provides: "This approach promotes regulatory flexibility, allowing the Authority to respond to market developments in a timely manner and appropriately tailor its regulatory treatment of various entities and activities."[13]

While flexibility to deal with rapidly evolving capital markets and financial system is advantageous, there should be a balance maintained between flexibility and accountability. The framework must ensure that accountability to legislatures is maintained while providing securities regulators with adequate tools to fulfill their mandate.

In addition, FAIR Canada is concerned that putting much of the substance of securities law into regulations will result in regulators being able to amend the substantive rules without legislative approval, thereby lessening accountability. Therefore, FAIR Canada believes that key components of our securities regime should be contained in the proposed PCMA rather than left to the regulations, in addition to there being a review of the securities legislation and securities regulators' operations on a periodic basis as set out above.

3. Restitution for Investors

Section 90(2) of the proposed draft PCMA allows the Tribunal to order a person who has contravened capital markets law to make restitution to one or more persons, if the Tribunal considers such

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regulates the securities industry throughout Canada. Its primary goal is the protection of the investor but other goals include capital market efficiency and ensuring public confidence in the system."

[12] http://ccmr-ocrmc.ca

[13] October 31, 2014 Commentary on the Cooperative Capital Markets Regulatory System Governance and Legislative Framework: Extension of Comment Period at page 5.

restitution to be in the public interest. This may be done directly, through an investor compensation fund, or by paying an amount of money to the CRMA who will allocate the money.

In our submission to the Ontario Securities Commission ("OSC") in December 2011 on proposed enforcement initiatives[14] and our fraud report in 2011[15], FAIR Canada recommended that securities regulators should have the ability to order restitution directly to investors. The Ontario Legislative Standing Committee on Government Agencies Report also made this recommendation in its findings. The OSC's Investor Advisory Panel has also called for this power in its submission on the OSC's proposed enforcement initiatives and noted that in the US, in certain cases, the SEC has the authority to order civil monetary penalties as well as disgorgement of financial gains. These civil penalties are collected by the SEC, which administers the "Fair Fund" for the benefit of investors who suffer losses resulting from fraud or other securities violations (section 308(a) of the Sarbanes-Oxley Act).

Currently the OSC has to apply to provincial court to get restitution for investors (pursuant to section 128 of the Ontario Securities Act) but it rarely does so and it is only available under the quasi-criminal power rather than the more commonly-used administrative power. FAIR Canada supports the ability of the Tribunal to order restitution.

Additionally, in order to ensure and enhance the integrity of the enforcement regime, FAIR Canada recommends that securities regulators try to address the issue that while a significant amount of fines are levied the actual collection rate by securities regulators is very low.

4. Secondary Market Liability Regime

The secondary market liability regime set out in the proposed draft PCMA is largely based on current provincial securities legislation. FAIR Canada supports the approach which suspends the limitation period for commencing a statutory secondary market civil liability claim. We recommend, however, that the provision take into account the problem that arises from there being a three year limitation period from the date of the misleading disclosure. If an issuer only corrects a misrepresentation very close to the end of the three year limitation period, section 171(2) of the PCMA will not provide sufficient time. A more fair approach would be to suspend the limitation period as soon as a lawsuit is started that asserts a claim on behalf of a proposed class of secondary market investors rather than only suspending the limitation period upon filing of the application for leave. FAIR Canada recommends that the limitation period for secondary market liability causes of action pleaded in an originating process be suspended from the date of filing the claim rather than from the date when the plaintiff files a notice of application seeking leave to proceed with the action.

FAIR Canada further recommends that a review be undertaken of corrective disclosure to assess whether investors are being unfairly harmed as a result of there being a three year limitation period for misrepresentations without any discoverability principle accompanying the limitation period. If corrective disclosure is provided in a significant number of instances after the three year limitation period has expired, the limitation period should be rethought.

FAIR Canada supports the new provision for civil liability for insider trading (section 129 of the proposed PCMA). A party who engages in inside trading/tipping/recommending should be liable to

[14] http://faircanada.ca/wp-content/uploads/2011/01/111220-FAIR-Canada-submission-re-OSC-proposed-enforcement-initiatives.pdf

[15] http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf

any person who traded during the relevant period, regardless of whether they purchased the securities from, or sold them to, the defendant.

5. Enforcement Provisions

(a) Criminal Offences:

FAIR Canada views the integration of the criminal offences into Part 5 of the CMSA as a positive development in that it may allow the CMRA to better contribute to the investigation of capital markets criminal offences.

(b) Modernization of Administrative and Regulatory Offences:

FAIR Canada supports the introduction of additional market conduct provisions which will allow regulators to have additional tools to combat fraud and other wrongdoing. We are supportive of such measures which include the unjust deprivation provision (section 63 of the proposed PCMA); benchmark manipulation provision (section 65 of the proposed PCMA); criminal breach of trust by dealers and investment fund managers (section 69 of the proposed CMSA); and the new evidence gathering tools (such as those set out in Part 11 of the proposed PCMA and Part 3 of the proposed CMSA in order to facilitate the investigation of criminal and quasi-criminal offences). We also welcome the inclusion of a provision prohibiting unfair practices (putting unreasonable pressure on another person to purchase, hold or sell a security or trade in a derivative (section 70 of the proposed PCMA)) (this will not be new for Saskatchewan or New Brunswick).

(c) Inclusion of a Whistleblower/Anti-Retaliation Provision:

FAIR Canada believes that whistleblower provisions are an additional tool to help detect investment fraud and other wrongdoing and that government and securities regulators should examine the potential for, and ideal structure of, a whistleblower program. As we noted in our recent fraud report, whistleblower programs have proved to be effective in other jurisdictions as they provide a new source of intelligence information.

Section 77 of the proposed PCMA and section 73 of the proposed CMSA both contain provisions which prevent reprisal against an employee for providing information to the CMRA or a law enforcement agency regarding an act of the employer, directors, officers, or other employees, that the whistle-blowing employee believes is contrary to capital markets law, or for testifying in a proceeding.

FAIR Canada recommends that there be further consultation on the best structure for a whistleblower program in Canada. While the provision is a step in the right direction, given the proposed provisions in the draft legislation, we question whether securities regulators will be willing or able to protect employees against retaliatory actions by their employer, especially those employees who are punished or disadvantaged in a less overt fashion (other than clear demotion or termination). As a result, we recommend that governments and securities regulators examine whether a reward-based regime such as the one operating in the United States would be more effective, or what other elements are required in order to make whistleblower protection as effective as possible. We also recommend that identity

protection for whistleblowers be considered, as this is another important element of a whistleblower program.

There are criminal sanctions provided for in the proposed CMSA for breach of this provision. There is no civil remedy or statutory cause of action set forth in either the CMSA or the PCMA. FAIR Canada recommends that such a cause of action be included.

6. Systemic Risk

Systemic risk is an investment risk that cannot be mitigated by individual investors or investment organizations through diversification strategies. Investors must therefore rely on regulators to ensure that this risk is appropriately mitigated.[16] As demonstrated during the last financial crisis, systemic risks can have devastating effects on the investing public and the broader economy and society as a whole.

The proposed legislation allows for the CMRA to designate any of the following as systemically important if their activities, material financial distress, failure or disruption can pose "systemic risk": institutions, benchmarks, and products (classes of securities/derivatives) and practices.

FAIR Canada urges securities regulators to be proactive in identifying practices and products that will likely cause harm to retail investors and could create systemic risks to the capital markets and financial system. To this end, regulators should include in their tool kit a range of options for addressing such products and practices, including prohibiting the sale of such products to individual retail investors, as has been prohibited by regulators in the UK.

7. Coordination with Other Regulators

FAIR Canada notes that the materials provided do not yet set out any details as to how the CMRA will interact with other provincial securities commissions. We expect these provisions will be published along with the draft regulations. FAIR Canada believes it is important that the regulatory system be designed so that it is efficient and effective, in order to fulfill its regulatory mandate. As such, it must provide for a swift and effective response to emerging and existing investor threats.

The proposed CMSA does refer to coordination. Proposed section 6(2) provides that "In fulfilling [its] mandate, the Authority must coordinate, to the extent practicable, its regulatory activities with those of other federal, provincial and foreign financial authorities so as to promote efficient capital markets, to achieve effective regulation and to avoid imposing an undue regulatory burden." FAIR Canada recommends that this proposed section be amended so as to also "achieve adequate protection of investors."

8. Investment Products that Are a Security

FAIR Canada supports a definition of "security" in the proposed PCMA that would allow the CMRA to regulate deposit and insurance based investment products, such as principal protected notes and segregated funds. Such products are generally caught by the definition of security but have been

[16] See the IAP submission on Over the Counter Derivatives Regulation for a further discussion of this point.

defined out of the term "security", even though the average retail investor likely views such products the same way they view securities – simply as "investments".

If all retail investment products were overseen by securities regulators, this would permit a consistent standard to be applied to the firms and individuals who recommend such products, including the disclosure rules on their sale and the know-your-product and suitability process (or, preferably, the statutory best interest standard) that must be carried out before they can be recommended. Such regulation at a consistent level would make sense since frequently these differing investment products are sold by the same "financial advisor" or the same entity, often through its bank or insurance affiliated arm.

As noted above, we make this recommendation on the assumption that it does not create jurisdictional issues with respect to constitutional law or, if it does, such issues can be resolved through the legislative architecture being used to vest the CMRA with powers derived from federal jurisdiction over bank products or provincial jurisdiction over insurance based products.

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

Sincerely,

Neil Gross
Executive Director, FAIR Canada

cc: William S. Rice, Chair, Alberta Securities Commission
Brenda Leong, Chair and CEO, British Columbia Securities Commission
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Peter Klohn, Chair, Financial and Consumer Services Commission of New Brunswick
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