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

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RE: TMX Consultation Paper on Emerging Market Issuers

FAIR Canada is pleased to offer comments on the Consultation Paper on Emerging Market Issuers (the "**Consultation Paper**") issued by the Toronto Stock Exchange ("**TSX**") and TSX Venture Exchange ("**TSX-V**") (collectively, the "**Exchanges**") regarding their review of their respective listing requirements applicable to issuers with a significant connection to an emerging market jurisdiction ("**Emerging Market Issuers**").

FAIR Canada is a national, non-profit 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.

Executive Summary

1. FAIR Canada is fully supportive of the Exchanges' Emerging Market Issuer review. FAIR Canada appreciates the Exchanges' undertaking of this initiative, as we believe that it is an important investor protection issue in Canada. FAIR Canada encourages Canadian securities regulators to work together with the Exchanges toward ensuring that the appropriate safeguards are in place to protect Canadian investors.

2. FAIR Canada does not believe that the Consultation Paper provides stakeholders with adequate information and perhaps reflects an absence of necessary research with respect to: (i) benchmarking to other jurisdictions' approaches to addressing issues related to Emerging Market Issuers; (ii) the history of listing Emerging Market Issuers in Canada; and (iii) statistical information regarding the amount raised in Canada by Emerging Market Issuers and their share price and market capitalization performance over time.

3. FAIR Canada does not believe that the Consultation Paper adequately addresses the difficulty Canadian regulators face in dealing with compliance and the requisite investigation of and enforcement action against Emerging Market Issuers.

4. FAIR Canada questions whether Canadian experts (investment dealers, lawyers, auditors and regulators) have appropriate resources and expertise available to conduct proper due diligence with respect to Emerging Market Issuers. Historically, due diligence for TSX- and TSX-V-listed Emerging Market Issuers has sometimes been conducted by underwriters, sponsors, lawyers and auditors with limited experience and expertise in the relevant emerging market.

5. In our view, Canada generally receives the lower-quality Emerging Market Issuer listings requiring greater due diligence and expertise.

6. FAIR Canada recommends that the TSX and TSX-V specify the resources, experience and expertise that a sponsor is required to possess in respect of the relevant emerging market. Additionally, where the management do not have relevant Canadian expertise, FAIR Canada recommends that sponsors should be required to have an ongoing relationship with the Emerging Market Issuer for a period of time (e.g. 2 years) to assist it with compliance with securities requirements.

7. FAIR Canada suggests that the TSX and TSX-V consider including Hong Kong as an acceptable jurisdiction in addition to those listed in the Consultation Paper.

8. FAIR Canada recommends that Emerging Market Issuers be required to have a minimum level of directors and officers insurance so that there is financial recourse available in the event of fraud or other non-compliance resulting in significant financial losses to investors.

FAIR Canada Comments

1. <u>FAIR Canada Supports Emerging Market Review</u>

1.1. FAIR Canada is fully supportive of the Exchanges' Emerging Market Issuer review. FAIR Canada appreciates the Exchanges' undertaking of this initiative, as we believe that it is an important investor protection issue in Canada. FAIR Canada encourages Canadian securities regulators to work together with the Exchanges toward ensuring that the appropriate safeguards are in place to protect Canadian investors.

2. <u>Consultation Paper Does not Reflect Adequate Research</u>

<u>Benchmarking</u>

2.1. In FAIR Canada's view, the Consultation Paper should have described other jurisdictions' approach to addressing the potential risks associated with listing Emerging Market Issuers. In particular, the TSX should have studied and described how Hong Kong regulates Emerging Market Issuers. The U.S. Securities and Exchange Commission's ("**SEC**") response to problems with Emerging Market Issuers should also have been discussed. In recent years, the majority of the problems with Emerging Market Issuers arising in Canada and the U.S. have been with Chinese Emerging Market Issuers. Hong Kong is the premier listing venue for Chinese Emerging Market Issuers and has had much greater success than exchanges in Canada and the U.S., raising far more money in IPOs and

secondary offerings and experiencing fewer scandals and problematic issuers. The Consultation Paper should have described why Hong Kong's experience has been far superior to Canada's.

History of Listing Emerging Market Issuers in Canada

2.2. We believe that the Consultation Paper should have discussed recent and historical problems with Emerging Market Issuers in Canada and in U.S. The TSX experienced similar problems with Chinese Emerging Market Issuers in the 1990s and with Emerging Market Issuers from other jurisdictions (including Semi-Tech, YBM Magnex, Noble China and South China Tire). The Consultation Paper should have discussed the regulatory problems that have arisen with various problematic Emerging Market Issuers in the past and more recent years. The Consultation Paper appears to largely focus on the problems associated with Sino-Forest Corporation, though this is not expressly stated.

Statistical Information

2.3. The TSX and TSX-V should publish information on the amount of money raised in Canada by Emerging Market Issuers over the past two decades or so and the performance of the Emerging Market Issuers (i.e. what is the value or return on capital raised in Canada by Emerging Market Issuers). What have been the costs and benefits of listing Emerging Market Issuers to the TSX and TSX-V to Canadian investors, the financial industry, and regulators? We expect that the data will show that Canadian investors have experienced negative returns and/or significant losses from investments in Emerging Market Issuers listed on the TSX or TSX-V. We expect that the regulatory costs (e.g. Sino-Forest, YBM, and Semi-Tech) have far outweighed any fees generated from the listings.

2.4. Ultimately the question should be asked whether Canada should be in the business of raising capital for Emerging Market Issuers, or whether the costs outweigh the benefits. Who wins (TSX and financial industry?) and who loses (investor and regulators?)? Is the damage to confidence in the integrity of our markets and regulatory system worth the benefits of listing Emerging Market Issuers?

3. Compliance and Enforcement

3.1. The Consultation Paper does not adequately address the difficulty that Canadian regulators face in dealing with compliance and the requisite investigation of and enforcement action against Emerging Market Issuers. It also does not discuss the costs incurred by regulators relating to Emerging Market Issuers.

3.2. The effectiveness of securities regulation is dependent on the ability of regulators to enforce compliance and to take effective enforcement action against persons who breach securities laws. Canadian-based issuers and their directors and senior management are required to comply with Canadian securities laws and, if they fail to do so, regulators can investigate and take enforcement action.

3.3. Experience has shown that Canadian regulators are often not able to mandate compliance, conduct proper investigations, or take effective enforcement action against Emerging Market Issuers and their directors and senior management. Furthermore, the investigations tend to be much more costly. In a speech at the Council of Institutional Investors Spring Meeting (April 4,

2011), SEC Commissioner Luis Aguilar noted in respect of "certain foreign companies abusing U.S. capital formation process" that

> …Enforcement against falsehoods in the context of these companies is difficult. The documents and people who have the information about the company and whether there was misconduct are often outside the reach of subpoena power. However, notwithstanding these obstacles, our staff is committed to doing everything they can with the resources we have. The SEC has already brought cases and will continue to do so.
>
> Nonetheless, investors should still be aware that the SEC and private plaintiffs may have a more difficult time enforcing their remedies and that recovery for investor losses could be limited. For one thing, the persons to punish and the assets that could satisfy a judgment may be located outside of the United States and harder to access. In addition, remedies obtained in the United States may not be enforceable in foreign countries, where the bulk of the assets might reside.
>
> The consequences of the growing problems in this area has real significance, because it has been reported that billions of U.S. savings and investment dollars have been entrusted with these companies.
>
> Finally, and to return to our earlier topic of capital formation, it's important to see the connection between capital formation and strong enforcement of securities laws. We have seen clearly that capital formation is improved with solid disclosures – but what happens when the disclosures are lies? That's when we need strong enforcement. Capital formation is strengthened when investors have confidence that the laws will be obeyed and that, when they're not, that the fraudsters will be made to pay. Moreover, strong enforcement – by providing deterrence - helps to ensure the disclosure is truthful and complete in the first place. Where savings and investments are allocated under inadequate or false information the environment for capital formation is negatively affected. That is why I've been a consistent advocate for a robust enforcement program and an adequately funded SEC. My hope is that potential fraudsters are scared into telling the truth to avoid the consequences.[1]

3.4. Benchmarking likely would demonstrate that Hong Kong regulators did not list Chinese Emerging Market Issuers until they had entered into regulatory cooperation arrangements with their counter-parts in China. It appears that the TSX and TSX-V promoted the listing of Chinese Emerging Market Issuers in the absence of adequate arrangements between Canadian and Chinese regulators to ensure the ability of Canadian regulators to investigate and take enforcement action.

4. Due Diligence

4.1. We question whether Canadian experts (investment dealers, lawyers, auditors and regulators) have adequate resources and expertise to conduct proper due diligence with respect to Emerging Market Issuers. Historically, due diligence for some TSX- and TSX-V-listed Emerging Market Issuers appears to have been conducted by underwriters, sponsors, lawyers and auditors with limited experience and expertise in the relevant emerging market.

4.2. At the same time the TSX is listing 3rd or 4th tier issuers who are in greatest need of in-depth due diligence.

[1] Commissioner Luis Aguilar, speech entitled "Facilitating Real Capital Formation" (April 4, 2011), online: <http://www.sec.gov/news/speech/2011/spch040411laa.htm>.

4.3. The highest quality Chinese issuers will list in China and Hong Kong. Hong Kong experts have the ability to undertake proper due diligence on Chinese issuers, directors and officers and controlling shareholders. As a general rule, issuers who are unable to finance and list in China and Hong Kong will seek financing and listing in Canada.

4.4. In essence, the TSX is listing the lower-quality issuers and due diligence is conducted by experts with limited resources and expertise in the relevant emerging market.

4.5. We do not mean that all Emerging Market Issuers are problematic or that Canadian issuers are free of scandal or non-compliance with securities laws. No doubt there are a number of emerging market companies that will be successful public companies. However the failure rate is far higher for Emerging Market Issuers.

4.6. The Consultation Paper sets out some of the problematic areas for Emerging Market Issuers. Another simple example is personal information forms ("**PIFs**"). The PIFs and related sources are much more useful when undertaking due diligence of directors and officers from Canada and other developed markets. The PIFs and related due diligence are unlikely to provide the same quality of information when they relate to persons located in emerging market jurisdictions. Hong Kong regulators have far better intelligence on directors and officers of Chinese issuers. In addition, Hong Kong Exchanges and Clearing Limited ("**HKEx**") has a listing committee composed of some forty practitioners who each have decades of experience and expertise in China. They are often able to identify problems other Hong Kong regulators may not be aware of with respect to directors, officers, and controlling shareholders (and with the business).

5. Sponsors

5.1. The TSX and TSX-V should specify the resources, experience and expertise that a sponsor is required to possess in respect of the relevant emerging market. Additionally, for issuers with senior management who are not familiar with Canadian capital markets and regulatory requirements, FAIR Canada recommends that sponsors should be required to have an ongoing relationship with the Emerging Market Issuer for a period of time (e.g. 2 years) to assist it with compliance with Canadian securities requirements.

6. Emerging Market Jurisdictions

6.1. TSX and TSX-V should consider including Hong Kong as an acceptable jurisdiction in addition to those listed in the Consultation Paper. We believe this based on the following factors:

- Hong Kong is a member of the IOSCO Technical Committee of regulators from developed markets.
- Securities regulatory legislation is broadly comparable to that of the U.K. and other Western jurisdictions.
- It provides corporate governance standards for listed companies that are broadly comparable to those in the U.K.
- English is an official language.
- The Securities and Futures Commission ("**SFC**") is a modern, efficient regulator that actively enforces compliance with securities laws.
- The OSC has regulatory cooperation arrangements with Hong Kong's SFC.

7. Financial Recourse

7.1. Emerging Market Issuers should be required to have a minimum level of directors and officers insurance so that there is financial recourse available to shareholders in the event of fraud or other non-compliance resulting in significant financial losses to investors.

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 Ermanno Pascutto at 416-214-3443 (ermanno.pascutto@faircanada.ca).

Sincerely,

Canadian Foundation for Advancement of Investor Rights