

2006

## Issues as an Impetus for Harmonizing Canadian Securities Law

Tabor Pittman

---

### Recommended Citation

Tabor Pittman, *Issues as an Impetus for Harmonizing Canadian Securities Law*, 12 LAW & BUS. REV. AM. 413 (2006)

<https://scholar.smu.edu/lbra/vol12/iss3/7>

This Comment and Case Note is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in Law and Business Review of the Americas by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# ISSUERS AS AN IMPETUS FOR HARMONIZING CANADIAN SECURITIES LAWS

*Tabor Pittman\**

THERE is currently heated debate in Canada about the state of its securities regulation framework. Much of the debate concerns whether Canada's multi-jurisdictional regulatory regime is an overall detriment to Canadian security issuers, investors, and the Canadian economy in general.<sup>1</sup> Canada's current securities regulatory structure is fragmented into thirteen distinct jurisdictions comprised of ten provinces and three territories.<sup>2</sup> Each jurisdiction derives its authority to regulate securities markets from the Canada Constitution Act, which empowers every province and territory to make laws relating to property and the incorporation of businesses within its borders.<sup>3</sup> The effect of this structure on Canadian securities issuers is that each issuer offering securities in more than one jurisdiction must comply with thirteen different sets of securities laws, none of which are identical.<sup>4</sup>

Proponents for regulatory overhaul have proposed various alternatives to remedy the problems many believe are caused by the current structure, including: (1) the recognition of mutual reciprocity of substantive securi-

---

\* The author graduated from Oklahoma State University in 2001 with a Bachelor's and Master's Degree in accounting. After graduation he worked as a staff auditor for one year each with the public accounting firms of Arthur Andersen, L.L.P. and PricewaterhouseCoopers, L.L.P. After working as an auditor for two years he worked at a Texas hedge fund for one year as a trade accountant. Subsequently, he attended Southern Methodist University Dedman School of Law to pursue a Juris Doctor degree where he is currently in his third year.

1. See generally Ryan R. Cox, Comment, *Canada: Governing the Future for Investor Confidence*, 38 INT'L LAW 971 (2004).
2. WISE PERSONS COMMITTEE, IT'S TIME, ch. 2, at 15 (Dec. 2003), [http://www.wise-averties.ca/finalreport\\_en.html](http://www.wise-averties.ca/finalreport_en.html). In 2003 the Canadian federal government formed the Wise Persons Committee to review the structure of securities regulation in Canada and make recommendations for the optimal securities regulatory structure for Canada.
3. Constitution Act, 1867, 30 & 31 Vict. c. 3 (U.K.), pt. VI (Distribution of Legislative Powers), § 92(11), (13); see BRUCE WELLING, CORPORATE LAW IN CANADA: THE GOVERNING PRINCIPLES 2 (Butterworths 1984).
4. ANITA ANAND & PETER KLEIN, THE COSTS OF COMPLIANCE IN CANADA'S SECURITIES REGULATORY REGIME 529 (2003), [http://www.wise-averties.ca/report\\_en.html](http://www.wise-averties.ca/report_en.html); see also ONTARIO SECURITIES COMMISSION BULLETIN, FIVE YEAR REVIEW COMMITTEE DRAFT REPORT—REVIEWING THE SECURITIES ACT § 1.2(d) (May 2002), <http://www.oscbulletin.carswell.com/bb/osc/bb/2522s/on2522s.htm> [hereinafter FIVE YEAR REVIEW COMMITTEE].

ties laws among regulators in the various jurisdictions combined with an initiative to harmonize securities laws across Canada;<sup>5</sup> or alternatively, (2) provincial and territorial relinquishment of securities lawmaking ability by ceding that authority to the federal government as chief securities regulator.<sup>6</sup> Even among those advocating some form of change, the viability of any particular alternative is itself somewhat divisive.<sup>7</sup>

At first glance, it seems obvious that Canada's regulatory system likely imposes unnecessary costs on security issuers.<sup>8</sup> For example, one study has shown that of the approximately 3,800 Canadian companies listed on the Toronto Stock Exchange, almost 1,200 were reporting issuers in each of the ten different provinces.<sup>9</sup> Moreover, almost 33% of Canada's 7,600 reporting issuers are reporting in more than one jurisdiction.<sup>10</sup> The costs of complying with multiple jurisdictional laws, coupled with the recent enactment in the United States of the Sarbanes-Oxley Act (with which Canadian companies trading on American exchanges must comply), have served as a catalyst for discussion among Canadian market participants about streamlining compliance requirements across Canadian jurisdictions.<sup>11</sup> Below is a discussion of some criticisms surrounding Canada's current regulatory framework and the perceived incremental costs it imposes on Canadian securities issuers. Next is an examination of the opposing view in support of the current system followed by a prediction of the future of Canadian securities laws.

## I. ARGUMENTS FOR HARMONIZATION OF CANADA'S SECURITIES LAWS

Canada's current securities regulatory structure has become the subject of various criticisms because of its lack of uniformity and harmonization.<sup>12</sup> Among the chief criticisms are that Canadian securities issuers incur both incremental pre-trading expenditures and opportunity costs as

- 
5. See CANADIAN SECURITIES ADMINISTRATORS, *BLUEPRINT FOR UNIFORM SECURITIES LAWS FOR CANADA 2-5* (Jan. 1, 2003), <http://www.cvmq.com/en/publi/FinalVersionUSLConceptProposal-English.pdf> [hereinafter *UNIFORM SECURITIES LAWS*]. The Canadian Securities Administrators, comprised of representatives from each regulatory jurisdiction, combined to propose Uniform Securities Legislation (USL) to be adopted across Canada. Under USL, each jurisdiction would practice reciprocity by allowing another jurisdiction's regulator to stand in the host jurisdiction's shoes and make regulatory decisions on its behalf.
  6. WISE PERSONS COMMITTEE, *supra* note 2, ch. 6, at 57.
  7. See generally Cox, *supra* note 1, at 995.
  8. See, e.g., Stephen Sibold, Submission of the Alberta Securities Commission to Joint Symposium of the TSE and the Capital Markets Institute on Canada's Securities Regulation System (Mar. 8, 2002), <http://www.rotman.utoronto.ca/cmi/march8.doc> (noting that the sheer number of regulators results in unacceptable costs).
  9. WISE PERSONS COMMITTEE, *supra* note 2, at 5.
  10. *Id.*
  11. See generally Ruth O. Kuras, *Harmonization of Securities Regulation Standards Between Canada and the United States*, 81 U. DET. MERCY L. REV. 465 (2004) (discussing internal harmonization of Canadian securities laws).
  12. DAVID JOHNSTON & KATHLEEN DOYLE ROCKWELL, *CANADIAN SECURITIES REGULATION 12* (2d ed. Butterworths 1998).

a result of Canada's fragmented structure.<sup>13</sup> Below is an overview of each of these criticisms.

#### A. INCREMENTAL PRE-TRADING COSTS

To demonstrate the incremental burdens borne by a Canadian issuer operating in a fragmented securities regime versus an issuer operating under a single securities regulator, it is helpful to start with a brief overview of the fundamental securities laws requirements that are common under both reporting structures. We will consider the regulatory framework in the United States as an example of a regulatory scheme operating under a single securities regulator. To begin, an issuer making a public securities offering under either regime is required to file a registration statement with its respective regulator, which must then become effective prior to selling the security to the public.<sup>14</sup> Likewise, public issuers in Canada and the United States are required to continually file reports updating their financial and operating status on a periodic basis.<sup>15</sup> Similarly, under either model, if a securities issuer wants to avoid the time and expense associated with the filings that accompany a public offering, it may do so only if it perfects an offering exemption pursuant to the relevant regulations.<sup>16</sup> By perfecting a registration exemption an issuer may offer and sell securities without filing a registration statement with the relevant securities regulator. In the United States, the Securities and Exchange Commission (SEC) is the chief securities regulatory authority; therefore, an issuer seeking to raise capital from investors in any state need only register with a single federal authority to comply with federal laws. Note, however, that a U.S. issuer may also be subject to dual regulation if state registration applies, but duplicative filing costs are largely minimal because much of a state's regulatory authority has been preempted by federal law.<sup>17</sup>

By contrast, Canada does not have a single regulatory authority equivalent to the SEC. Instead, Canadian companies must register in and comply with the laws of every jurisdiction from which they seek to solicit capital.<sup>18</sup> As a result, Canadian issuers usually incur two basic types of incremental costs that issuers operating under a single regulator avoid:

13. ANAND & KLEIN, *supra* note 4, at 522.

14. 15 U.S.C. § 77(e) (2006); *see, e.g.*, Securities Act, R.S.Q., ch. V-1 s. 24 (1964) (restricting trade in any security by an issuer prior to registration in Quebec); *see also* Marc I. Steinberg & Lee E. Michaels, *Disclosure in Global Securities Offerings: Analysis of Jurisdictional Approaches, Commonality and Reciprocity*, 20 MICH. J. INT'L L. 207, 212 (1999).

15. 15 U.S.C. § 78(m) (2006); Securities Act, R.S.Q., ch. V-1 s. 35 (1964) (requiring annual renewal of the registration statement).

16. 15 U.S.C. § 77(c) (2006); Securities Act, R.S.Q., ch. V-1 s. 28 (1964).

17. Steinberg & Michaels, *supra* note 14, at 228 (noting that Canadian pre-trading requirements are similar to those in the United States). Note also that securities offerings effected under Rule 506 of Regulation D, a widely used SEC rule that satisfies the Securities Act section 4(2) exemption, do not have to comply with state laws due to the Rule's preemptive authority. 17 C.F.R. § 230.506 (2006).

18. *See* Kuras, *supra* note 11, at 467.

(1) initial and continuous filing fees due each provincial and territorial regulator in every jurisdiction that the issuer solicits capital, and (2) the legal cost associated with learning and complying with substantive differences in the law between the various provincial and territorial jurisdictions.<sup>19</sup> At first glance, filing fees might seem to be an immaterial expense, but because the average Canadian issuer is much smaller than the prototypical American issuer the cumulative effect of these costs are often, in fact, material.<sup>20</sup>

Undoubtedly, the more significant cost results from an issuer having to learn and stay apprised of multiple provincial rules and regulations. Though the precise costs are generally difficult to ascertain, one study has indicated that the combined cost to issuers with securities trading on the Toronto and Venture stock exchanges may reach as much as \$14.2 million annually.<sup>21</sup> For instance, currently there are jurisdictional inconsistencies about what types of entities are required to be registered in a given jurisdiction.<sup>22</sup> Most provinces require registration when a person “trades in a security,” but some have a universal registration requirement applicable to every issuer, while others only require registration when a person “is carrying on business as a dealer or adviser.”<sup>23</sup> Moreover, as a preliminary matter, every potential registrant must research each jurisdictional definition of security to ascertain whether or not it is required to file there in the first place.<sup>24</sup> An example of a substantial difference in the definition is illustrated by comparing Ontario’s definition of the term security to British Columbia’s definition: Ontario includes in its definition an interest in a trust, whereas British Columbia does not.<sup>25</sup> One study designed to assess the incremental costs caused by multiple regulators indicated that up to 50% of total issuer time spent dealing with filings was attributable to Canada’s fragmented system.<sup>26</sup> The same study also found that Canadian securities issuers will forego their ideal offering structure, albeit reluctantly, in exchange for a sub-optimal format solely to avoid the incremental regulatory burdens inherent in Canada’s current framework.<sup>27</sup> Likewise, issuers seeking to offer securities pursuant to a registration exemption are faced with a similar obstacle of crafting the offering to satisfy

---

19. ANAND & KLEIN, *supra* note 4, at 525; *see also* Jeffrey A. Lehman, Note, *The Bre-X Stock Debacle: Why The Enactment Of Canadian Federal Securities Legislation Would Be Good As Gold*, 24 *BROOK. J. INT’L L.* 823, 836 (citing Bertrand Simon, *Canada Divided Over a Single Watchdog*, *FIN. TIMES*, May 26, 1996, at 23).

20. *See* Cox, *supra* note 1, at 975; *see also* ANAND & KLEIN, *supra* note 4, at 523.

21. CHARLES RIVER ASSOCIATES CANADA LTD., *ESTIMATING THE INCREMENTAL COSTS OF MULTIPLE SECURITIES REGULATORS IN CANADA* § 4.2, at 31 (June 30, 2003), *available at* [http://www.crai.ca/pubs/pub\\_3403.pdf](http://www.crai.ca/pubs/pub_3403.pdf) [hereinafter CRA].

22. *See* UNIFORM SECURITIES LAWS, *supra* note 5, at 15.

23. WISE PERSONS COMMITTEE, *supra* note 2, at 35.

24. *Id.* (noting that each province forbids trading in securities unless a registration statement is on file).

25. JOHNSTON & ROCKWELL, *supra* note 12, app. B, at 329.

26. CRA, *supra* note 21, at 31.

27. *Id.*

the technical exemption provisions of each jurisdiction.<sup>28</sup>

### B. OPPORTUNITY COSTS

Pre-trading costs aside, perhaps an issuer's most compelling reason to support a movement to harmonize securities laws in Canada stems from the opportunity costs associated with multiple filings. Opportunity cost in this context refers to costs incurred when business is lost or foregone due to the burdens appurtenant to multi-jurisdictional filings.<sup>29</sup> For example, to the extent practical finance savvy issuers will time an offering to correspond with favorable market conditions.<sup>30</sup> Thus, where additional filings or registration statement approvals cause delay, market windows may diminish resulting in a lower offering price and ultimately less capital per share to the issuer. In an interview conducted during one study focusing in part on opportunity costs, an issuer conducting an initial public offering expressly blamed "regulatory impediments" for causing it to restrict the scope of its offering and forego "an opportunity for growth."<sup>31</sup> In the same study, respondents indicated that a minimum of five additional days were required to complete registration due to multiple filings.<sup>32</sup> But perhaps an even more tangible loss occurs when an issuer opts not to offer securities in a particular province because of the burdens and costs associated with maintaining continuous regulatory compliance in that province.<sup>33</sup> Study participants have also indicated that if they had not been able to perfect an exemption in particular jurisdictions, they would have foregone seeking out investment in those jurisdictions due to regulatory burdens.<sup>34</sup> The bottom line is that although opportunity costs are inherently difficult to measure in terms of dollars because they are an unknown quantity, recent studies indicate that issuers perceive the current multi-jurisdictional framework as a negative force impeding their ability to raise capital in Canada.<sup>35</sup>

## II. ARGUMENTS FOR MAINTAINING THE STATUS QUO

There are two primary arguments routinely advanced for maintaining Canada's regulatory framework. Perhaps the most forceful argument supporting Canada's locally oriented securities regulation scheme is that local regulators are better situated to understand the needs of local issuers and investors and are thereby in a superior position to tailor regula-

---

28. ANAND & KLEIN, *supra* note 4, at 529.

29. *Id.* at 528.

30. Anita Indira Anand, *The Efficiency of Direct Public Offerings*, 7 J. SMALL & EMERGING BUS. L. 433, 444 (2003).

31. ANAND & KLEIN, *supra* note 4, at 522.

32. *Id.*

33. CRA, *supra* note 21, at 31.

34. ANAND & KLEIN, *supra* note 4, at 522.

35. *Id.* at 521 (analyzing opportunity costs in the context of business lost by market intermediaries that opt not to serve clients due to regulatory complications caused by multiple jurisdictions).

tions accordingly than a national regulator would be.<sup>36</sup> The second argument frequently cited is that the costs attributable to Canada's fragmented structure are practically immaterial and as such do not warrant a system-wide overhaul.

A. ISSUERS BENEFIT FROM CLOSE PROXIMITY WITH  
THEIR REGULATORS

Even proponents for harmonized laws acknowledge that there is some issuer benefit in having its regulator familiar with local markets.<sup>37</sup> For example, one study indicated that there are a substantial amount of unique infrastructures that support capital raising efforts for companies operating in local geographic regions, and that local regulators develop expertise within those regions to meet issuer needs.<sup>38</sup> Another study credits the proximity of the Alberta Securities Commission (ASC) to local issuers with enabling the ASC to identify a need for capital pool programs to assist small cap companies with raising funds in a local region.<sup>39</sup> The authors of the study are skeptical about whether a national regulator would have been so responsive to local issuer needs.<sup>40</sup> They also express concern that a single regulator may introduce unnecessary political pressures that could improperly influence Canadian issuers.<sup>41</sup>

Advocates of the current system also emphasize the benefits of local regulation in the context of Canada's market composition. To illustrate, the typical Canadian company has shareholder equity somewhere in the neighborhood of \$10 million.<sup>42</sup> Thus, it is argued that these small companies will inherently face trading discounts due to insufficient liquidity, and therefore require "more flexible and restrained regulation" to maintain an active trading market.<sup>43</sup> Likewise, small issuers have expressed concern that a large national regulator would pay more attention to larger companies with a greater public float.<sup>44</sup>

On the other hand, detractors from the local benefits school of thought argue that Canada's locally oriented structure is effectively "a balkanized approach to securities regulation that makes it more time consuming and expensive for issuers to raise capital across the country."<sup>45</sup> Moreover, proponents for change assert that local benefits can be preserved under a

36. See, e.g., Sibold, *supra* note 8, at 6; see also WISE PERSONS COMMITTEE, *supra* note 2, at vii.

37. FIVE YEAR REVIEW COMMITTEE, *supra* note 4, § 1.2(a).

38. POONAM PURI, LOCAL AND REGIONAL INTERESTS IN THE DEBATE ON OPTIMAL SECURITIES REGULATORY STRUCTURE 211-14 (Oct. 7, 2003), [http://www.wise-averties.ca/reports/WPC\\_6.pdf](http://www.wise-averties.ca/reports/WPC_6.pdf).

39. CECILE CARPENTIER & JEAN-MARC SURET, SECURITIES REGULATION IN CANADA § 3.3, at 60 (July 29, 2003), <http://www.cirano.qc.ca/pdf/publication/2003RP-12.pdf>.

40. *Id.*

41. *Id.*

42. *Id.* at 140.

43. *Id.*

44. *Id.*

45. FIVE YEAR REVIEW COMMITTEE, *supra* note 4, § 1.2(a).

regulatory model consisting of a national regulator with multiple local branch offices.<sup>46</sup> Another rebuttal lodged by harmonization proponents is that although an issuer may have its head office located in a given jurisdiction, its operation may expand across several provinces and therefore affect the economies of several provinces.<sup>47</sup> Hence, they argue that the magnitude of any benefit attributed to a local regulator having regional expertise lessens in favor of a consolidated regulator coordinating with multiple jurisdictions to protect investors while fostering capital formation.<sup>48</sup>

#### B. COSTS ASSOCIATED WITH MULTIPLE REGULATORS ARE LARGELY IMMATERIAL

Proponents of the current system maintain that incremental issuer costs associated with multiple regulators have been effectively mitigated by various technological advances and regulatory consolidation. For instance, in January of 1997 Canada launched its System for Electronic Document Analysis and Retrieval allowing securities issuers to make regulatory filings in a central location available to each province or territory.<sup>49</sup> Even more notable is Canada's implementation in 1999 of the Mutual Reliance Review System (MRRS), whereby an issuer submits its prospectus to a single principle regulator (usually located in the same jurisdiction as the issuer's principal office) responsible for collecting other jurisdictions' comments and resolving them with the issuer.<sup>50</sup> The practical effect is to relieve the issuer from having to coordinate with multiple regulators, thus reducing unnecessary duplication of regulator comments regarding an individual issuer's registration statement.<sup>51</sup> Another ramification of MRRS has been to induce local regulators to rely on the principal regulators located in other provinces, thereby resulting in fewer levels of review.<sup>52</sup> Feedback from participants about MRRS has been largely positive and has likely mitigated some of the costs associated with Canada's multi-jurisdictional framework.<sup>53</sup>

Despite the warm reception given MRRS by marketplace participants, it has some significant limitations. First, it only applies to prospectuses, annual information forms, and exemptive relief applications; it does not apply to entire registration statements.<sup>54</sup> Further, reliance on the principal regulator is purely optional, and each province retains the right to perform a full review of any documents submitted by an issuer.<sup>55</sup> In fact,

---

46. CRA, *supra* note 21, at 7, 35.

47. PURI, *supra* note 38, at 214.

48. *Id.*

49. System for Electronic Document Analysis and Retrieval Homepage, [http://www.sedar.com/sedar/background\\_on\\_sedar\\_en.htm](http://www.sedar.com/sedar/background_on_sedar_en.htm).

50. FIVE YEAR REVIEW COMMITTEE, *supra* note 4, § 1.2(a).

51. *Id.*; see also CARPENTIER & SURET, *supra* note 39, § 1.3.1, at 25.

52. CARPENTIER & SURET, *supra* note 39, at 25.

53. See CRA, *supra* note 21, at 30 n.46.

54. *Id.*

55. FIVE YEAR REVIEW COMMITTEE, *supra* note 4, § 1.2(d).

studies have shown that some non-principal regulators, despite the option to rely on the principal regulator, often engage in full re-examination of prospectuses thereby significantly diminishing the benefits of MRRS.<sup>56</sup> Another drawback is that while MRRS compels jurisdictional reciprocity to some degree, it does not eliminate the filing or continuous reporting fees due each jurisdiction from the issuer.<sup>57</sup> Lastly, MRRS may be largely ineffective for initial public issues of novel instruments where each provincial regulator continues to scrutinize offering details.<sup>58</sup> Thus, those types of issuances remain subject to “conflicting requests for modifications and delays.”<sup>59</sup>

Setting aside technological and regulatory advances, study results have shown that the actual substantive disparity in securities laws among regulatory jurisdictions is much less than proponents for harmonization perceive.<sup>60</sup> Similarly, the aggregate results taken from several case studies focusing specifically on incremental costs associated with compliance have shown those costs to be immaterial, with the possible exception of incremental compliance costs on initial issuers.<sup>61</sup>

### III. ISSUERS AS AN IMPETUS FOR HARMONIZATION

Canada is likely to implement some form of securities laws harmonization in the near future. There are several compelling forces that will likely bring about some form of harmonization in Canada’s regulatory framework, not the least of which is issuer requests for a more efficient market.<sup>62</sup> Participating issuers in one particular study indicated “a deep level of frustration with the current regime.”<sup>63</sup> As we have seen, issuers bear the burden of complying with multiple securities regulators whether they are registering a secondary offering, engaging in an initial public offering, or perfecting an exemption.<sup>64</sup> Moreover, the strongest argument for maintaining the status quo, namely that the local nature of Canada’s structure better serves Canadian issuers and investors, is mitigated by recent studies confirming that those benefits can be maintained without the duplication of efforts inherent in a fragmented system.<sup>65</sup> Further, the proposal for Uniform Securities Laws contains specific provisions designed to preserve the benefits appurtenant to local regulatory authorities.<sup>66</sup> Hence, at least with regard to issuers, the arguments for securities laws reform in Canada probably outweigh the arguments for maintaining

---

56. CARPENTIER & SURET, *supra* note 39, at 32.

57. *Id.*

58. CRA, *supra* note 21, at 30.

59. *Id.*

60. CARPENTIER & SURET, *supra* note 39, at 33.

61. ANAND & KLEIN, *supra* note 4, at 553.

62. WISE PERSONS COMMITTEE, *supra* note 2, at 10.

63. ANAND & KLEIN, *supra* note 4, at 522.

64. *Id.* at 522-23.

65. PURI, *supra* note 38, at 249.

66. UNIFORM SECURITIES LAWS, *supra* note 5, at 5, 15 (allowing for each jurisdiction to enact local rules where needed).

the current structure. Barring severe resistance from local governments, Canada will likely undergo some form of change soon.



# **Point-Counterpoint Perspectives**

