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Commission

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MAIL AND E-MAIL

Five Year Review Committee
j Purdy Crawford, Chair
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Dear Committee Members:

The following is the submission of the Nova Scotia Securities Commission on the draft report of your Committee dated May 29, 2002. The submission is made by chapter and for the most part by recommendation.

Chapter 1: The Need for a Single Regulator

Recommendation 1

It is not surprising that the Committee would arrive at this recommendation. There can be no doubt that a single regulator administering uniform or a single securities law would produce market efficiency and reduce professional fees incurred by market participants. However, it is less clear that the burden of regulatory fees would be significantly reduced in view of the modest fees charged by nine of the thirteen provincial and territorial regulators.

This recommendation would be strengthened by empirical data which quantifies the cost efficiencies which would be achieved by its implementation thereby allowing governments to determine A whether the prize is worth the fight.@

In order to quantify the cost efficiencies necessitates that the Committee recommend the approach and structure which should be adopted. Without the structure being known, it is not possible to quantify the benefits. The Committee=s position varies little from that of the TSX and IDA, both of whom advocate national regulation but recoil from the difficult task of suggesting the design of the structure.

The Capital Markets Institute at the University of Toronto has undertaken a project to quantify regulatory costs of the current system but that alone will not suffice to allow the benefits which are to be realized by a new unknown system to be quantified.

The NSSC further suggests that the Committee consider whether the most effective and efficient strategy for achieving a single regulator regime is an incremental approach based upon uniform legislation and delegation. This approach would build a platform from which a single regulator model would naturally evolve, would achieve short term efficiencies and would allow the CSA to remain focussed on its primary responsibility rather than being distracted by the monumental task of moving directly to a single regulator model.

Recommendation 2

The NSSC supports this recommendation and would point out that it has had rule making authority since 1996 allowing it to delegate to other regulators in other jurisdictions. It has been frustrating that other jurisdictions do not have the authority to accept the delegation. This is particularly so with respect to Ontario which is highly critical of the *status quo* but which has made no effort to move in this significant and important area.

The NSSC also suggests, for consideration of the Committee, the following to enhance the effectiveness of the CSA:

1. Prudent Imperfection/Incremental Policy Development - In its quest for perfect solutions the CSA tends to delay the implementation of change until, on occasion, the event which precipitated the need for change, ceases to be topical. An approach which would seek practical, if not perfect, solutions would greatly improve the CSA process. Because CSA policy development is frequently delayed there is a

tendency to override policy development by granting discretionary relief. This is an undesirable way to implement policy change as the OSC itself has acknowledged in a number of decisions. To avoid this it is critical that the CSA policy development process be made more efficient.

2. Deemed Compliance - Considerable compliance costs could be removed from the Canadian securities regulatory process if CSA were to adopt an approach whereby home jurisdiction compliance would be deemed to be host jurisdiction compliance. For example, the NSSC has proposed a system whereby a reporting issuer which complies with the requirements of its home (principal) jurisdiction vis-à-vis continuous disclosure would be exempt from the Nova Scotia requirements. No CSA jurisdiction has repudiated this concept yet none has endorsed it from a practical perspective.

Chapter 3: Securities Regulation - Only Part of the Capital Markets Picture

The Committee recommends that there be a single prudential regulator in Canada. It would be helpful if the Committee clarified whether the prudential regulator would also be responsible for the prudential regulatory component of dealer regulation and if so, whether this addition of a new regulator in the dealers= arena would be helpful.

Chapter 6: Rulemaking

Basket Clause

The basket clause recommendation would align the OSA with the NSSA amendments enacted in 1996.

Ministerial Approval

The NSSC would urge the Committee to give consideration to not only reducing the period for Ministerial approval but also to address the apparent reason for the Ministerial approval requirement. The OSC rule making process is replete with requirements to ensure transparency. The Ministerial approval process should be concerned with adherence to the transparency requirements. Instead, in some instances (for example the financial planners rule), it is being used by lobbyists to A unmake@ or Aremake@ the Commission=s decision. In other words, a second opportunity to influence decision making which has already been subject to considerable transparency. There can be no

question that democratic principles require that the Commission be subservient to the Government. However, the process by which it is achieved ought not to be the Minister=s veto because the Minister=s decision is not subject to the transparency to which the Commission=s decision is subject. Rather, the process by which the policy decision should be dealt with is through the Governor-in- Council=s regulation making authority. This is not a suggestion for change in the legislation but rather a suggestion that the Committee comment on this matter.

Blanket Orders

Blanket orders are relieving in nature. In that context it is difficult to understand why they should be subject to a sunset period. The alternative to a blanket order is a series of orders issued in individual applications. There is no restriction on the number of applications which the Commission can consider and with respect to which it may grant relief. Therefore, there should be no restriction on blanket orders. The sunset period proposal adds inefficiency which the Committee purports to abhor.

The NSSC has jurisdiction to grant blanket orders as do a number of other securities regulators in Canada.

Refused Exemption Orders

The jurisdictional basis for exemption orders is largely based on the Commission=s perception of the public interest and the granting of the order not being contrary or prejudicial to that interest. There is no entitlement to the order. For that reason, under the NSSA the refusal to grant an exemption order of any type is not appealable. Of course it can be attacked on administrative law grounds.

Under OSA the refusal to grant a discretionary order is appealable, other than an exemption order under section 74, and as such a record of proceedings is required to be maintained and reasons for the decision must be given.

Rather than urging the Commission to give reasons for refusing discretionary orders which are required in any event except for section 74 applications, it is submitted that the Committee should be recommending the elimination of the appeal right from the refusal to grant all discretionary relieving order. The Courts are ill-equipped to consider Commission decisions which are based on the public interest in the context of exemption applications.

Chapter 7: The Impact on the Internet

Security Issuer Dealer Category

The NSSC agrees with the recommendation that there be a registrant involved in Internet offerings. However, the recommendation is, it is submitted, confusingly articulated. A registered security issuer is a dealer. It is suggested that the recommendation be restated to provide that an underwriter independent of the issuer be involved.

The security issuer dealer category originally was designed to accommodate remote junior mining company issuers. The accommodation is no longer required. To use it for Internet offerings is disconnected from its original purpose and is a classic example of Ashoe horning@ antiquated law into the modern era.

Chapter 8: Registration

The Committee couples, as is not unusual, the Aknow your client@ and Asuitability@ rules. The know your client rule was historically focussed on the protection of the dealer and its solvency. Since September 11/01 it has become even more important that this rule be maintained as a requirement independent of suitability. This is the basis for effective anti-money laundering initiatives. The BCSC has invoked this rule in the last couple of years for just such a purpose.

Chapter 9: Self-Regulation

Required Recognition of SROs

The NSSC strongly urges the Committee to reconsider its recommendation for the following reasons:

1. Any organization of registrants which seeks to establish standards for its members should not be discouraged. The restriction should be that its members not be permitted to leverage off of the standards in marketing where the standards and their enforcement are not subject to statutory regulatory oversight as is the case with an SRO.
2. The members of the organization in question may be a subset of members of an SRO. The recommendation has the potential to create competition which, in and by itself, is not necessarily bad, but would place the statutory regulator in the position of having different legislated standards for registrants who perform the same regulatory function. Different standards result from the legislative requirement that the members of an SRO must, as a matter of statute, adhere to its standards. For example, dealers in mutual

funds who are not investment dealers must be MFDA members. If those dealers or their employees wish to establish an association which has standards which exceed those established by MFDA, there should be no reason to deny them the ability by requiring them to seek SRO status.

SRO/Trade Association Conflict

Although the Committee=s recommendation that the trade association function of the IDA should ideally be separated from the SRO function has logical merit and in fact was advocated by the IDA a number of years ago, the IDA has significantly improved its regulatory role in the last few years. In the circumstances, and in view of the significant advances recently made by the IDA, the NSSC would urge the Committee to consider whether this is the appropriate time, on a cost-benefit analysis, for the securities industry to undergo such a radical change.

A more topical aspect of the SRO system upon which the Committee=s views would be useful, is whether there should be only one SRO in Canada responsible for dealer regulation supported by a single compensation fund.

Chapter 12: Disclosure Standards

The Committee relies heavily on the Exchange requirements in concluding that reform is not necessary in this area. The Committee has not focussed on unlisted reporting issuers. It would be helpful if the Committee clarified whether the unlisted issuer market should be subject to different rules than the listed issuer market.

Chapter 14: Financial Statement Issues

Financial Institutions and GAAP

The NSSC encourages the Committee to consider the following:

1. A prudential regulator override bifurcates the market between those institutions which are SEC registrants and those which are not since the former would not have the benefit of the override. This was illustrated by the direct retained earnings charges in the situations referred to by the Committee. Only non-US listed issuers used it.

2. If prudential regulator systemic concerns can override investor concerns, investors are losing the benefit of disclosure at precisely the time which is the most important to them. If such is to be the case, significant investor

education should be undertaken to ensure that the significance of this is understood in the investor community. Certainly the business press did not seem to have an appreciation a few years ago when the retained earnings charges were accessed by three institutions.

Chapter 17: Mutual Fund Governance

Governance Reform and Prescribed Restrictions

Quid Pro Quo

A large component of the mutual fund industry has reacted to the mutual fund governance concept proposal by demanding, what it calls, a *quid pro quo*. The NSSC has strong views on this matter.

It is a dangerous precedent for statutory regulators to succumb to industry demands that there be trade-offs for new regulatory requirements. Regulatory reform should serve a purpose and not come at an expense to investors.

The NSSC has long supported, and in fact advocated, mutual fund governance reform for years before its colleagues recognized the need for reform in this area. The NSSC has taken the position that mutual fund governance reform is needed precisely because the conflict of interest rules are currently both too restrictive in their absolute prohibitions and unsatisfactory in the relief structure.

Currently, statutory regulators are empowered to grant relief on a case by case basis. However, statutory regulators are ill equipped to determine when relief ought to be granted. A more reasonable approach is to put conflicts management in the hands of an independent governance body whose members are independent and who have liability for their decisions. The NSSC does not view this as a *quid pro quo* but rather a reason for an independent mutual fund governance body.

On the other hand, the mutual fund governance concept proposal has no relevance to a number of other mutual fund rules which define the very essence of a mutual fund to the retail investor. Two such examples are the liquidity and the concentration rules. Canadians invest in mutual funds because of their liquidity and diversification. A governance body adds nothing to liquidity and diversification that the manager itself could not bring to the matter. If these rules make sense in a non-governance body environment, they make equal sense in the context of a governance body environment. The NSSC believes that they make sense in the current context. Therefore they ought not

to be changed. The NSSC urges the Committee to comment on this issue.

Removal of Managers

The NSSC believes that the Committee=s recommendation that the governance body have the authority to terminate the mutual fund manager will encounter considerable resistence from the industry. This is not a reason to abandon the recommendation but we believe that the recommendation is subject to reasonable criticism and that there is a more efficient way in which to achieve the objective.

The criticism is that it is unreasonable that a manager be terminated by surrogates (body members) who themselves are not elected by the unit holders albeit that they must have the unit holder=s best interest in mind.

The NSSC believes that a more balanced and effective remedy would allow unit holders to ultimately be the decisions makers. However, experience has indicated that this remedy, on a corporate basis, would be ineffective because by its nature, a mutual fund is widely held and does not have institutional investors. Therefore, to give practicality to the remedy requires that it be an individual investor=s decision.

The individual investor=s decision model would rely on the investor=s right to redeem his or her units without cost in circumstances where the Committee=s model would have terminated the manager. To make this meaningful, in these circumstances, the manager would be responsible for deferred sales charges. When the units were sold on a front end load basis the manager would be responsible for reimbursing the investor for a portion of the front end commission based on the deferred sales charge formula.

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The NSSC=s comments have been limited to those matters which it believes to be of particular importance from the perspective of a small jurisdiction and securities regulation in Canada generally. The NSSC appreciates the opportunity to make these submissions, commends the Committee for the thorough, thoughtful and sensitive approach which it has taken to recommending improvements in the Canadian securities regulatory system and recognizes the immense contribution of Ontario and the OSC to Canadian securities regulation.

Respectfully submitted,

Robert B. MacLellan, Chairman