Towards More Encompassing Rules: Globalization and Securities Regulation in Canada

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I. Introduction

What do we mean by "globalization" in relation to "securities regulation in Canada"? "Securities regulation in Canada" is the setting of rules in the making of markets in Canadian debt and equity securities. "Globalization" is more problematic: to the extent that the concept has become overworked and vague as it has gained cachet in journalese, we do well to consider how it applies for our present purposes. One source defines "globalize" as "… to develop or be developed so as to make possible international influence or operation".[1] Another defines "globalization" also in a value-neutral sense, as "the action or an act of 'globalizing' which is further defined, in a question begging way, as to "make global'.[2] A third defines "globalist" as someone who thinks in terms of the well-being of the world as a whole or promotes sensitivity to global political issues in others.[3] I prefer a broad amalgam of definitions 1 and 3: to develop or cause to be developed for the benefit of possible international influence or operation. Globalization in this sense is generally considered to be a good thing.

There are arguably three leading sets of rules, actual and proposed with globalizing underpinnings which the securities generalist should know about, which apply or could apply to Canadian securities regulation: (1) recourse by issuers and securities regulators to norms of the International Accounting Standards ("IAS") in Canada;[4] (2) The Multijurisdictional Disclosure System ("MJDS")[5] as it relates to Canadian issuers seeking access to the U.S. capital markets; and (3) the

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[1] New Dictionary of English (Oxford: Clarendon Press, 1998).

[2] Shorter Oxford English Dictionary (Oxford: Oxford University Press, 1998).

[3] Dictionary of English (Cambridge: Cambridge University Press, 1996).

[4] See U.S. Senate Committee on Banking, Housing and Urban Affairs Washington D.C Statement of Sir David Tweetie February 14, 2002.

[5] Paul Weiss Law Firm paper, "The Multijurisdictional Disclosure System After Eleven Years" and *The Securities Act of 1933* (Aspen Publishers: New York, 2003) and *The Securities Act of 1934* (Aspen Publishers: New York. 2003). The mirror image of

Uniform Securities Law proposal of the Canadian Securities Administrators.[6]

II. International Accounting Standards in Canada

The IAS are quite clearly 'developed or causing to be developed for the benefit of possible international influence or operation'. The influence or operation is actual rather than possible. What is the IAS? IAS is the distinct body of accounting rules developed and administered by the International Accounting Standards Board (IASB) based in London. The rationale of the IAS is coterminous with the rationale for the IASB. Firstly, the large number of differing sets of national accounting standards create ambiguity as to which standard ought to apply when there is a choice between the "home" jurisdiction and the "foreign" jurisdiction. IAS represents the lowest common denominator.[7] Secondly, while the United States GAAP is the archetypal accounting reporting system based on a detailed rule-based approach to accounting standards, it does not follow that such a system always produces the best individual rules or even a set of accounting rules. The IAS standards are designed to be interpreted broadly for their spirit and purpose, not gleaned for loopholes,[8] as the Enron debacle well illustrated. Thirdly, no national accounting body has worldwide ascendancy. International standards must be set by an international group with an international outlook.[9] Fourthly, it commonly occurs that a national arbiter of accounting rules finds it difficult to act alone on a matter. An inclination to take the toughest position on an issue often results in putting those subject to that standard at an unfair competitive disadvantage vis-a-vis those subject to a foreign body of rules.[10] IAS differs in many respects from Canadian GAAP[11] – IAS being rarely seen in Canada or Alberta. Most practicing accountants, let alone lawyers, are dimly aware of them. The IAS will catch on in two scenarios: firstly, IAS is potentially useful in cases of say, an Icelandic company seeking to raise money in Alberta through a sale of shares – IAS stands out as a common denominator between Icelandic GAAP and Canadian GAAP and conversely, for a Canadian company seeking

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Canadian MJDS for U.S. issuers is not considered here.

[6] Uniform Securities Law proposal, proposed National Instrument 21-101, Canadian Securities Administrators.

[7] U.S. Senate Committee on Banking, Housing and Urban Affairs, statement of Sir David Tweetie, February 14, 2002.

[8] *Ibid*.

[9] *Ibid*.

[10] *Ibid*.

[11] See for example, GAAP 2001: A Survey of National Accounting Rules, Section 3, Country Summaries, Canada.

to raise money in Iceland. Secondly, and more importantly, IAS represents a useful 'lingua franca' of accounting where a company has extensive international operations. It is extremely unwieldy bordering on the impossible to juggle nine or ten national GAAP's in one, say, annual report. It is clear that the reach of IAS will gain scope to the extent that capital markets themselves globalize, which they are, and at a faster pace than globalization of securities regulation. The cooperative Norwalk arrangement between United States FASB and the IASB in September 2002[12] point the way to increasing recourse to IASB in the United States. As the United States becomes accustomed to use of IASB in cross-border transactions or for United States companies acting abroad, there should be a trickle-down effect in Canada.

III. Multijurisdictional Disclosure System (MJDS)

The MJDS between Canada and the United States ranks among the most important bilateral issuer-to-regulator securities instrument in the world. It has proven enormously popular in Canada – over two hundred Canadian issuers have had recourse to it since its inception in 1993.[13] The MJDS represents a first-order globalizing instrument insofar as Canadian companies use it to enable securities undertaking in the United States through a document prepared in accordance with Canadian rules and GAAP. The MJDS was jointly enacted by the SEC for Canadian registrants in the U.S. and by National Instrument 71-101 for American registrants in Canada. The MJDS lowers the mutual barriers to the United States and Canadian capital markets by enhancing the liquidity of the capital markets by permitting issuers in one country to make offerings in the other country while remaining under the regulatory authority of the country of origin. Of relevance to Canadian issuers are the provisions of the United States MJDS. The MJDS in the U.S. is implemented through several[14] layers of forms to bring Canadian registrants inside the ambit of United States securities regulation. For clarity, it makes sense to walk the reader through the steps involved in getting registered under the United States securities laws. Let us assume the Canadian issuer wants to qualify for United States continuous disclosure under MJDS. Filing SEC Form 40-F enables Canadian issuers intending to use the MJDS to file its Canadian continuous disclosure documents with the SEC to become registered under the Securities Act of 1934, and exempt from the American

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[12] IASB Insight, October 9, 2002.

[13] Paul Weiss occasional paper, The Multijurisdiction Disclosure System (unpublished), p.5

[14] *Ibid*.

continuous disclosure rules. At the same time, the issuer may 'wrap' the American law around its Canadian annual information form. For S.E.C. purposes, the Canadian issuer must have a 'public float' over $75 million U.S. and one year's standing as a reporting issuer in a Canadian jurisdiction. Canadian companies must reconcile their financial statements with U.S. GAAP.

It is appropriate in this connection to consider the impact of the Sarbanes-Oxley Act on MJDS. Prima facie, it affects United States listed companies and exempt foreign issuers. This appears to exclude MJDS issuers, who are not listed in the United States and are not exempt issuers (they are registrants under the *Securities Act of 1934*).

From a Canadian perspective, the MJDS marks a significant breakthrough in the globalization of securities laws. As already noted[15] since July 1, 1993, over 200 Canadian companies have applied for MJDS. This represents on the one hand a significant fraction of the total pool of Canadian companies that could take advantage of it over a ten-year interval. There is little reason why it should not get extended to other capital markets, much like Canada's tax treaty network, but for the fact that the United States market is a colossus tending to overshadow every other market. From an American perspective, the MJDS looks quite different. Canada is insignificant as a source of capital for U.S. companies. Even the very largest Canadian companies – those which represent significant aggregations of capital in Canada – represent at best middling companies on the list of say, the New York Stock Exchange. Finally, there is an overarching, nagging fairness concern from the SEC's viewpoint that Canadian issuers making Canadian filings with Canadian securities regulators are being let off lightly, compared to the corresponding obligations of similarly sized American firms. One must reluctantly conclude that MJDS's days in its present form are numbered. One would hope that this paragon of globalization would not be snuffed out for parochial reasons, such as the perverse notion that the American capital market is primarily for the benefit of Americans.

IV. Blueprint for a Uniform Securities Law (USL) for Canada

In March 2002, the Canadian Securities Administrators ("CSA") gave the go-ahead to the USL Study Group under the aegis of the ASC to draft and solicit public comment on the USL. Implementation on a Canada-wide basis is the ASC's top priority. On January 30, 2003, the Study Group came forward with its initial proposal and request for comments by April 30, 2003. It should be borne in mind that the CSA-

[15] *Supra* note 12.

sponsored interprovincial initiative does not have the field to itself: thus the federal government's Ministry of Finance has nominated Michael Phelps to chair the so-called "Wise Persons" Committee to go over much the same ground and the same globalization motivation that prompts the CSA committee. At the back of the "Wise Persons'' agenda is the notion of some form of national securities regulator, which is certainly –to put it mildly – not a central aim among the intentions of the CSA committee. Secondly, there is some dissension in the ranks of the provinces on priorities. British Columbia regards consolidation of financial services legislation into an omnibus bureau as its first priority, ahead of the USL project. It is significant that British Columbia has not pulled out of the USL project, as a tacit admission that the interprovincial initiative is compatible with British Columbia's aims. Not surprisingly, Québec's position is up for grabs. The outgoing Parti Québécois government championed a consolidation of Québec financial services regulation under one roof, similar to British Columbia. The new Liberal government has not yet made known its stance and priorities in this area, and may do well to await the National Assembly. Finally, the provincial governments are themselves appointing persons to consider the issue of financial services regulation on a provincial level. The USL group contends that regardless or perhaps in view of these three initiatives, a comparative study and harmonization is a valuable contribution to the ongoing discussion.

How, then does the USL committee's project relate to globalization, given that it is not acting in a policy vacuum? Taken as a body of rules, the aim of the project is to harmonize rules on a national, or better, interprovincial level. The intended result is to make provinces conform to a common interprovincial set of rules in place of the parochial provincial rules we have come to know. The USL as a whole implies a methodology for aggregating securities rules and potentially forms a basis for global securities regulation in the future.

How is this document and process relevant to securities law globalization? Taken as a corpus of rules, the motivation of the entire document is to harmonize securities laws at an interprovincial level. The result is a tangible step in the transfer of authority to enact securities rules from the provincial to the national level. The USL as a whole also implies a methodology for aggregating securities rules, and forms a basis for global securities legislation in the future. The key methodological concept is a "platform". The "platform" is the common denominator USL rule which operates in all Canadian jurisdictions. Through the appropriate national instrument, an issuer may opt to file under the "platform" provision of the projected CSA national instrument. It is not clear whether an issuer could opt out of the USL if

it chose to do so, and even less, why it would want to. The USL group scrutinizes the existing rules of Ontario, Québec, Alberta, Manitoba and British Columbia and synthesizes them into a uniform rule. Sometimes the rule is the result is a creative synthesis of an existing rule; otherwise it is the common rules of the provinces taken as a whole. It is this commonality and interprovincially binding character of USL rules which permit the Securities Regulatory Authority (SRA) of first instance, on the one hand to retain all or none of its jurisdiction over the matter and on the other hand to delegate all or none of its jurisdiction to fellow Canadian SRA's. It is more efficient in complex factual situations to have interprovincial delegation of powers. The USL thus ensures harmonization, while leaving room for local interpretation and application of the rules.

Given that consent by the "home" province to have the issuer's filing recognized interprovincially, opting out by the provinces on a case-by-case basis could undermine the intent of the USL. Some provinces can be expected to be more protective of their turf than others. To an extent not foreseen by the USL Study Group, the USL Project implementation is critically dependent on a considerable degree of good faith among the participants. The USL proposal goes a long way towards rectification of what Dr. Jeff MacIntosh of the University of Toronto Law Faculty termed the "thirteen headed hydra' of Canadian securities regulation.[16] Under USL, the heads of rules are in common. To the extent that inefficient distribution or the complete lack of powers by provincial SRA's is one of the main underpinnings of the argument for a federal regulator, it follows that the USL removes the thrust in some quarters for a national securities regulator. By the same token, however, it could be argued that the trend of globalization of securities rules favours a federal body incorporating the USL, which would be superior overall to a provincially-based USL.

To impart a sense of the undertakings of the USL in harmonizing provincial legislation, it is appropriate to examine some typical findings of the Study Group. The impact of harmonization on the so-called "closed system" is a worthwhile undertaking. Our present-day "closed system", as it is sometimes called, provides that an issuer seeking to sell securities to the public in a given jurisdiction must either file a prospectus or avail itself of a prospectus exemption. The rules vary in many respects between provinces. The authors wryly observe that the amount of regulatory effort devoted to prospectus distributions relative to continuous disclosure is that of the proverbial tail wagging the dog.[17]

The Study Group found that the Prospectus Requirements of

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[16] *Financial Post*, June 6, 2002, p. 15.

[17] *Ibid*.,V.

the various provinces under consideration are fairly uniform and can be considered "harmonized" already.[18] The same cannot be said in regard to the prospectus exemptions.[19] The exemption rules are clearly central to the prospectus regime, and vary widely among the provinces. Thus the USL Study Group says, "The USL would reconcile Alberta and British Columbia's capital raising exemption contained in the Multilateral Instrument 45-103 with O.S.C. rule 45-501 and the regime in Québec."[20] Clearly, not all of the USL Study Group's task lies behind it. Turning to specific exemptions, the prescribed minimum amount when the purchase price for securities is higher than a prescribed minimum, appears to be on the way out, supplanted by the "accredited investor" exemption and the offering memorandum ("O.M.") exemption.[21] The accredited investor exemption already exists in Alberta, British Columbia and Ontario. An accredited investor is an institutional investor or a high net worth individual. The Ontario version is likely to be adopted as part of USL holus-bolus.[22] The private issuer exemption adverts to no more than 50 beneficial security holders in a jurisdiction who meet a "close relationship" test. This test has always been a fairly loosely defined concept, which the USL Study Group indicates is likely to be replaced by OSC rule 45-101, the closely held issuer exemption. This exemption enables an issuer to raise up to $3.0m so long as it has no more than 35 beneficial securities holders.[23] The discussion relating to family, close friends and business associates in the USL is somewhat ambiguous in the light of the O.M. and accredited investor exemptions.[24] The O.M. exemption in Alberta and British Columbia (NI 45-103) permits an issuer to issue securities to an unlimited number of persons under the O.M. without being a registrant. All other provinces, except Québec and Ontario, have MI 45-103 under review. This section illustrates well that USL at times seems to resemble a crazy quilt set of overlapping jurisdictions.[25] This outcome may be a result of the process of the Study Group of inviting comments from issuers, as compared to the Task Force on Reserve Reporting, in which industry participants were integral to the process of drafting the proposal. The exemption for distributions in Canada outside the local jurisdiction enables a distribution in other Canadian jurisdictions without special rules. This is a significant globalizing provision in USL. With respect to private placements by Canadian issuers outside Canada,

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[18] *Ibid.*

[19] *Ibid.*, section VII(1).

[20] *Ibid.*, section VII(2).

[21] *Ibid.*, VII (2)a.

[22] *Ibid.*, VII (2)b.

[23] *Ibid.*, VII (2)c.

[24] *Ibid.*, VII (2) d.

[25] *Ibid.*, VII(2) e.

this is permissible without a prospectus provided that such securities do not return to Canada, thus counting as an exempt distribution. Private placements by foreign issuers to purchasers outside Canada lie outside the jurisdiction of a SRA provided the securities do not resell in Canada or through a Canadian exchange. Distributions by a local issuer to purchasers outside the local jurisdiction is exempt where the public offering document is filed in Canada, the United States or United Kingdom. The purchasers are outside the local jurisdiction; the underwriter agreement, if any, prohibits sales to person in the local jurisdiction; and no steps have been taken with the effect of creating a demand for them in the local jurisdiction. This represents a significant globalization of the rules regarding prospectuses *ex juris*.[26] The reader will appreciate the scope and depth of the USL project when the level of analysis in this basic section, the closed system, is applied to every single statutory provision in the five securities acts of the provinces under scrutiny.

V. Conclusion

Prioritizing our three developments in order of practical importance from a globalization point of view, one would have to rank MJDS first, notwithstanding its precarious status as a reality that cuts a swath across the Canada-United States cross-border securities market; USL second, as a body of potential law with significant reach across provincial boundaries in Canada; and the IAS third, dependent upon further globalization of securities markets to achieve its niche.

[26] Notice,VII(3)d.