Environmental Law Centre

Murray and Anne Fraser Building
University of Victoria
P.O. Box 2400 STN CSC
Victoria, BC, Canada
V8W 3H7

www.elc.uvic.ca

Securities Disclosure Requirements for Canadian Mining Interests

Researcher: Leo Lane
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Leo Lane

I. The Current Regulatory Regime

Securities regulation in Canada is conducted under a highly fragmented and complex regime. An issuer[1] must comply with the requirements of every jurisdiction in which its securities will be traded, which for most public companies means compliance with 13 different bodies of legislation. In addition to provincial securities acts and regulations, the main sources of disclosure requirements in Canada are the national policies and instruments issued by the Canadian Securities Administrators (CSA)[2], the *Canada Business Corporations Act*[3] ("*CBCA*") and its regulations[4], and the listing requirements of the stock exchanges. This paper will focus on the securities legislation found in British Columbia and Ontario and the major CSA policies and instruments.

A. The Prospectus

The prospectus is a hallmark of the closed system of securities regulation[5]. Under provincial legislation no person may distribute a security without first filing a preliminary prospectus and a prospectus and has been issued a receipt from the relevant securities commission[6]. There are several exemptions from this requirement, for example stock dividends and sales to banks or dealers buying as principals do not require a prospectus[7].

The prospectus must provide "full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed."[8] The prospectus is to be set out in narrative form, must contain audited income statements and balance sheets from previous years, and is subject to specific filing requirements. Detailed content requirements for prospectuses are set out in the various provincial securities rules[9] and in National Instrument 41-101 *Prospectus Disclosure Requirements*. Reporting issuers with may be able to bypass some of these requirements by taking advantage of the prompt offering qualification system (POP). Under this

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[1] Defined as "a person who (a) has a security outstanding (b) is issuing a security, or (c) proposes to issue a security" BC *Securities Act* (*"BCSA"*), R.S.B.C. 1996 c.418.
[2] The CSA is comprised of all the provincial and territorial securities commissions.
[3] *Canada Business Corporations Act*, R.S.C. 1985, c. C-44. (Applies to federally incorporated companies).
[4] *Canada Business Corporations Regulations* ("*CBCA Regulations*"), SOR/2001-512.
[5] The closed system places hold periods and other resale restrictions on new issues, thus delaying the securities' introduction to the secondary markets. Compare this with the proposed Continuous Market Access system discussed in Part II, under which new issues do not require a prospectus and can be immediately re-traded.
[6] *BCSA*, s.61; *Ontario Securities Act* ("*OSA*"), R.S.O. 1990 c. S.5, s. 53.
[7] *BCSA*, ss. 73-76; *OSA*, ss. 72-74.
[8] *BCSA*, s. 63; *OSA*, s. 56. (See Part I.C below for a discussion of "material" in the disclosure context.)
[9] BC *Securities Rules* ("*BCRules*"), B.C. Reg. 194/97, ss. 96-98, 112; Ontario Securities Commission (OSC) Rule 41-501, *General Prospectus Requirements*.

system the issuer files a short form prospectus that incorporates by reference, rather than restates, information already reported in its Annual Information Form. The required contents of a short form prospectus for mining projects are set out in National Instrument 44-101.

Mineral projects face the additional requirement of filing a technical report describing each property material to the issuer.[10] The report must be filed upon first becoming a reporting issuer and with each subsequent preliminary prospectus or preliminary short form prospectus. Form 43-101F prescribes the contents of the technical report—such things as drilling results, mineral reserve estimates, and a discussion of bond posting, remediation and reclamation of the property.[11]

B. Continuous Disclosure

After distribution has ceased, every reporting issuer must continue to disclose certain information to regulators and its security holders. Investors use this information to decide whether to buy or sell the issuer's securities, and at what price. Continuous disclosure is of two basic types. First is periodic disclosure—information such as annual and interim financial statements that must be filed at regular and set intervals. The second is timely disclosure, triggered by material changes in the issuer's affairs.

Financial Disclosure

An issuer must file financial statements annually and quarterly. The statements must be developed in accordance with generally accepted accounting principles and must be delivered to each holder of the issuer's securities that is located in the relevant province.[12] Annual financial statements must be audited and filed within 140 days of the end of the financial year.[13] They must include: a balance sheet, an income statement, a statement of retained earnings, and a statement of changes in financial position.[14] Interim statements must be filed within 60 days

[10] *BCRules*, ss. 109-110; NI 43-101 *Standards of Disclosure for Mineral Projects*, Part 4.
[11] Form 43-101F, Items 13, 19, and 25 respectively.
[12] *BCRules*, s 149; *OSA*, s. 79.
[13] *BCRules*, ss. 3(4), 145; *OSA*, s.78.
[14] *BCRules*, s. 145(2); *Ontario Securities Act Regulations* ("*ORegs*"), R.R.O. Reg. 1015, s.10.

after the end of the quarter.[15] The quarterly statements need not be audited[16] and need include only an income statement and a statement of changes in financial position.[17]

For federally incorporated companies, periodic financial disclosure requirements are set out in the *CBCA*[18]. The Act provides for signed approval of financial statements by the directors,[19] distribution of statements to shareholders,[20] and qualifications of an independent auditor.[21] The contents and means of preparation of financial statements are prescribed by the *CBCA Regulations*.[22]

Proxies and Information Circulars

A proxy is defined by the legislation as the actual form on which a security holder nominates another person to "attend and act for and on the security holder's behalf at a meeting of security holders."[23] The nominee then may attend the meeting and must vote as directed by the security holder. An issuer must send a proxy form to each of its security holders in the province whenever it gives notice of a security holders' meeting.[24] While proxies are required for every such meeting, they are typically used for annual general meetings.

An information circular containing all the information security holders need to make informed decisions on proxy votes must accompany the proxy form and notice of the meeting.[25] The information circular must be prepared in accordance with the regulations and in the prescribed form (Form 30).[26] One of the requirements of Form 30 is that the information sent out in the circular cannot be more than 30 days old. The information must be clearly presented and understandable to security holders. The eleven required items are: revocability; solicitors (those calling the proxy); direct and indirect material interest of solicitors and directorial nominees; securities and principal holders; election of directors; executive compensation; indebtedness of directors, executive officers and senior officers; insiders' interests in material

[15] *BCRules*, s. 144(1); *OSA*, s. 77.
[16] *BCRules*, s. 144(3); ORegs, ss. 8,9.
[17] *BCRules*, s.144(4); ORegs, s. 7(1).
[18] *CBCA*, ss. 155-172.
[19] *Ibid*., s. 158.
[20] *Ibid*., s. 159.
[21] *Ibid*., s 161.
[22] *CBCA* Regulations, ss. 70-72.
[23] *BCSA*, s. 116 "proxy"; *OSA*, s. 1(1) "proxy".
[24] *BCSA*, s. 117; *OSA*, 85.
[25] *BCSA*, s. 117(2); *OSA*, s. 86.
[26] *BCRules*, Form 30; *OSA*. S. 84 "information circular"; ORegs, s.176 and Form 30.

transactions; auditor's appointment; management contracts; and specific information not dealt with in another item.

For mineral projects, an issuer must also file a Form 43-101F1 technical report along with an information circular if the circular concerns an acquisition of a material mineral property that is to be purchased with securities of the issuer.[27]

The *CBCA* has detailed rules regarding annual shareholders' meetings[28] and proxies.[29] The *Regulations* dictate the form of proxy[30] and the specific contents of proxy circulars.[31]

Material Change Reports ("MCRs")

A reporting issuer must issue and file a press release and file a MCR whenever there is a material change in its affairs.[32] "Change in affairs" in this context means a change in the issuer's business, operations, assets or ownership. The legislative definition of "material change" includes the decision to implement that change made by the board of directors, or by senior management who believe that the decision will probably be approved by the board. [33] The legislation sets out slightly different time frames for press releases[34] and MCRs.[35]

Where publication of a material change would be unduly detrimental to the reporting issuer, or where the material change is a senior management decision and there is no suggestion of insider trading,[36] the issuer may file a MCR with the Commission[37] on a confidential basis (i.e. its release is delayed).[38] The issuer must periodically convince the Commission that the information needs to be kept confidential, and prior to its release insiders are not allowed to trade the issuer's securities. The purpose of the confidentiality exemption is to protect the interests of issuers and their investors against competitors or negotiating parties who could make strategic use of the information.

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[27] NI 43-101, Part 4.2(1)3.
[28] *CBCA*, ss. 132-146.
[29] *Ibid*., ss. 147-154.
[30] *CBCA* Regulations, ss. 54-56.
[31] *Ibid*., ss. 57-69.
[32] *BCSA*, s. 85; *OSA*, s. 75.
[33] *BCSA*, s. 1(1) "material change"; *OSA*, s. 1(1) "material change".
[34] *BCSA*, s. 85(1)(a); *OSA*, s. 75(1). [as soon as practicable; "forthwith"]
[35] *BCSA*, s. 85(1)(b); *OSA*, s. 75(2). [as soon as practicable but within 10 days]
[36] See discussion of *Insider Trading Reports* below.
[37] For this report "the Commission" refers to the local provincial or territorial securities regulatory body.
[38] *BCSA*, s. 85(2); *OSA*, s. 75(3).

Insider Trading Reports

The legislation defines an "insider" as

(a) a director or senior officer of the issuer,

(b) a director or senior officer of a company that is itself an insider or subsidiary of the issuer,

(c) a person who owns (directly or indirectly) or controls the voting rights of more than 10% of the outstanding voting securities of an issuer, or

(d) the issuer itself if it has acquired any of its own securities.[39]

A person must file an insider trading report when the person becomes an insider and whenever the insider's ownership or control of the issuer's securities changes.[40] The report must disclose any direct or indirect beneficial ownership or control (i.e. trustees are exempt) of the issuer's securities, and any change in ownership or control since the latest insider report was filed. The person has 10 days after becoming an insider or after the change takes place in which to file the report.[41]

Annual Reports and Annual Information Forms ("AIFs")

Beyond the annual financial disclosure requirements mentioned above, securities legislation does not mandate an annual report. Any other information that an issuer includes in these glossy documents is not obligatory.

Companies issuing securities under the POP system must file an AIF each year within 140 days after the issuer's fiscal year end.[42] The purpose of the AIF is to provide background material relevant to understanding the nature of the issuer's operations and future prospects. An important feature of the AIF is that any of its required material may be incorporated by reference to previously filed information, thus saving the issuer considerable time and effort.

National Instrument 51-102 Continuous Disclosure Obligations

The proposed NI 51-102 seeks to provide issuers with a single set of disclosure requirements. The Instrument is expected to make disclosure simpler, less expensive, and more

[39] *BCSA*, s. 1(1) "insider"; *OSA*, s. 1(1) "insider".
[40] *BCSA*, s. 87; *OSA*, ss. 107-109.
[41] *BCRules*, s. 155.1.
[42] *BCRules*, s. 184(2); *OSA* s. 81(2); OSC Rule 51-501 *AIF and MD&A*.

uniform across the 13 jurisdictions in Canada. NI 51-102 regulates the form and content of issuers' annual and interim financial statements, proxies and information circulars, MCRs, and AIFs, and executive compensation statements. Most continuous disclosure requirements will remain substantially the same under the new instrument, but the Instrument will shorten filing deadlines for financial statements and will create new disclosure obligations relating to business acquisitions and documents of incorporation.

The provincial regulators have drafted new rules[43] in preparation for NI 51-102, expected to come into force in 2003. The rules incorporate the Instrument into provincial legislation by revoking existing rules that would be redundant under NI 51-102, and by exempting issuers from certain provisions of the securities acts if the issuer complies with similar provisions in the new Instrument. The new rules are set to come into effect on the same date as NI 51-102.

National Instrument 43-101 Standards of Disclosure for Mineral Projects[44]

As mentioned above, mineral projects are subject to additional disclosure requirements under NI 43-101, developed by the CSA. NI 43-101 came into force on February 1, 2001 and replaced National Policies 2-A and 22. The purpose of the Instrument is to enhance the accuracy and integrity of disclosure in the mining industry by establishing national standards. It governs how issuers disclose technical and scientific information about their operations to the public.

NI 43-101 requires that any oral, written, or electronic disclosure about an issuer's material mineral projects be based on the advice of a "qualified person." The Instrument defines a qualified person as

(a) an engineer or geoscientist with at least five years experience in mineral exploration, mine operation or mineral project assessment or a combination of these;
(b) who has experience relevant to the mineral project and technical report; and
(c) who belongs to a professional association.[45]

In some circumstances the qualified person must also be independent of the issuer.[46] Non-independent persons include those who by reason of employment, securities ownership, affiliation or physical proximity are in some way connected with the issuer.[47]

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[43] BC Instrument 51-108; OSC Rule 51-801 *Implementing NI 51-102*.
[44] For a plain-language, FAQ-style explanation of the NI 43-101 requirements, see CSA Staff Notice 43-302.
[45] NI 43-101, Part 2(2) "qualified person".
[46] *Ibid*., Part 5.3.
[47] *Ibid*., Part 1.5.

Whenever an issuer relies on a qualified person in filing a technical report, the issuer must disclose a substantial amount of information about that person. This includes disclosure of the person's name, address, occupation, qualifications, the person's relationship to the issuer, and any previous involvement the person may have had with the property that is the subject of the report.[48]

As mentioned above, the form and contents of a technical report are dictated by Form 43-101F1. The Form calls for a detailed description of the property, including factors such as location, ownership, environmental liabilities, required permits, accessibility, infrastructure, and history.[49] The report must include exploration and drilling results, as well as sampling methods, sample preparation, and data verification measures.[50] The Form imposes rules regarding mineral resource and reserve estimates, and prohibits references to unproven and improbable resources or reserves in an economic evaluation used in a feasibility study.[51]

The technical report is an important component of continuous disclosure for issuers involved in mineral projects. In addition to the prospectus and proxy requirements mentioned earlier, the issuer must file a technical report to accompany an offering memorandum, an annual information form, a take-over bid circular, or a material change report provided these disclosures relate to mining projects on material properties.[52]

System for Electronic Document Analysis and Retrieval (SEDAR)

The creation of SEDAR has been an important addition to the continuous disclosure regime. Under NI 13-101, every issuer that is required to file a document under securities legislation must file it in an electronic format. The list of documents that must be filed with SEDAR includes any document required to be filed because it was sent by an issuer to its security holders[53], and any document required to be filed because it was filed with a government agency or stock exchange located outside the local jurisdiction.[54] All of the documents discussed above—long and short form prospectuses, AIFs under POP, annual and interim financial

[48] *Ibid*., Part 8.
[49] Form 43-101F1, Items 6-8.
[50] *Ibid*., Items 14-16.
[51] *Ibid*., Item 19.
[52] NI 43-101, Part 4.2.
[53] NI 13-101 *System for Electronic Document Analysis*, Part 2.2(1)4.
[54] *Ibid*., Part 2.2(1)5.

statements, proxy and information circulars, etc.—must be filed electronically.[55] Use of the SEDAR database is not reserved for investors. It can be accessed free of charge at www.sedar.com.

C. The Materiality Standard

The question "what is material ?" is central to any analysis of continuous disclosure. Only material changes trigger the disclosure obligation. The legislation defines a material change as one that would reasonably be expected to have a significant effect on the market price or value of any of the issuer's securities.[56] The terms "reasonably be expected" and "significant effect" harbour considerable ambiguity, and are themselves of little help to issuers deciding what to disclose. Adding to the uncertainty, the legislation uses the term "material fact" to refer to "a fact that significantly affects, or could reasonably be expected to significantly affect, the market price or value."[57] Finally, "material information" is used to refer to both material facts and changes.

The leading case on material fact and change is *Pezim v. British Columbia (Superintendent of Brokers)*[58] ("*Pezim*"). The Commission decided that the defendant directors had failed to disclose material changes of assay results in a timely way. The defendants argued that the legislation only demands disclosure of material changes, and since the ore was in the ground whether or not it was discovered, there had been no change. The Supreme Court of Canada disagreed, finding that even without any physical change the information constituted a material change for the purposes of the *Securities Act*. The drilling report withheld in this case was found to be the type of information security holders need to make investment decisions and thus exactly the type of information disclosure rules are aimed at. The court in *Pezim* also held that the legislative duty to disclose is accompanied by a duty on directors to actively inquire whether there has been a material change before buying or selling securities.

Iacobucci, J. summed up the court's reasons for finding against the defendants:

> In the mining industry, mineral properties are constantly being assessed to determine whether there is a change in the characterization of the property. Thus, from the point of view of investors, new information relating to a mining property (which is an asset) bears significantly on the question of that property's value. Accordingly, I agree with the approach taken by the

[55] *Ibid*., Part 2.2(1)1 and Appendix A.
[56] *BCSA*, s. 1(1) "material change"; *OSA*, s. 1(1) "material change".
[57] *Ibid*., "material fact".
[58] [1994] S.C.J. No. 58

> Commission, namely that a change in assay and drilling results can amount to a material change depending on the circumstances.

Thus rather than relying on the artificial distinction between "fact" and "change," one ought to assess materiality in a contextual fashion, giving regard to the interests of investors and the purposes of disclosure legislation.

Unlike the "market impact" test applied in Canada, materiality in the US is based on the "reasonable investor" test. The latter test defines a fact, change, or piece of information as material if a reasonable investor would consider it important in making an investment decision. This definition more closely links disclosure requirements to the investment decision process. The mechanics of financial markets are often mysterious, and it would seem that intuitively it is easier for issuers to determine what a reasonable investor would find important than to reasonably predict how a change may affect market prices.

The US standard also allows for disclosure of information that an investor would consider important even though it may not affect the price of the security. For instance, information regarding a mining operation's environmental impact may be important to a reasonable investor without necessarily having an affect on the price of the issuer's securities (due to lax environmental standards, e.g.). Although to date no court has interpreted materiality as comprising such extrinsic considerations, it is not unthinkable. It is simplistic in the extreme to assume that market prices accurately reflect the reasonable investor's preferences, and the market impact test seems an unnecessary abstraction from the purposes of disclosure rules.

The OSC's Five Year Review Committee (discussed below) recently recommended that to increase consistency with US standards, current securities legislation be revised to incorporate the reasonable investor standard.

D. Enforcement

Failure to file, provide, deliver or send a record as required by provincial legislation is an offence. The legislation also makes it an offence to contravene any of a number of enumerated sections and regulations, the penalties for which are capped at $1 million or 3 years imprisonment or both.[59] For certain offences including tipping and insider trading, the legislation imposes a minimum penalty equal to the person's ill-gotten profit, and a maximum penalty equal to three times the profit earned.

[59] *BCSA*, s. 155(1); *OSA*, s. 122.

If the Commission considers that a person has contravened the *Securities Act* ("the Act") or its regulations, the Commission may apply to the Supreme or Superior Court for one or more of a multitude of orders, including a compliance order, an order to disgorge moneys made by contravening the Act, an order setting aside a securities transaction, an order appointing a director of the person in contravention, and an order that the person pay damages to any other person.[60]

Even without application to the court the Commission has wide enforcement powers, which it may exercise following a hearing and a determination that issuing the order is in the public interest. The most commonly exercised is the cease-trade order[61], but the commission may also order the resignation of any director or officer of an issuer, or prohibit a person engaged in investor relations activities from disseminating certain types of information to the public, or from engaging in any investor relations activities at all.

A person convicted of an offence against the Act or regulations is liable for the costs of investigating the offence.[62] The limitation period for commencement of enforcement proceedings under the Act is six years.[63]

The most severe sanction in the securities regulation regime is prosecution under the *Criminal Code* ("*CC*").[64] Prosecution will likely only be conducted where the accused's conduct has been flagrant, persistent, or malicious. Unlike provincial securities sanctions, *CC* offences are consistent across all jurisdictions and may easily be enforced nationally. Some of the offences relevant to disclosure are: conspiracy[65], including conspiracy to commit an unlawful purpose such as non-compliance with a provincial statute; fraud[66], defined as defrauding a person or the public of property by a falsehood; spreading false news[67], which encompasses spreading misinformation that frustrates the purposes of disclosure requirements; and false prospectus[68], which is deception by filing or delivering a false statement, account, or prospectus.

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[60] *BCSA*, s. 157; *OSA*, s. 126.
[61] *BCSA*, s. 161(1)(b); *OSA*, s127.
[62] *BCSA*, s. 160.
[63] *BCSA*, s. 159; *OSA*, s. 129.1.
[64] *Criminal Code*, R.S.C. 1985, c. C-46.
[65] *Ibid*., s. 465.
[66] *Ibid*., s. 380.
[67] *Ibid*., s. 181.
[68] *Ibid*., s. 400.

E. Civil Liability

A person who buys securities offered by a prospectus that contains a misrepresentation may sue for damages the issuer and its directors, every underwriter required to sign the certificate in the prospectus, every person whose consent has been filed as prescribed[69], and every person who signed the prospectus.[70] The legislation vitiates a person's liability if the person proves that the purchaser had knowledge of the misrepresentation. Persons other than the issuer will not be held liable for misrepresentations made on the authority of an expert if the person did not believe and had no reasonable grounds to believe that there had been a misrepresentation. Likewise, experts themselves will not be held liable for any parts of the prospectus made under their own authority unless they knew of the misrepresentation or failed to investigate reasonably whether there was a misrepresentation. The action is further limited to only those damages that represent the depreciation of value of the purchaser's securities resulting from the misrepresentation.

The statutory right of action for misrepresentations in a circular or notice[71] or in a prescribed disclosure document[72] is virtually identical to that above, with similar exemptions and damages provisions. In all these actions, the standard of reasonableness to be used when evaluating a person's reasonable grounds for belief, or the reasonableness of an investigation, is that required of a prudent person in the circumstances.[73]

If a dealer or offeror of securities was required by the Act[74] to deliver a prospectus and failed to do so, the person who was entitled to receive the prospectus may sue the dealer or offeror for damages.[75]

The provincial securities acts create detailed rights of action for persons who sustained losses as a result of tipping or insider trading.[76] A person in a special relationship[77] with an issuer who trades securities on the basis of undisclosed information is liable to the buyer or seller

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[69] Including a qualified person who prepares a technical report under NI 43-101, but only with respect to a misrepresentation contained in the report, opinion or statement made by the person.
[70] *BCSA*, s. 131; *OSA*, s. 130.
[71] *BCSA*, s. 132; *OSA*, s. 131.
[72] *BCSA*, s. 132.1.
[73] *BCSA*, s. 133, *OSA*, s. 132.
[74] *BCSA*, s. 83; *OSA*, s. 71.
[75] *BCSA*, s. 135; *OSA*, s. 133.
[76] *BCSA*, s. 136; *OSA*, s. 134.
[77] Includes an insider, associate, or affiliate of the issuer, as well as a person proposing to make a take-over bid for the securities of the issuer, and anyone who has learned of a material fact from a person in the preceding categories. See *BCSA*, s. 3.

with whom the person traded, for any damages the innocent party sustained. Similarly, a person in a special relationship who "tips" another with undisclosed information is liable for damages resulting to any third party that the person who received the tip may transact with.

Generally, the civil liability regime of disclosure legislation provides relief only where there has been intentional or negligent wrongdoing, and only to the extent that the plaintiff suffered financially as a result.

II. The Future of Securities Regulation

Canada is one of the few developed nations without a central body governing securities regulation. The lack of harmonization and uniformity in the present regime is its most frequently cited malady.[78] Current coordination and cooperation efforts are seen as insufficient measures for attracting foreign investors to Canadian markets. Canada's securities market is small and fragmented—it represents only about two percent of the world's capitalization. This feature, in conjunction with the high costs of compliance across 13 jurisdictions, often causes foreign issuers to seek alternatives.

The provinces' securities legislation is similar in many major respects, but the commissions often act as if each of them were a sole regulator. For instance, an issuer must file all offering documents and continuous disclosure documents (many of which are virtually identical) with each of the commissions and receive administrative clearance from each province in which its securities will be traded. Such duplication leads to serious inefficiencies.

The problems identified have given rise to several coordination and cooperation initiatives. One of these is the CSA's Uniform Securities Legislation Project.[79] The Project identifies Canada's multiple jurisdictions and varied securities legislation as contributing to much of the burden on market participants. It finds harmonization efforts insufficient and aims to develop uniform securities legislation within two years for adoption across Canada. The members of the Project's Steering Committee are chairs and vice-chairs of provincial securities commissions.

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[78] Harmonization refers to a system of cooperating jurisdictions across which the same effect is achieved through different legislation. Increased harmonization is widely acknowledged as desirable. However, many authorities are satisfied with the current level of uniformity and express concern over potential stifling of creativity and flexibility under a uniform system.

[79] CSA Notice 11-303: *The Uniform Securities Legislation Project*.

Harmonization and uniformity are also advocated in the studies and reports produced by the provincial commissions. The two most influential projects are briefly outlined below.

A. Ontario Securities Commission's Five Year Review Committee

The draft report of the OSC's Five Year Review Committee ("the Committee") follows two years of research and consultation. The report calls for wide-ranging changes to Ontario's regulatory framework following a US-style approach of tough-minded financial reforms. The US is the most heavily regulated financial market in the world, and the recent disintegration of investor confidence there has led to still more restrictive securities legislation. The US approach is typified by the *Sarbanes-Oxley Act of 2002* ("*Sarbanes-Oxley*").[80] *Sarbanes-Oxley* imposes comprehensive disclosure and corporate governance requirements on issuers, including markedly more stringent requirements of auditor independence. The Act grants the Securities Exchange Commission (SEC) enhanced powers of enforcement and investigation. The theory underlying the Five Year Review Committee's report is that harmonization of Canadian securities legislation with US requirements will attract investment from that country's vast pool of funds.

The Committee's foremost recommendation is for the creation of a single securities regulator with responsibility for all of Canada's capital markets.[81] In the meantime, the Committee calls for significant harmonization reforms, including granting provincial commissions the authority to delegate their regulatory powers and responsibilities to any other securities regulatory authority. In addition the Committee recommends that securities legislation across the country be amended to provide for "mutual recognition" whereby a securities regulator may deem that compliance with another jurisdiction's securities laws constitutes compliance with its own.[82]

Part 4 of the Committee's report deals exclusively with the closed system of disclosure requirements. The report recommends that the CSA harmonize continuous disclosure requirements and create a common base level of requirements applicable to all reporting issuers.[83] As discussed above, this process is already well underway with NI 51-102. The Committee proposes that following the implementation of certain reforms, such as a civil

[80] 15 U.S.C.S. (2002).
[81] OSC *Five Year Review Committee Draft Report*, 28.
[82] *Ibid*.
[83] *Ibid*., 74.

liability regime for continuous disclosure and enhanced continuous disclosure standards for all issuers, the hold periods and seasoning periods currently in place could be eliminated.[84]

On the issue of materiality, the Committee recommends that the Act's timely disclosure requirements not be amended to require disclosure of "material information" (i.e. material changes *and* material facts).[85] The Committee does recommend, however, that the existing standard of materiality be changed to the "reasonable investor" standard applied in the US.[86] There are various other disclosure reforms in the report, including reduced periods for filing financial statements,[87] audits of quarterly financial statements, [88] and filing of press releases on SEDAR.[89] The overall tone of the report is exemplified by the following recommendation:

> 49. We urge the Commission to pro-actively monitor ongoing U.S. developments relating to auditor independence and to consider what reforms are necessary to ensure that Canada does not lag behind international standards.[90]

B. BCSC's *New Concepts for Securities Legislation*

In stark contrast to the prescriptive approach adopted by the OSC is the doctrine espoused by the BC Securities Commission. The BCSC's Vice-Chair sent a lengthy letter to the Chair of the Five Year Review Committee detailing the BCSC's criticisms of the Committee's draft report.[91] The letter disputes any pressing need for a single Canadian securities regulator, claiming, "the biggest threat to our markets is not multiple regulators or differences in securities legislation, but over-regulation"(p.1). Thus while the OSC sees uniformity and investor protection as crucial for international competitiveness, the BCSC seeks competitiveness by drastically simplifying and economizing the raising of capital.

The BCSC endorses the Committee's recommendations for harmonization of securities laws, delegation between regulators, and mutual recognition. Given the common approval of such provisions it is likely they will be among the first to be introduced into the legislation.

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[84] *Ibid*., 80 and 81.
[85] *Ibid*., 86.
[86] *Ibid*., 88.
[87] *Ibid*., 92.
[88] *Ibid*., 93.
[89] *Ibid*., 94.
[90] *Ibid*., 99.
[91] Comment letter on OSC Five Year Review Committee's Draft Report, sent by Brent W. Aitken to Purdy Crawford on May 29, 2002.

The main objection that the BCSC voices against a US-style approach to securities regulation is that Canadian markets and issuers are far too small to bear the costs of compliance. The BCSC's letter to the Five Year Review Committee claims that Canada's system of regulation "offers investor protection just as effective as that in the US"(p. 3), and with lower costs of compliance. These sentiments are echoed by many market experts, including Barbara Stymiest, CEO of the Toronto Stock exchange:

> Just on the size differences alone, trying to import the U.S. rules into Canada would impose a virtually intolerable, added burden [on] our small companies with no discernible benefit . . . I believe we took an early lead in the quality of our corporate governance in the early 1990s, and that Sarbanes-Oxley has yet to demonstrate it's a superior approach.[92]

As part of its Deregulation Project, the BCSC has released the report *New Proposals for Securities Regulation*.[93] The Proposals are grouped under four main headings: The Continuous Market Access System, Registration, Investor Remedies, and Enforcement and Public Interest Powers.

The proposed Continuous Market Access (CMA) system (Chapter One) would replace the current prospectus-based system with one based on up to date continuous disclosure of all material information. Under the proposal, issuers are subject to more stringent periodic continuous disclosure requirements and must disclose all material information about their operations. In exchange, the issuer is not required to produce a prospectus and instead may issue securities based on its continuous disclosure record. The issuer need only file a press release disclosing the offering. This change would eliminate hold and resale periods for securities. The reasoning behind such a drastic reform is that the closed system is overly expensive and complex. The BCSC claims that the prospectus is of limited relevance for investors, who typically rely on advisors rather than documents required by statute. The report highlights the fact that while the present legislative scheme is chiefly concerned with the primary market (the sale of a new securities issue), 98% of trading takes place in the secondary market. Implementation of a CMA system would require an overhaul of the *Securities Act* and would preclude BC's adoption of many of the CSA's National Instruments and Policies. Furthermore, it is doubtful whether such a change, if carried out by the BCSC without the support of the other

[92] Quoted in "U.S.-style rules an 'intolerable burden'" *The Financial Post* (27 September 2002) FP1.
[93] BC Notice 2002/20.

regulators, would have any significant impact on the national legislative regime, since issuers would still be obligated to comply with the requirements of the remaining 12 jurisdictions.

The Code of Conduct in the Proposals (Chapter 2) would replace existing detailed prescriptive rules with general principles. The BCSC justifies its Code on the basis that prescriptive rules can't possibly keep pace with constantly changing markets and commercial practice, and that such rules encourage a "loophole" mentality in issuers. Conversely, the BCSC claims, general principles are responsive to issuers' changing needs and "force firms to think about the reasons behind the rules as opposed to blindly following them."[94]

The Proposals set out a number of new investor remedies (Chapter 3) and enforcement and public interest powers (Chapter 4). One of the investor remedies, the right to sue anyone who participated in fraud, market manipulation, misrepresentation, or unfair practices represents a significant development in investor protection. However the protections against abusive litigation are numerous, and it is unclear whether under a system of widespread deregulation enhanced investor remedies and enforcement powers would be of much use. For example, one of the proposed remedies is the right to sue a firm and its directors and officers for failure to comply with the applicable code of conduct. Litigating violations of "general principles" presents the plaintiff with unique difficulties.

It is difficult to predict how securities regulation in Canada will change over the next few years. For the moment the stock exchanges and industry support the BCSC's approach, while law firms and investors groups generally endorse the views of the OSC. However, due to the amount of attention currently being focused on securities legislation, we are likely to see significant changes from either or both efforts before long.

[94] *New Proposals for Securities Regulation*, 56.