



Policy Submission: Expert Panel on Securities Regulation

August 12, 2008

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Introduction

AME BC is pleased to contribute to the federal Expert Panel on Securities Regulation in Canada recommendations to the Minister of Finance, and the provincial and territorial ministers responsible for securities regulation, on ways to improve securities regulation in Canada.

AME BC's submission addresses the consultation questions set out by the Expert Panel in order for it to make recommendations on the content, structure, and enforcement of securities regulation in Canada.

Our recommendations are based on the principle that solutions must enhance the goals of sound and productive regulation, and at the same time preserve the parts of the securities market that are proven and working well. The challenge is to coordinate, standardize, and to provide for innovation to reflect capital market changes, yet allow for the tremendous difference in size and industries that characterize our markets.

Canada's capital market comprises a relatively small proportion of the global market – under 2% - and consists of regional capital markets that vary greatly among provinces. Given its predominance of small cap issuers, the Canadian market presents some unique opportunities and challenges. This small cap market offers access by both issuers and investors to the vibrant 'ground level' opportunities for growth that play a significant role in the health of our economy. Effective regulatory structures and practices should enable small issuers to grow and mature, while at the same time sufficiently safeguard investors and provide confidence in the market.

The US Securities and Exchange Commission defines a company as small if it has less than US \$75¹ million in market capitalization. Applied to the Canadian exchanges, approximately 91% of all publicly

¹ Companies without a calculable public equity float will qualify if their revenues were below \$50 million in the previous year. Source: (U.S.) Federal Register; Vol 73, No. 3; January 4, 2008; Rules and Regulations

listed companies in Canada. Ontario houses the largest TSX issuers, and 43% of issuers domiciled in Ontario are listed on the TSX Venture exchange. There are more publicly listed companies headquartered in British Columbia than in any other province – 1,265 (or 35%) compared to about 1,020 (or 28%) in Ontario, and 720 (or 20%) in Alberta.

Mineral exploration companies, which account for about 25% of the publicly listed companies in Canada, finance their programs through the sale of shares because they have no cash flow. Financings tend to be small and relatively frequent, relating as they do to the stages of exploration and exploration results. Due to the frequency of financings junior companies pay a disproportionate amount in regulatory compliance costs based on the amount of funds raised.

Mineral exploration companies typically reduce their issuing costs by selectively listing in only a few of Canada's 13 jurisdictions, each of which collect fees and require differing documentation and legal fees. As a consequence, domestic capital markets are biased against residents of a majority of provinces that don't warrant the time and expense of qualifying new and normally less expensive stock issues, which is to say that many constituents of less populous jurisdictions cannot get in on the ground floor or participate in most later stage financings.

Changes to the content, structure and enforcement of securities regulation in Canada should recognize these fundamental characteristics, provide innovation, and maximize the opportunity for small companies to mature and access other capital markets.

Consultation Item 1: Objectives, Outcomes and Performance Measures

The objectives of the International Organization of Securities Commissions:

- The protection of investors
- The promotion of fair, efficient and transparent capital markets
- The reduction of systemic risk

Questions:

1. Should Canada have a common set of objectives?
2. What should the objectives be?
3. Should the reduction of systemic risk be an explicit objective?
4. Should there be an objective to enhance the competitiveness of Canada's capital markets?

Response:

AME BC supports the idea of common objectives to ensure and promote investor protection, and fair, efficient and transparent capital markets. Common objectives should lead to consistency of principles,

and take into account the fact that different characteristics of industrial markets require different rule-based solutions.

In addition to investor protection and fair, efficient and transparent capital markets, the objectives should include enhancing the competitiveness of Canada's capital markets. In our experience, competition spurs innovation in rules and processes that serve industry and the integrity of the markets well. Examples of innovation include continuous market access and the material information standard.

Consultation Item 2: Principles-Based Securities Regulation

Questions:

1. Could a more principles-based approach improve securities regulation in Canada?
2. Are there areas of securities law or regulation that are overly prescriptive and could benefit from a more principles-based approach?
3. What core regulatory principles should constitute the foundation of securities law?
4. What are the risks and challenges of a more principles-based approach to regulation?

Response:

A more principles-based approach would provide the benefit of allowing for some innovations, however, rules remain necessary to ensure clarity and consistency in achieving desired outcomes. A purely principles-based system poses risk management issues, and in practice would prove costly to issuers who would incur substantial legal fees to audit their practices for compliance. Some combination of principles-based and rules-based regulation would be preferable to a single approach. In a combined model, principles can guide the desired outcomes relating to information/disclosure, for example, and be supported by rules where specific outcomes may be unclear to issuers. We will elaborate on this disclosure example further.

Corporate governance is a serious issue because it is central to maintaining investor confidence. In order to be meaningful, guidelines require specific recommendations, such as independence of the CEO from the Board Chair, or that the audit committee should be wholly independent and financially literate. The reality is these guidelines will be harder to meet, as director liability is increasing fewer individuals are disposed to sitting on junior Board of Directors and small issuers often don't have the financial resources to compensate a US style Sarbanes Oxley Board.

Our opinion is that disclosure of what a company does to achieve good corporate governance and disclosure of procedures it has in place are more informative and appropriate than its ability to meet a prescribed list of requirements. We do not see any need for an increase or change in corporate governance rules at present as a number of new National Instruments are in place. Prospectus-level disclosure currently available to investors through the SEDAR system should allow a continuous market

access system for raising capital such that a full prospectus is not needed to raise funds by a reporting issuer. A disclosure-based system over a system of prescribed rules for governance would recognize that all issuers can disclose but not many can compensate a slate of independent Directors.

Disclosure requirements must be reasonable as the dollar costs and cost of management time applied to disclosure must be weighed and balanced against the equally important benefits to shareholders of allowing management to spend the majority of its time building the company. This is especially true for junior companies, where regulatory costs are disproportionately high as compared to larger companies and it is difficult for junior companies to allocate large resources strictly for such purposes.

A combination of principles-based and rules-based regulation would enable issuers to achieve desired regulatory outcomes that are meaningful for their size, market and financial characteristics.

Consultation Item 3: Proportionate Securities Regulation

Questions:

1. To what extent is there need for proportionate regulation in Canada?
2. What areas of securities regulation impose undue burden and could benefit from proportionate regulation?
3. Should the economic characteristics of a company determine how it is regulated?
 - a. If so, what should be the economic characteristics?
4. What role could risk analysis play in the regulation of businesses?

Response:

We are recommending a proportionate, tiered system with the exception of enforcement and penalties which would apply to all issuers regardless of size, with appropriate regulation for small issuers as the best approach for the unique structure of Canada's public company market.

Proportionate regulation could effectively achieve the objectives of investor protection, and fair, efficient and transparent capital markets. Recognizing that appropriate rules are – to some extent – based on size of company and revenue, there is value in achieving some degree of uniformity within revenue-based tiers. A proportionate, tier-based system would address the respective sets of risk factors posed by different sized companies.

Canada has a disproportionately large number of small companies trading publicly, or put another way, a very small number of very large companies. One of the key economic advantages to doing business in

Canada is the access to a speculative pool of capital at relatively low cost by small cap issuers. This access is made possible by our unique venture class regulations in an appropriately regulated market place. We believe that an important public policy objective should be to encourage innovation and new and vibrant activity in all markets, and to enable the junior market to thrive and mature to the extent possible.

The national rules and instruments currently in place contain tiered rules to allow for venture issuers. There are, essentially, three tiers in place among companies that are listing on the TSX V, the TSX and large multinationals accessing capital on international markets (generally those meeting MJDS requirements). The small cap companies would largely disappear under regulatory compliance requirements that are too costly, and particularly at the MJDS level at the extreme. This tiered system can be preserved under any regulatory structure with the understanding it doesn't mean less regulation. AME BC wants regulation that is appropriate for the Canadian capital markets.

Risk factors vary also depending on size of company, but generally are managed most effectively through enforcement. Rule-breakers engage in sophisticated deceptions that intentionally evade established rules and procedures. The appropriate balance of risk management and cost effectiveness should be viewed through the lens of enforcement and penalties.

Consultation Item 4: Enforcement

1) Enforcement under a more principles-based approach

Questions:

1. What would be the opportunities and risks to enforcement under a more principles-based approach in Canada?
2. Should enforcement action be taken solely on the basis of a breach of principle?
3. Would the current system be sufficiently well-positioned to enforce a more principles-based approach?

Response:

Enforcement is one aspect of securities regulation that would benefit from a single set of rules, and application of rules that is national in scope, with provision of regional services.

2) Independent adjudication

Questions:

1. Should the adjudicative function be made independent of the securities regulatory agency?
2. Should a pan-Canadian adjudicative tribunal be established?
3. What governance model should be considered in the creation of this tribunal?
4. Would a separate adjudicative tribunal help with the enforcement of principles-based regulation?
5. In what ways could the enforcement of securities law and regulation be strengthened in Canada?

Consultation Item 5: Securities Regulatory Structure**Question:**

1. What are the strengths and weaknesses of the passport system as it is currently being implemented?

Response:

We believe that the passport system serves the market effectively, as it provides for consistency of broad principles and flexibility where needed to strengthen the market.

Single Securities Regulator

2. Which structural model (passport or single securities regulator) would be best for Canada?
3. Which model would best support the adoption of new regulatory approaches, including proportionate regulation and a more principles-based approach?
4. Which would fulfill the need for the effective governance of Canada's capital markets?
5. What are the opportunities and risks of moving to a single securities regulator?
6. How could a single securities regulator be implemented without being unduly disruptive to the marketplace?
7. In particular, what can be done to effect a smooth transition?
8. What is the best way forward for the federal and provincial governments? In the absence of an agreement, what do you suggest as an alternative model?

Response:

Canada has the benefit of concentrated pockets of expertise such that it is reputed there are more geologists per capita in Vancouver than any other North American city; Calgary is the centre of oil and gas, and Toronto has a diversified industrial base and is the centre for institutional investors. Naturally the investor following and type of businesses seeking public funds reflect these regional characteristics.

Our view is that small mineral explorers in Quebec, Manitoba or Ontario have the same requirements and issues as the ones in BC no matter where the industry is concentrated. Therefore we see sectoral expertise in the division between venture class issuers and senior issuers, regardless of industry. The main centres for offices are those with the current big four provincial securities commissions; however each office should have the experience and capability needed to cover the range of venture class issuers and the senior issuers as a separate sector. The expertise allocation would reflect the venture – senior or with a tiered division in regulations.

Concluding remarks

Overall, what should be the key elements of a model common securities act to improve securities regulation in Canada?

How should the transition be managed and executed to minimize the disruption in Canada's capital markets?

If a National Securities Commission is created, the securities law should be the national and multilateral instruments we now have with the differences among the provinces removed. That may not be possible, but a federal securities regime that wasn't harmonized at the start would only encourage a sub set of provincial restrictions - instead of 13 regulators there would be 14 regulators.

We also recommend a disclosure-based system that allows easy access to filing documents and making contact with the regulator in one's time zone either through electronic means or regional offices. The market benefits under a national regulator that operates on a cost efficient basis such that all policies and rules are subject to a cost benefit review, carried out with meaningful input from the Issuers and those affected by any proposal.

The key to innovation is to allow regional initiatives to be heard and implemented nationally. If not, then a province will end up implementing initiatives in its own jurisdiction and the national system will be undermined. Under a single regulator this regional experience may not be possible. A national regulator would have to have the same ability to provide regional innovations under, which could eventually be adopted across the country. There are obvious advantages to the capital market in the single regulator

concept but there are some significant drawbacks including the representation of regional and junior capital markets and innovation (both the lack of and the time to achieve change).

One potential solution may be to have a single national regulator with two tiers, the senior tier having offices in Montreal, Toronto, Calgary and Vancouver. This senior tier would address the matters of particular concern to the large national and international issuers and meet the more onerous requirements that such issuers are currently subject to including the MJDS System as it applies to issuers seeking to make offerings in the United States.

The second or junior tier would also have offices in Montreal, Toronto, Calgary and Vancouver with the head office possibly located in Vancouver. Issuers would be able to graduate to the senior tier on meeting senior tier requirements. The junior tier would allow for innovation to occur such as that which has occurred and is occurring in British Columbia. There would also be more flexibility in this system to reflect the regional junior markets such as mining, oil and gas, and high tech sectors.

We would propose one national set of rules with each tier having its own criteria within the national scheme much like the TSX and the TSX Venture Exchange systems currently in place.

The concept of two tiers and each tier having its own head office and structure would continue to encourage innovation applicable to each tier and yet meet the obvious regional requirements particularly for the junior capital markets.