UNIFORM SECURITIES LEGISLATION PROJECT

COMMENTARY ON

CONSULTATION DRAFTS

December 16, 2003

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I. INTRODUCTION

The CSA are pleased to present consultation drafts of a Uniform Securities Act ("USA") and Model Administration Act ("MAA") (collectively the "Consultation Drafts"). The publication of these Consultation Drafts is an important milestone in the CSA's Uniform Securities Legislation ("USL") Project.

1. Background

The CSA launched the USL Project in the spring of 2002. At that time, debate on reform of Canada's system of securities regulation was gaining momentum. The central theme of the debate is that Canadian capital markets need a more streamlined system of securities regulation with fewer administrative hurdles. This debate continues today with the initiatives of the provincial ministers responsible for securities regulation[1] (the "Ministers' Initiative") and the work of the federal Wise Persons' Committee.[2]

The CSA believe that the USL Project provides an attainable solution to what is widely regarded as a key problem with Canada's system of securities regulation - the costs of identifying and reconciling inter-jurisdictional variations in laws, rules and administrative procedures - without being dependent on the final outcome of the debate.

Despite our decentralized system of securities regulation, the CSA have recognized for many years the need for regulation that is streamlined and seamless and have worked together to harmonize and co-ordinate our regulatory efforts. Uniform laws are the next step in this evolution.

The CSA launched the USL Project in the spring of 2002[3] under the direction of a senior-level committee (the "Steering Committee") with the following mandate:

> The objective of the USL Project is to develop a uniform act and uniform rules within two years that would be adopted across Canada. Although the primary focus is to achieve harmonization of legislation, we will take advantage of opportunities to simplify the system when that can be accommodated within the timeframe.

Following a detailed review of representative Canadian securities legislation, we published in January 2003 a concept proposal entitled "Blueprint for Uniform Securities

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[1] See discussion paper "Securities Regulation in Canada: An Interprovincial Securities Framework" (June 2003).

[2] See http://www.wise-averties.ca/

[3] See CSA Notice 11-303 *The Uniform Securities Legislation Project* (March 8, 2002).

Laws for Canada" (the "Concept Proposal").[4] The Concept Proposal sets out the CSA's views on how to rationalize the substantive differences identified in current legislation and discussed proposed policy changes. We received over 80 comment letters and the Steering Committee engaged in extensive consultation with stakeholders. After carefully considering the comments and stakeholder input, we published a summary of comments and responses to the comments in July 2003.[5]

Having considered comments on the Concept Proposal and stakeholder feedback, we began to work on draft legislation. CSA staff, under the direction of the Steering Committee, worked with an independent legislative drafting consultant with experience in provincial legislative counsel offices to develop the accompanying Consultation Drafts.

2. The Situation in Québec

Although the CVMQ is an active participant in the USL Project, Québec's civil law regime and particular legislative drafting requirements will necessitate adjustments to the USL in this jurisdiction.[6] Moreover, certain modifications to the Consultation Drafts are also required in order to take into account Québec's existing legislative corpus, notably the recently adopted *Act respecting the Agence nationale d'encadrement du secteur financier*.[7] Accordingly, while the legal texts in Québec will not be strictly uniform with the USL in other jurisdictions, they will reflect in many instances the same consensus policy decisions that underlie the Consultation Drafts so that, as a practical result, there will be a largely harmonized set of requirements across the country.

3. The Situation in British Columbia

The BCSC is an active participant in the USL project but is also working on a parallel project of more fundamental streamlining and simplification of British Columbia's legislation. The BCSC expects that, if British Columbia proceeds with that legislation, it will include harmonized interfaces with the legislation in other provinces (either the USL or the current legislation) to ensure that market participants are not faced with conflicting regulatory requirements.

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[4] See CSA Notice and Request for Comment 11-402 *Concept Proposal for Uniform Securities Legislation* (January 30, 2003). See pp. 6 ff of the Concept Proposal for a more detailed description of the methodology of our analysis.

[5] See CSA Notice 11-304 *Responses to Comments Received on Concept Proposal "Blueprint for Uniform Securities Legislation for Canada*" (July 31, 2003).

[6] See, for example, Parts 8 and 9 of the Uniform Securities Act which deal with civil liability in the primary and secondary markets have been adapted to the Civil Code of Québec.

[7] Statutes of Québec, 2002, c. 45.

4. Status of the Consultation Drafts

The Consultation Drafts are the CSA's legislative proposal for uniform securities legislation. They have not been reviewed or approved by any provincial or territorial government, nor have they gone through the processes that typically accompany the introduction of new legislation such as legislative counsel, government caucus and cabinet review.

II. OVERVIEW OF THE CONSULTATION DRAFTS

1. The Uniform Securities Act

The USA is "platform" legislation, meaning that it contains the core, fundamental principles of securities laws. The detailed requirements that overlay these fundamental principles will be contained in rules made under the legislation.

Platform legislation is instrumental to achieving both the uniformity and streamlining goals of the USL Project. The USA reflects the CSA's consensus on the fundamental principles of securities regulation and establishes a common platform on which future regulatory initiatives can be based.

The USA will also allow CSA members to be flexible and responsive to regulatory imperatives through the rule-making process, which is significantly faster than legislative amendment. The example of the so-called "Zimmerman amendments" to the take-over bid provisions cited in this respect in the Concept Proposal bears repeating here. Though non-controversial, the Zimmerman amendments took four years to be passed by the legislatures of all applicable jurisdictions.

The USA is also instrumental to streamlining. As the Final Report of the Five Year Review Committee observed, the Ontario *Securities Act* "is cluttered with outdated provisions that have been superseded by rules". The same can be said of most, if not all of our current statutes.[8] Moreover, securities legislation has not been updated in several decades in a few jurisdictions. The USL Project provides a good opportunity for them to modernize as well as harmonize.

The platform approach in the USA has the most significant impact on the continuous disclosure, take-over bid, and prospectus and registration (including exemption) parts of current legislation. Rules in these areas have already been substantially developed as concurrent CSA initiatives (*e.g.*, proposed continuous disclosure requirements) will be

[8] See Five Year Review Committee Final Report: Reviewing the Securities Act (Ontario) (March 21, 2003), at p. 71.

developed under the USL Project (*e.g.*, uniform exemption, registration and take-over bid rules).

The overview of the USA in the next part of this Commentary identifies important provisions from our current legislation that are not contained in the Consultation Drafts but will be replaced by uniform rules.

2. The Model Administration Act

The MAA is model legislation. It contains the procedural provisions of securities laws that would apply to the Alberta Securities Commission and to market participants in Alberta. The CSA recognize that it would be desirable to have uniform procedural and substantive provisions, but the former cannot be easily harmonized because they must fit within the laws of the province or territory from which the SRA derives its authority. The MAA will provide the framework for the administration act that each jurisdiction will adopt so as to ensure as much uniformity of content as possible. Each jurisdiction's Administration Act will contain provisions for the following common elements:

1. The formation, constitution and governance of the SRA and the SRA's ability to delegate powers, functions and duties to its staff;
2. Information sharing;
3. Powers and procedures respecting investigations;
4. Powers and procedures for hearings by the SRA and public interest orders that may be made by the SRA after a hearing;
5. The review of decisions by the SRA and the appeal of decisions of the SRA;
6. The powers for the Lieutenant Governor in council to make regulations; and
7. The procedure for the SRA to make rules.

The overview of the USA in the next part of this Commentary identifies the areas where the MAA and USA should be read together.

3. Transitional Matters

The Consultation Drafts are silent with respect to transitional provisions. Thoughtful, practical transitional provisions will be required to ensure a clear, effective transition from current legislation to the USL.

III. THE UNIFORM SECURITIES ACT

Part 1: Purpose and Interpretation

1. Introduction

Part 1 of the USA contains definitions and interpretive provisions. Part 1 follows the current approach of securities legislation in that most defined terms apply generally and are located at the front of the USA. There are a few terms that are defined for a specific purpose. They are discussed in the context of the relevant Part.

Definitions are central to any statute and are particularly important to securities laws since defined terms essentially set the ambit of activity that is subject to regulation. Uniform definitions will provide greater certainty to market participants and will eliminate the need for many applications for exemptive relief in inter-jurisdictional transactions. There will be uniform definitions of fundamental terms such as "control person", "distribution", "insider", "mutual fund", "non-redeemable investment fund", "officer" and "senior officer". The definitions of "security", "trade" and "reporting issuer" differ in minor ways, as explained below.

2. Defined Terms Relating to Derivative Contracts

There are differing approaches to the regulation of trading in derivatives in different provinces. The CSA recognize that it would be desirable to harmonize the regulation of derivative contracts, but this initiative is beyond the scope of the USL Project. The USA accommodates the differences in regulation without detracting significantly from uniformity. Specifically:

1. In Ontario and Manitoba exchange-traded derivatives (except equity options) are regulated under commodity futures legislation rather than securities legislation. The concept of an "exchange-traded derivative" will therefore not be included in Ontario and Manitoba, and the definition of "security" in these two jurisdictions will not include "exchange-traded derivatives".

2. Currently, Ontario regulates over the counter derivatives ("OTC derivatives") under securities legislation if the product falls within one of the heads of the definition of "security". The regulatory structure of OTC derivatives will be maintained in Ontario by

    (a) not including a definition of derivative in the USA, but including a head of rule-making authority enabling the Commission to define "derivative"; and

(b) not including a "derivative" in the definition of "security"[9].

3. The definition of "trade" in Ontario will not include entering into a derivative.

3. Definitions of "material fact" and "material change"

The USA defines "material fact" and "material change" based on the reasonable investor materiality standard. For example, a "material fact" means, when used in relation to an issuer or its securities, a fact in respect of which there is a substantial likelihood that a reasonable investor would consider it important in making a decision, including a decision to purchase, hold, sell or redeem securities of the issuer and a decision to vote.[10] This is a change from the current definitions of material change and material fact which are based on a market impact standard of materiality.[11] For example, currently a material fact means when used in relation to securities issued or proposed to be issued, a fact that would reasonably be expected to have a significant effect on the market price or value of the issuer's securities.

We are proposing a reasonable investor standard of materiality for three principal reasons:

1. The reasonable investor standard is consistent with the test in the United States and the test that applies in the insider trading context in the Québec Act;

2. We believe that the reasonable investor standard will be more effective in the enforcement of insider trading; and

3. The reasonable investor standard has already been adopted in a number of contexts in provincial and territorial securities law and the proposed change provides an opportunity to rationalize materiality standards within Canada.[12]

The reasonable investor standard was not contemplated in the Concept Proposal, but it has been the subject of extensive public debate and comment in the past. The CSA

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[9] As a result of the different approach that Ontario is taking with respect to derivatives, there will be parts of the USA that will be drafted differently for Ontario. For example, the prohibitions against fraud and market manipulation and front-running will be drafted in Ontario to include specific references to derivatives.

[10] The USA also has a context specific definition of material change for investment funds.

[11] The standard of materiality in the Québec Act in the insider trading context is a reasonable investor standard.

[12] See, for example, National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*, National Instrument 81-102 *Mutual Funds*, and OSC Form 41-501F1 *Information Required in a Prospectus.*

obtained public comment on similar proposed amendments to these definitions in 1997[13], and the Five Year Review Committee obtained comments on a consistent proposal, which it ultimately recommended in its Final Report.[14]

4. Definition of "reporting issuer"

The definition of reporting issuer in the USA provides largely uniform tests for when reporting issuer status arises, with two exceptions:

1. there is a residual ability for jurisdictions to prescribe additional means of becoming a reporting issuer; and

2. the circumstances in which an issuer becomes a reporting issuer by virtue of an exchange listing will be determined by rule or order. This differs from the Concept Proposal, which contemplated that a stock exchange listing would give rise to reporting issuer status only if the exchange carries on business in and is recognized in the jurisdiction, subject to a *de minimus* test. The CSA considered this matter further and concluded that each jurisdiction should be able to decide whether to impose reporting issuer status on an issuer as a result of its listing on a particular exchange, whether or not the exchange carries on business in the jurisdiction.

Part 2: Marketplaces, Self-Regulation and Market Participants

1. Introduction

Part 2 of the USA contains provisions relating to the oversight of self-regulatory organizations ("SROs") and market participants. It retains the concept of mandatory recognition for exchanges that carry on business in the jurisdiction and introduces it for quotation and trade reporting systems. Recognition of other entities like SROs and clearing agencies will not be mandatory, but the SRA may designate the entity as requiring recognition after giving the entity an opportunity to be heard. Once designated as requiring recognition, the entity cannot carry on business in the jurisdiction unless it is recognized by the SRA. The SRA will grant recognition if it would be in the public interest to do so. Ontario's Securities Administration Act will require clearing agencies and SROs to be recognized if they are carrying on business in Ontario. In Québec, all

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[13] See CSA Notice 53-302 *Report of the Canadian Securities Administrators - Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change"* (November 3, 2000).

[14] See Five Year Review Committee Final Report, *supra* note 8.

SROs will be required to be recognized if they are carrying on business in Québec, as is the case currently.

The USA continues to give SRAs oversight responsibility for recognized entities. The MAA strengthens the SRAs' oversight powers by giving SRAs the ability to order, after a hearing, a person to comply with a recognized entity's decisions, policies and similar instruments. The USA also gives recognized entities statutory immunity in connection with functions that have been delegated to them by the SRAs.

2. Powers of Recognized Entities

Recognized entities are required to regulate their participants. The USA gives recognized entities certain powers to meet this requirement. For example, the USA provides all recognized entities with the power to regulate a person with respect to the person's activities while a participant or an employee, agent or subscriber of a participant. Currently only some jurisdictions provide recognized entities with this power. The USA also allows the SRA to authorize recognized entities to

1. exercise many of the same powers regarding compelling evidence and conducting hearings as are vested in the court for the trial of civil actions;

2. apply to court for the appointment of a receiver to oversee the affairs of a participant; and

3. file a copy of a decision or settlement agreement with the court so it can be enforced as though it were a judgment of the court.

Part 3: Registration

1. Introduction

The adviser and dealer registration requirements are contained in Part 3 of the USA, which maintains the current requirement for both securities firms and their representatives to be registered. Part 3 will also contain certain key provisions that are ancillary to the registration regime like provisions regarding the application process, voluntary surrender of registration and continuing obligations following a suspension or termination of registration. In accordance with the platform nature of the USA, details regarding the manner of applying for registration, registration categories, the criteria for obtaining registration, ongoing responsibilities of registrants and renewal, surrender and termination procedures will be contained in a Uniform Rule.

2. The Registration Trigger

The dealer registration requirement in most Canadian jurisdictions is currently triggered whenever a person trades in a security (the "trade trigger"). This differs from the current dealer registration requirement in Québec, which applies to a person who carries on business as a dealer (the "business trigger"), and from the "in the business test" that determines when a person must be registered as an adviser in most Canadian jurisdictions.

We indicated in the Concept Proposal that the USA would preserve the trade trigger for the dealer registration requirement. We also, however, recognized criticisms that the trade trigger is too broad and acknowledged the recommendation of Ontario's Five Year Review Committee that the dealer registration requirement be moved to a business trigger. Upon further policy analysis and consideration of industry feedback, we have included in the USA a business trigger for both adviser and dealer registration.

Moving the dealer registration requirement to a business trigger is consistent with the existing adviser registration requirement and, as noted above, will harmonize the dealer registration requirement across Canada with the existing provision in Québec (as well as the regulatory approach to participant registration in foreign jurisdictions like the United States, Australia and the United Kingdom). A business trigger will also obviate the need for some exemptions to the dealer registration requirement that are necessary under the current trade trigger.

Part 4: Prospectus Requirements

1. Introduction

Part 4 of the USA sets forth the core prospectus requirement by prohibiting any distribution of securities except pursuant to a prospectus or an exemption from the prospectus requirement. It also provides the flexibility to accommodate alternative offering systems that are based on an issuer's continuous disclosure record, like the "integrated disclosure system" proposed by the CSA in January 2000[15] and the "continuous market access" system proposed by the British Columbia Securities Commission in April 2003.[16]

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[15] See CSA Notice and Request for Comment 44-401 and 51-401 *Concept Proposal for an Integrated Disclosure System* (January 28, 2000).

[16] See BC Notice 2003/12 *The BC Model – Draft Legislation, Commentary And Guides For A New Way To Regulate* (April 15, 2003).

Part 4 maintains the current requirement that a prospectus provide full, true and plain disclosure of all material facts relating to the securities issued or proposed to be distributed, and includes general provisions relating to the filing of a prospectus and the issuance of receipts. The rules will contain particulars with respect to the form and content of a prospectus, the specific grounds on which a prospectus receipt must be refused, the process by which prospectuses are filed and cleared, prospectus amendment requirements, delivery obligations and lapse date details. This is consistent with the platform nature of the USA as well as current regulatory practice, which finds the majority of all prospectus-related requirements in rules[17] instead of the statute.

2. Prospectus Exemptions

Although exemptions from the prospectus requirement are specifically contemplated in Part 4, we do not propose to include these exemptions in the USA itself. Instead, we will harmonize and consolidate most prospectus exemptions in a Uniform Rule, while some jurisdictions may also opt to enact local rules to preserve additional exemptions that are considered to be local in both nature and scope. The Concept Proposal discusses in some detail the various prospectus exemptions proposed to be carried forward under USL.

Part 5: Continuous Disclosure

1. Introduction

The provisions of Part 5 relating to issuers' continuous disclosure ("CD") obligations are limited to a general enabling authority regarding the kind of disclosure to be required under the rules, coupled with a provision for SRA reviews of an issuer's CD record.

Details regarding the preparation, filing and release of CD materials will be contained in Uniform Rules. In this regard, the USA will dovetail with Proposed National Instrument 51-102 *Continuous Disclosure Obligations*[18], which harmonizes, consolidates and improves upon current CD requirements applicable to reporting issuers (other than investment funds), and Proposed National Instrument 81-106 *Investment Fund*

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[17] See, for example, National Instrument 41-101 *Prospectus Disclosure Requirements*, National Instrument 44-101 *Short Form Prospectus Distributions*, National Instrument 44-102 *Shelf Distributions*, National Instrument 44-103 Post-Receipt Pricing and National Instrument 81-101 *Mutual Fund Prospectus Disclosure*. See also OSC Rule 41-501 *General Prospectus Requirements* and the various local instruments in other CSA jurisdictions which permit compliance with the OSC rule in lieu of local requirements with respect to the form and content of prospectuses.

[18] See CSA Notice and Request for Comment relating to Changes to Proposed National Instrument 51-102 *Continuous Disclosure Obligations* (June 20, 2003).

Continuous Disclosure,[19] which will apply to all types of investment funds and will introduce CD obligations that are particular to these issuers.

The Concept Proposal highlights some of the improvements that would be brought about by each of these proposed instruments, both of which we expect to implement before completing the USL Project.

2. Becoming and Ceasing to be a Reporting Issuer

The definition of "reporting issuer" in the USA will substantially harmonize the tests for determining whether or not an issuer becomes subject to statutory CD requirements.[20] The USA will also enable the securities regulatory authority to designate an issuer to be a reporting issuer, either on its own motion or on application from an interested person. The rules will permit a reporting issuer to voluntarily surrender its reporting issuer status.

Part 6: Trade and Related Disclosure

Part 6 brings together the USA provisions relating to insider reporting and the early warning system.

1. Insider Reporting

Division 1 of Part 6 provides generally for the filing of insider reports. The details of an insider's reporting obligations, including the time periods for filing, the form and content of an insider report, and the manner of filing, will be set forth in a Uniform Rule.

As noted in the Concept Proposal, existing insider reporting requirements are largely harmonized in Canada, and National Instrument 55-102 *System for Electronic Disclosure by Insiders* has introduced uniform forms and filing procedures. These will be carried forward under USL. The USA will, however, adopt a broader, streamlined approach to the kinds of interests that are currently reportable by covering any right or obligation to buy or sell securities and also any interest in a related financial instrument.

2. Related Financial Instruments / Equity Monetization

The term "related financial instrument", which is defined in Part 1 of the USA, generally captures derivative-based interests. By requiring an insider to report an interest in, or right or obligation associated with, a related financial instrument, the USA will require

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[19] See CSA Notice and Request for Comment relating to Proposed National Instrument 81-106 *Investment Fund Continuous Disclosure* (September 20, 2002).

[20] See the discussion of the definition of "reporting issuer" in Part 1, above at p. 7.

disclosure to the marketplace of so-called "equity monetization" transactions, regardless of their technical form. These transactions allow an investor to receive a cash amount similar to proceeds of disposition and to transfer part or all of the economic risk and/or return associated with securities without actually transferring legal and beneficial ownership. In this regard, the USL will maintain and adapt Proposed Multilateral Instrument 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization).*[21]

3. Definition of "Insider"

The USA defines "insider" in a manner that is generally consistent with current securities legislation, but with certain refinements aimed at limiting the insider reporting obligation to "true" insiders and obviating the need for exemptive relief in recurring circumstances.[22] These refinements include

1. confining the definition of "senior officer" to an issuer's CEO, CFO or COO or any other officer "whose responsibilities routinely give the officer access to inside information relating to the issuer";

2. including in the definition of "insider" only those directors and senior officers of an issuer's subsidiary whose responsibilities routinely give that person access to inside information relating to the reporting issuer; and

3. excluding from Division 1 a person who is deemed to beneficially own securities merely because they are owned by one of its affiliates.

The Concept Proposal contemplated a function based approach to determining who the senior officers of an issuer are for the purposes of insider reporting, based around a definition of "executive officer". On further consideration, we have decided to incorporate the function based approach into the definition of "senior officer" yet retain the references to CEO, CFO or COO to provide the clarity and certainty that issuers require in this context.

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[21] See Notice of Proposed Multilateral Instrument 55-103 *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (November 28, 2003).

[22] See CSA Staff Notice 55-306 *Applications for Relief from the Insider Reporting Requirements by Certain Vice-Presidents*, which discusses the phenomenon of "title creep" or "title inflation" and its effect on insider reporting obligations as a result of the current title-based definition of "senior officer" in most jurisdictions, and National Instrument 55-101 *Exemption from Certain Insider Reporting Requirements*, which, among other things, exempts from the insider reporting obligation persons who are insiders of a reporting issuer only by reason of being directors or senior officers of minor subsidiaries of a reporting issuer or of affiliates of other insiders of the reporting issuer and who do not have access to undisclosed material information concerning the reporting issuer.

The Concept Proposal also stated that a reporting issuer would not be an insider of itself. We initially proposed deleting this aspect of the definition since, in many cases, an issuer that acquires its own securities will immediately cancel the securities. We also recognize that this aspect of the definition may create some confusion on the part of market participants, since there may be a question, for example, as to whether an issuer that acquires its own securities, and then immediately cancels them, "holds" the securities for the purposes of the definition. However, as a result of our consideration of stakeholder comments and our own ongoing consideration of this matter, we have decided to retain this aspect of the definition of "insider". We will consider any related concerns in a proposed rule relating to exemptions from the insider reporting requirement.

4. Early Warning System

Division 2 of Part 6 establishes the framework of the early warning system. The following particulars, among others, will be included in a Uniform Rule:

1. the ownership thresholds at which the early warning reporting obligation is initially triggered and beyond which subsequent reports are required;
2. the time periods for delivery and filing;
3. the content of early warning disclosure;
4. the manner of filing;
5. any moratoriums or other limitations on further acquisitions; and
6. appropriate exemptions from or relaxations of the general provisions for offerors under a formal take-over or issuer bid or for passive institutional investors.[23]

5. Control Persons

As noted in our response to comments received on the Concept Proposal,[24] we have decided not to impose a general advance notice requirement on all control person distributions made pursuant to a prospectus exemption. MI 45-102 *Resale of Securities* will be amended to make the notice requirements relating to the control person prospectus exemption more meaningful.

Part 7: Take-over and Issuer Bids

Part 7 of the USA contains the basic obligations of an offeror under a take-over bid or an issuer bid to communicate its bid to the target security holders, to make adequate

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[23] National Instrument 62-103 *The Early Warning System and Related Take-over Bid and Insider Reporting Issues* will form the basis of a Uniform Rule regarding the early warning system.

[24] See CSA Notice 11-304 *Responses to Comments Received on Concept Proposal "Blueprint for Uniform Securities Laws for Canada"* (Appendix B, No. 155).

financing arrangements in the case of a cash bid and to treat target security holders equally, and of an offeree issuer's board of directors, to respond to a take-over bid with a recommendation to accept or reject the bid or a statement that they are not making a recommendation. The take-over and issuer bid requirements will apply to both direct and indirect offers.

A uniform rule will contain the details with respect to the threshold required to trigger the take-over bid requirements, the form and content of take-over or issuer bid circulars and related materials, the manner of communicating the bid to target security holders and to the offeree issuer, the time periods for delivery or filing, the requirements for notices of change or variation, the filing of a bid circular and related materials, the types of bids that will be exempt from the formal bid requirements, and the circumstances where parties will be deemed to be acting jointly or in concert with an offeror.

Part 8: Civil Liability – General

Part 8 contains the rights of action that currently exist for primary market purchasers and in connection with insider trading. Part 8 reflects only minor differences from what was contemplated in the Concept Proposal. This draft legislation basically harmonizes existing provisions. We have not updated it to reflect the more recent thinking that is behind the secondary market liability provisions in Part 9. Before finalizing the USA, we will examine the possibility of updating Part 8.

There are uniform[25] rights of action for misrepresentations in a prospectus, an offering memorandum, and take-over and issuer bid disclosure documents.[26] Defences have been added to these heads of liability to parallel those available in the secondary market context. There are uniform withdrawal rights for purchasers under an offering memorandum that is required to be delivered under the exemption on which the issuer has relied. Part 8 also contains rights of action against persons who engage in insider trading, tipping, procuring or front-running.[27]

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[25] Québec has certain recourses that are in addition to those set out in this Part. For example, Québec's current securities legislation also has a recourse for revision of price. Moreover, a recourse for rescission does not preclude a recourse in damages, as is the case under the USA. In order not to limit recourses already available to Québec investors, the status quo will be maintained in the Québec version of the USA.

[26] The final USA will also contain appropriate rights of action for purchasers under non-prospectus alternative offering systems to ensure that no offering is done without liability for misrepresentation.

[27] Note that the civil remedies for insider trading and front running have been modified from current legislation so as to correspond to the proposed prohibitions in Part 12 of the USA.

Additionally, Part 8 contains rights of action against a dealer or offeror for failure to deliver a prospectus or take-over or issuer bid disclosure document, and against an issuer for failure to deliver a required offering memorandum. There is a civil remedy against an issuer or selling security holder who fails to file a prospectus. This last provision provides purchasers under an illegal distribution with a civil remedy.

Part 9: Secondary Market Civil Liability

Part 9 introduces a secondary market civil liability regime. It is based almost entirely on Ontario's secondary market civil liability regime which was passed by the Ontario Legislature (but has not yet been proclaimed).[28] [29] The Ontario regime is in turn based on the recommendations of the Allen Committee report,[30] the CSA Civil Remedies Committee,[31] and the Five Year Review Committee.[32]

Part 10: Inter-Jurisdictional Arrangements and Immunity

Part 10 of the USA contains three types of provisions to enable "one stop" regulation for market participants.

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[28] See *Keeping the Promise for a Strong Economy Act (Budget Measures, 2002)*, c. 22 S.O. 2002, formerly Bill 198, 3rd Sess., 37th Leg., Ontario, 2002, (Royal Assent given on December 9, 2002) as proposed to be amended by Bill 41, T*he Right Choices Act (Budget Measures), 2003*. Bill 41 was given first reading in the Ontario Legislature on May 22, 2003. The Ontario Legislature adjourned on June 26, 2003, without having given Bill 41 second reading. The USA includes the Ontario statutory civil liability regime as it was proposed to be amended by Bill 41.

[29] The definition of "responsible issuer" in Bill 198 differs from that proposed in the USA. Bill 198 defines "responsible issuer" to mean a reporting issuer or any other issuer with a real and substantial connection to Ontario, any securities of which are publicly traded. Part 9 of the USA defines "responsible issuer" to mean a reporting issuer in that particular jurisdiction or any other jurisdiction of Canada. This departure from Bill 198 wording ensures that security holders in a province where the issuer is not a reporting issuer will have the same rights as security holders in jurisdictions where the issuer is a reporting issuer. Ontario intends to maintain the Bill 198 definition of "responsible issuer". In the OSC's view, the Bill 198 definition of "responsible issuer" is sufficiently broad to provide a right of action against an issuer who is not a reporting issuer in the investor's resident province.

[30] See the Final Report of the TSE Committee on Corporate Disclosure (the "Allen Committee"), *Responsible Corporate Disclosure: A Search for Balance* (March 1997).

[31] See CSA Notice 53-302 *Proposal for a Statutory Civil Remedy for Investors in the Secondary Market and Response to the Proposed Change to the Definitions of "Material Fact" and "Material Change"* (November 3, 2000).

[32] See the Five Year Review Committee Final Report, *supra* note 8 at pp. 129-133.

1. Legal Delegation

The first set of provisions allows an SRA to delegate any of its powers, functions and duties to another SRA in Canada and to accept a delegation from another SRA. The effect of legal delegation is that one SRA could make discretionary decisions on behalf of all other SRAs. The USL proposals enable legal delegation but do not mandate it. The decision to delegate will rest with each SRA and its overseeing government; they will decide which powers, functions and duties they will delegate and to which SRA(s).

2. Mutual Recognition

Part 10 also includes provisions that achieve "one stop" regulation based on acceptance of the securities laws of another jurisdiction, or what we would loosely term a "mutual recognition" approach. These provisions allow the SRA

1. to adopt or incorporate the securities laws of another SRA or a foreign regulator;

2. to accept compliance with the laws of another SRA rather than requiring compliance with provisions of local securities laws; or

3. to deem that compliance with the laws of another SRA constitutes compliance with local securities laws.

3. Adoption of Another SRA's Decision

Part 10 includes a provision that allows an SRA to adopt a decision made by another SRA. This provision is intended to permit case-by-case and after the fact adoptions of individual decisions, for example in an enforcement context.

4. Immunity Provisions

Part 10 also contains immunity provisions that are similar to those in current securities legislation but have been revised to provide appropriate immunities to SRAs and their employees acting under a delegation. The immunity provisions in the USA extend immunity to both the SRA and a delegate of the SRA for good faith acts done under local securities laws and under the laws of another Canadian jurisdiction.

5. "One stop" Regulation

The delegation, mutual recognition and immunity provisions in Part 10 were specifically contemplated in the Concept Proposal and were recommended by the Five Year Review Committee.[33]

The USA will also allow SRAs to continue to use exemptions under Part 11 to implement "one-stop" regulation.

The SRAs could use one or more of the provisions that authorize delegation, mutual recognition, adoption of decisions, or exemptions to eliminate the administrative overlap that results from the current structure of Canadian securities regulation. The SRAs expect to enter into inter-jurisdictional agreements to document their delegation and mutual recognition arrangements.

6. Reviews and Appeals

The provisions regarding reviews and appeals of delegated decisions are in Part 6 of the MAA. The provisions contemplate a right to appeal a final decision of an SRA to the appropriate court in both the delegate and delegating jurisdictions. This structure preserves all possible appeal rights, but it also gives rise to the possibility of having multiple appeals of the same decision with different outcomes. A single stream of appeal model whereby the appeal specifically lies to the courts in the delegate jurisdiction would remove the potential for multiple appeals but would also raise complex legal and constitutional issues.

Part 6 of the MAA also contains the provisions regarding review by the SRA of decisions made by staff. Only the SRA delegate can review decisions of its staff made under authority delegated by another SRA.

Part 11: Decisions and Rule-Making Authority

Part 11 contains provisions of a general nature that provide the SRAs with the ability to make, revoke and impose terms and conditions on decisions and to grant exemptions from securities laws.

Part 11 also contains the heads of rule-making authority that apply to the USA.[34] The heads of authority were drafted with the intention of harmonizing and consolidating

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[33] See Five Year Review Committee Final Report, *supra* note 8 at pp. 40-41.

[34] There are also provisions respecting regulations and rule-making in the MAA. See Part 7. These heads of authority are in the MAA for one of two reasons: 1) they are subject matters over which only the Lieutenant Governor in Council has regulation-making authority and the SRA does not have rule-making authority, so it is

existing rule-making authority. There is also a general head of rule-making authority that is intended to apply in the event that a rule needs to be made in response to unforeseen market circumstances.

It is highly desirable to have common heads of rule-making authority so as to provide for uniform rules.[35] However, the procedure for making rules will be unique to each jurisdiction. This will ensure transparency and will preserve the appropriate level of government oversight and accountability in rule-making procedures. Consequently, each jurisdiction will maintain procedures for rule-making in or under its own Administration Act.

Part 12: Prohibitions, Duties, Offences and Penalties

1. Introduction

Part 12 of the USA contains uniform prohibitions, offences, and defences. Part 12 also contains the penalties that can be imposed by a court in a quasi-criminal context. Regulatory penalties such as freeze orders, administrative penalties and orders available to the SRA after a hearing, are set out in Part 6 of the MAA. The investigative powers of the SRA are contained in Part 3 of the MAA. As such, Parts 3 and 6 of the MAA and Part 12 of the USA should be read together.[36] The discussion below is confined to the differences between the Concept Proposal and the proposals in Part 12 of the USA and Part 6 of the MAA.

2. Due Diligence Defence

The USA provides a general due diligence defence that is consistent with the defence available at common law. The general due diligence defence is in place of the context-specific due diligence defences that exist in current legislation. The general due diligence defence provides that a person does not contravene securities laws if the person reasonably believed in mistaken facts which, if true, would not have resulted in the contravention of securities laws and that person exercised all reasonable diligence. The

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necessary to put these subject matters in the MAA to preserve the status quo in each jurisdiction, and 2) they relate to matters contained in the MAA (for example, the conduct and governance of the SRA; the practice and procedure for investigations, examinations and inspections under securities laws; and the hearing procedures).

[35] It is possible, though, that differing provincial legislative conventions may result in variances from the proposed uniform rule-making heads of authority in some jurisdictions. For example, British Columbia proposes adopting a general rule-making authority provision like the one in its current legislation. The British Columbia provision would include a general authority to make rules for the purpose of regulating trading in securities and carrying out the purpose of the Act, together with specific authorities where legally necessary.

[36] This structure was contemplated in the Concept Proposal. See the discussion at pp. 7-12 and in Appendix A.

defence is not available in civil actions under Part 8 or Part 9, which contain more specific due diligence defences.

3. Front-running Prohibition

The front-running prohibitions in current securities acts are limited to trading with knowledge of the investment program of a mutual fund or a client of a portfolio manager. It became apparent during the drafting of the enforcement provisions that our approach to front-running needs to be updated to reflect the scope of activity that should be prohibited. The USA prohibits trading, tipping or otherwise taking advantage of material order information, which is defined as information regarding an order or intended order for the purchase or sale of securities that could reasonably be expected to affect the market price of those securities. The front-running prohibition is analogous to the insider trading prohibition. Accordingly the maximum fines for front running parallel those for insider trading. The definitions of "profit made" and "loss avoided" in the context of the fines for front-running and insider trading will be contained in the USA or rules.

4. Insider Trading Prohibition

Three changes to the insider-trading regime are proposed in Part 12. First, the prohibition on tipping has been expanded to prohibit a person in a special relationship with a reporting issuer who has knowledge of an undisclosed material fact or change from encouraging or recommending to another person that that person buy or sell securities of the reporting issuer.[37] The rationale for this is that the act of procuring a trade on undisclosed material information is as harmful to market integrity as is informing someone of undisclosed material information. The prohibition on procuring is based on similar provisions in place in other jurisdictions such as the UK, Australia and the US.

Second, the insider trading prohibitions have been drafted to cover equity monetization transactions. This is consistent with the policy objectives behind proposed MI 55-103.[38]

Finally, the definition of "person in a special relationship with a reporting issuer" has been expanded to contemplate indirect offering structures. To remove any doubt that the underlying operating company in an indirect offering structure and its significant shareholders, employees, affiliates and associates fall within the definition of person in a special relationship with a reporting issuer, the USA provides that a reference to a reporting issuer in the definition of person in a special relationship includes a reference to a subsidiary of the reporting issuer.

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[37] Québec also has this prohibition in its current legislation. However, it is broader as there is no need, in most cases, to establish a "special relationship with a reporting issuer" for this prohibition to apply.

[38] *Supra* note 21.

We also note that the Insider Trading Task Force, comprised of representatives from Canada's SROs and the CSA, recently released a report that makes numerous recommendations to increase the effectiveness of the current insider trading regime.[39]

We intend to review the USA once the recommendations of the task force have been debated publicly through the comment process on the Insider Trading Task Force Report and these Consultation Drafts.

IV. CONCLUSION

The CSA value the input we have received through formal comments and informal consultations, which have contributed significantly to the development of these Consultation Drafts of the USA and MAA. We look forward to receiving comments on the drafts to help us improve them further as we move on to the next phase of this important project.

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[39] *Illegal Insider Trading in Canada: Recommendations on Prevention, Detection and Deterrence* (November, 2003). The Task Force is comprised of representatives from the ASC, BCSC, CVMQ, OSC, the Investment Dealers Association of Canada, the Bourse de Montréal, and Market Regulation Services Inc.