THE CANADIAN BAR ASSOCIATION

L'ASSOCIATION DU BARREAU CANADIEN

Capital Markets Stability Act

CANADIAN BAR ASSOCIATION
BUSINESS LAW SECTION

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500-865 Carling Avenue, Ottawa, ON, Canada K1S 5S8
tel/tél : 613.237.2925 | **toll free/sans frais** : 1.800.267.8860 | **fax/téléc :** 613.237.0185 | info@cba.org | **www.cba.org**

PREFACE

The Canadian Bar Association is a national association representing 36,000 jurists, including lawyers, notaries, law teachers and students across Canada. The CBA's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the CBA Business Law Section, with assistance from the Legislation and Law Reform Directorate at the CBA office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the CBA Business Law Section.

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I. INTRODUCTION

The Canadian Bar Association's Business Law Section (CBA Section) welcomes the opportunity to comment on the revised consultation draft of the *Capital Markets Stability Act (Canada)* (CMSA) released by Finance Canada on May 5, 2016.

The CBA is a national association representing over 36,000 jurists, including lawyers, Quebec notaries, law teachers and students across Canada. Its primary objectives include improvements to the law and the administration of justice. The CBA Section members are expert lawyers from across Canada in all areas of securities law, including securities filings, initial public offerings, corporate governance, continuous disclosure, registrants, and other legal financial matters, and from transactional and regulatory practices and litigation practices.

Our comments focus on four topics: Governance; Information Collection and Disclosure; Systemic Risk; and Reviews, Orders and Enforcement. The CBA Section supports many amendments to the CMSA in response to stakeholders' feedback. The CBA Section recommends that time for consultation be extended in the future to allow for more robust feedback.

II. GOVERNANCE

The governance structure of the cooperative capital markets regulatory system (the Cooperative System or CCMR) is not completely fleshed out. In particular, the CBA Section encourages further consultation on the role of the regulator and on regulatory coordination and fragmentation.

A. Role of the Regulator

The regulator, referred to in the CMSA as the Authority, is intended to become Canada's sole securities regulator for the jurisdictions that opt into the Cooperative System. As such, the Authority must have the capacity to fulfill both the provincial mandates of protecting the public and fostering fair and efficient capital markets, and the federal mandate of stabilizing the financial system. It remains unclear how the Authority will be able to do so.

Section 2 of the CMSA defines the Authority by reference to the *Capital Markets Regulatory Authority Act* (CMRAA), which has not yet been released for comment. This leaves many questions about whether and how the Authority has the ability to fulfill these distinct mandates. Issues that need to be addressed include how the Authority will be structured and funded, how its directors and officers will be appointed, and the procedure for its tribunal. Each of these is discussed separately. The CBA Section encourages further consultation to address these realities.

B. Structure and Funding of the Authority

With the structure of the Authority unknown, its ability to fulfill its mandates remains unclear. Only with the introduction of the CMRAA can that be assessed. Although the provincial and federal mandates are complementary, they are different in focus and present different organizational requirements. Under the existing regime with separate provincial and federal regulators, each regulator has its own institutional knowledge and presence, and enforcement capacity. It is unknown to what extent, if any, this presence and capacity will be supported and maintained under the Cooperative System. Fulfilment of the provincial mandates likely requires a physical presence for investigations and adjudication. In structuring the Authority, the CBA Section recommends striking a balance between a centralized structure to streamline processes and reduce bureaucracy, and a physical presence in participating jurisdictions to support existing institutional capacity and to investigate and adjudicate matters promptly. The CBA Section encourages further consultation on how to effectively structure the Authority to fulfil its mandates.

The funding arrangement will be an important element in this structure, especially for smaller capital markets. Currently, each jurisdiction funds its own regulator and determines its own needs. The Cooperative System will likely involve combined resources. While potentially beneficial in many ways, the funding model will need to be clearly laid out to adequately support all participating jurisdictions, including a presence, as needed, in smaller provinces. An important consideration for the funding model is whether provinces will have authority to add to or reduce their own capacity to match demand and fiscal restraints. Granting this authority will allow jurisdictions to influence the agenda for the Authority, and will assist provinces to effectively serve the provincial components in their jurisdiction, mitigating some smaller market concern of being overlooked by larger markets.

C. Appointment of Directors and Officers

Because the goal of the Cooperative System is to have the Authority be the sole securities regulator in Canada for participating jurisdictions, the appointment process for its directors and officers will be important for setting its agenda and priorities. This process must allow participants of all market sizes to have meaningful input in directing the Authority. The Chief Regulator must consider both small and large markets and the relationship between them, to effectively serve the Authority's mandates.

D. Tribunal Procedure

The tribunal procedure is noticeably absent from the CMSA, although the Authority has a tribunal function. Presumably, this will be covered in the CMRAA, but that remains to be seen. Details such as how hearings will occur (whether investigatory or in drafting regulations), what right of appeal will exist (internal or external), and what role the Authority will have in the prosecution of offences still need to be determined. These will all affect the Authority's ability to fulfill its mandates.

We also question how the Authority's administration and enforcement power will be applied. For example, what will distinguish the criminal offences in Part 5 of the CMSA from offences in Part 9 of the provincial *Capital Markets Act*? This overlap creates unnecessary duplication where the Authority and peace officers will both investigate the same conduct under the same regulatory scheme for similar offences. How will the Authority coordinate enforcement of criminal offences? CMSA section 6(1)(d) states that the Authority's mandate is (among other things) to "provide leadership and coordination of enforcement of criminal law relating to capital markets", but it is not clear how this will be achieved in practice. Peace officers, as defined under the *Criminal Code*, will have the power to investigate and pursue criminal offences in Part 5 of the CMSA. This fragments the role of the Authority in its mandate to protect the investing public, as it possesses substantially similar powers under Part 3 as peace officers under Part 5 of the CMSA.

Language requirements are another important consideration for the tribunal. Given that the Cooperative System will include New Brunswick (and may also include Quebec), it needs capacity to hear matters and provide services in the official language of choice.

E. Regulatory Coordination and Fragmentation

Many of the numerous questions the CBA Section has about the governance structure of the Cooperative System cannot be answered without all relevant legislation under the proposed regime. The current approach of releasing various pieces of legislation at different times has made it difficult to assess how the many parts of the Cooperative System will work together and to assess the effectiveness of the governance structure as a whole. The CBA recommends that all relevant legislation be released together, with ample time for robust consultation.

The CMSA provides limited information on the role and involvement of non-participating jurisdictions, and the interplay between non-participating and participating jurisdictions. We acknowledge that the CMSA is intended to complement the existing capital markets regulatory framework, not be a substitute for or replace it. To do this effectively, the CMSA needs to involve non-participating jurisdictions to the extent possible. The CBA Section supports the commitment in the CMSA to foster regulatory coordination with other jurisdictions and sources, including the requirement to consider the extent to which a benchmark, product or practice is already regulated by another regulator before making regulations; and in particular, the requirements to notify and provide non-participating jurisdictions with details of any urgent orders granted. While these are important steps, the CBA Section recommends that the CMSA include further details on the interplay with non-participating jurisdictions. As stated in our 2014 submission,[1] an interface mechanism with non-participating jurisdictions needs to be in place before the CCMR is finalized. The mechanism should be made available for public comment.

III. INFORMATION COLLECTION AND DISCLOSURE

Under Part 1, Information Collection and Disclosure, the CBA Section has comments on the applicable privacy legislation, appropriate safeguards and criteria for disclosure, the value of section 10(d), the amendments to section 13(1), and the requirement to seek information from existing sources.

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1 www.cba.org/CMSPages/GetFile.aspx?guid=5ee39dc5-a70c-4539-99ab-a1de7fabe059

A. Applicable Privacy Legislation

As articulated in our 2014 submission,[2] what privacy legislation will govern the personal information handling practices of the Authority must be clear. CMSA s. 12 permits a person to disclose personal information to the Authority for the purpose of the administration of the CMSA or of assisting in the administration of capital markets or financial legislation in Canada or elsewhere. It is unclear whether the Authority is a provincial or federal government agency and consequently, whether provincial or federal privacy legislation governs its personal information handling practices. The CBA Section recommends that this be clear in the CMSA.

B. Appropriate Safeguards and Criteria for Disclosure

The exceptions to the Authority's confidentiality obligations for disclosure of non-public information remain broad. As stated in our 2014 submission,[3] the CBA Section believes that additional safeguards should be included in the CMSA. At the very least, disclosure should be conditional on the Authority being satisfied that the information will be treated confidentially by the person to whom it is disclosed (see s. 22(2) of the *Office of the Superintendent of Financial Institutions Act*). There should be a balance between the purposes specified for the collection of information by the Authority and the need to maintain confidentiality and security over the information collected.

If the Cooperative System allows this broad disclosure, the CBA Section recommends that the CMSA state criteria for when this can occur. Section 15(1)(b), for example, is one of a number of CMSA provisions where foreign law and foreign law enforcement activities may reach into Canada. This raises a number of questions: Must the foreign legal requirements and enforcement practices be substantially similar to those in Canada? Must the Authority provide written reasons on how assisting the foreign jurisdiction will further the Canadian economic interests referenced in the CMSA? Does the party whose information will potentially be disclosed have any right to make representations or to seek review prior to the disclosure? In all these provisions, it should not be a matter of discretion for the Authority. The CMSA should explicity address these issues.

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2 See Footnote 1.

3 *Ibid.*

C. Value of Section 10

The CBA Section reiterates its comments from its 2014 submission[4] on the value of s. 10 (Request of Chief Regulator), with the provisio that we support the addition of s. 10(2). For one, it is unclear why it is necessary under s. 10 that the Chief Regulator may require a person to provide records and information for the same purposes as under s. 9 (Duty to keep and provide information). A person facing a s. 10 request should be able to make representations to the Chief Regulator or have an opportunity to say why disclosure should not be required. For example, if the records and information are not required for the specified purposes or providing the information would cause undue hardship. At a minimum, the CMSA should specify that s. 10 is exclusive of the powers of the Authority in Part 3 and could not be used by the Authority to circumvent the due process safeguards associated with reviews and inquiries.

D. Amendments to Section 13(1)

The CBA Section is pleased that the reference to "regulations" in CMSA s. 13(1) (Confidential Information) was removed, as recommended in our 2014 submisson. The CBA Section recommends that s. 13(1) be amended further to include the Chief Regulator (in addition to the Authority). The section omits the Chief Regulator even though separate provisions require information to be provided to the Authority and the Chief Regulator.

E. Requirement to Seek Information From Existing Sources

The CBA Section supports the amendments in Part 1 to seek information from existing sources before seeking it directly from market participants. Sections 9 and 10 now require considering whether it is practicable to obtain the required information from another source. This is a positive step to reduce duplication and improve efficiency.

IV. SYSTEMIC RISK

The CBA Section has a number of questions about the definition of "systemic risk" and how the benchmarks provisions will work in practice. The CBA Section encourages the CCMR to provide additional clarity in response to our questions.

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4 See Footnote 1.

A. Definition of "Systemic Risk"

Use of the term "stability"

The definition of "systemic risk related to capital markets" has been tightened up significantly. However, we continue to have concerns about use of the term "stability". The definition of "systemic risk related to capital markets" relies on the interpretation of this term, which is not defined. What is the meaning of stability? The CBA Section recommends that the CMSA address this question.

Guidance on what is "material"

The revised CMSA adds a "materiality" requirement to the impact of adverse effects on the Canadian economy. The CCMR says that adding "materiality" established a threshold for the exercise of the Authority's powers, but arguably that was always implied. Generally, materiality can be difficult to assess, particularly for the economy, as impacts on the economy can be material and adverse for some participants and not for others. The CBA Section recommends that the CMSA include guidance on what is material.

In this vein, phrases such as "systemically risky" and "systemically important" have no legal meaning in securities law and are essentially policy-oriented phrases. There should be a formal process to make a determination or finding of systemic risk. Reference could be made to macroeconomic criteria, including whether the systemic risk relates to: a recession brought about where it would otherwise not be expected to occur; significant exacerbation or prolongment of an existing recession; ora significant loss of value in the capital markets unlikely to be corrected in normal market cycles or perhaps over the course of a year. Additional critiera should be explored, and a defined process established to make these determinations. Questions to be answered include how will determinations of economic policy risk and causality be made, who will be consulted, what written analysis and justification will be provided, and will there be an opportunity for comment on the underlying analysis and justification.

Appropriate Standard

As discussed in our 2014 submission[5], we are not clear on the standard that must met prior to making orders such as an order designating a benchmark as sytemically important. The CBA Section encourages the CCMR to provide further clarity.

B. Entity Level Designation Powers and Benchmarks Provisions

The CCMR states that "all entity level designation powers except for trade repositories have been removed from the revised consultation draft and that the new draft is updated to set out a range of regulation making powers to focus on systematic important products and benchmarks and systematically risky practices." These amendments, which narrow the Authority's range of regulation making power, raise questions about how and to what extent the Authority will regulate these entities (trading facilities, clearing houses, credit rating organizations and capital market intermediaries) moving forward. We understand these entities were removed because the CCMR believes they are already sufficiently regulated. The CBA Section encourages the CCMR to provide further detail on the treatment of these entities in relation to the CMSA. For example, we presume that benchmarks may apply to these entities, but would like further clarification.

The CBA Section would also like clarity about benchmarks in the CMSA. It is not clear how the benchmarks section will work in practice. Under CMSA s. 18 (Designation order – systemically important), the Authority can designate a benchmark as systemically important if an impairment to the benchmark's reliability or a loss of confidence in its integrity or credibility could pose a systemic risk to capital markets. This section lists factors to be considered in the decision, but the factors are not indicative of what would be considered "systemically important". Further, s. 19 (Content of regulations) sets out the types of regulations that could be promulgated, but not the form these regulations will take. The CBA Section encourages the CCMR to revise the benchmark provisions, considering the following questions: What form will the regulations take in the regime? Once a benchmark is established, what will happen? How will the benchmark provisions interact with the risky products and practices provisions, which deal with securities and derivatives? Is there any overlap between them? How will these rules intersect with the rules of non-participating jurisdictions?

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5 See Footnote 1.

V. REVIEWS, ORDERS AND ENFORCEMENT

The CBA Section has comments on the opportunity to be heard vs. opportunity to make representations, the production order provisions, removal of sections 77 and 78, and urgent orders and the involvement of non-participating jurisdictions.

A. Opportunity to be Heard vs. Opportunity to Make Representations

We support the inclusion of "opportunity to be heard" as a new right (in s. 18(3)) and in place of the "opportunity to make representations" in various parts of the CMSA. We appreciate the CCMR addressing this concern voiced in our 2014 submission[6]. We also support the inclusion of s. 24(6), giving persons directly affected by an order an after-the-fact opportunity to be heard in the circumstances of s. 24(5).

B. Production Order Provisions

We note the amendments and new provisions on to production orders. In particular, section 44 (Order) moves the term "an issuer" toward the front of the section. The previous wording could have been read to exclude issuers that are not capital markets intermediaries. We understand this is not a substantive change but rather a clarification that issuers are subject to orders under this provision.

We also support the new section 45 (Application for review of production order) which will provide a needed avenue for redress by persons subject to production orders.

C. Removal of Sections 77 and 78

Former ss. 77 (Court to Consider Restitution Order) and 78 (Community Impact Statement) have been removed. This is not discussed in the Commentary. We understand that the subject of s. 77 is now included in the *Canadian Victims Bill of Rights*. We are curious about the rationale for deleting s. 78.

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6 See Footnote 1.

D. Urgent Orders and Involvement of Non-Participating Jurisdictions

We support the amendments in ss. 24(7) and 24(8) to notify non-participating jurisdictions of urgent orders. However, under s. 24(5), we see no reason why affected provincial regulators, participating or not, could not be consulted on a real time basis on an urgent order. Provincial regulators have established procedures for these situations and have experience in responding. They could be involved without any significant delay in the process.

VI. CONCLUSION

The CBA Section welcomes the opportunity to comment on the revised draft CMSA. We would be happy to discuss any of our comments in more detail. We recommend and encourage the CCMR, going forward, to release final drafts of all relevant legislation together, and to allow time for robust consultation. This will result in a more efficient and effective regime that is complementary with the regulatory schemes in non-participating jurisdictions.