



**BETWEEN THE LINES**

## Misguided

Note to expert panel: Securities regulation in Canada needs a complete overhaul, not just a minor tune-up

by **Al Rosen**



**A**nyone saving for retirement should cringe at the mere mention of a principles-based framework with respect to securities regulation in Canada. It's a wonderful notion that companies might abide by a simple set of guidelines grounded in honesty and integrity. But many of them won't—or not for very long at any rate. There is a slippery-slope nature to the problem, and most people, be they executives or investors, are driven by monetary goals that often conflict.

The issue of principles-based regulation has come up again now

that the expert panel on securities regulation has begun its public consultation process on developing a new national regulatory model. The panel is charged with examining several areas, one of which is our desultory enforcement record. In essence, too many people are screwing over pensioners and getting away with it.

The panel's consultation paper, however, leans toward the myopic in the sense that significant focus is put on examining a principles-based regulatory framework. Such consideration, especially to the apparent exclusion of other, better alternatives, seems regrettably misguided.

The accounting world, for instance, has had significant experience in the rules-based versus principles-based debate. The U.S. was traditionally said to be rules-based in its financial reporting, and yet, all those rules could not prevent accounting frauds. Canada has fewer prohibitive rules, but regulators faced the challenge of punching air when it came to cracking down on bad behaviour.

The distinction between specific rules and broader principles was shaky at best. And now, the chair of the International Accounting Standards Board claims that U.S. rules are, in fact, principles-based. That's a pretty circular conclusion to a decades-long debate that, frankly, we should avoid when it comes to choosing a framework for securities regulation in Canada.

Neither rules nor principles are better per se. The only workable (and sensible) solution is to have both. In the end, it means that the same amount of effort must still be put into maintaining the system. But, it also means that investors would be adequately protected by two levels of safeguards once a few other pieces of the puzzle are put into place. Those pieces would include a new independent body to set the rules and principles, and a separate body that is tasked solely with enforcing those guidelines and making recommendations back to the rule-makers.

The principles-supported-by-rules framework is not only intuitive, but there is already a prototype that seems to work well in Canada. Few things are more complicated than our tax rules. Despite thousands of pages of prohibitions, some ingenious soul always snakes through a loophole. But often waiting on the other end is a noose in the form of the General Anti-Avoidance Rule. Known as GAAR, this overarching principle can be used to quash schemes that run afoul of

the spirit, if not the letter, of the rules. And of course, the Canada Revenue Agency is responsible for throwing this weight around to protect the public interest. The agency does not set the rules, nor try to minimize taxes for Canadians. It simply uses its judgment to enforce the rules established by Parliament. The whole concept works on checks and balances, and properly delineated roles and objectives.

In sharp contrast, our current securities regulation framework is beset by provincial political bickering, conflicted input from industry SROs, and various securities commissions that must balance the wants of corporations with the needs of investors. Consequently, Canadian retirees and savers alike are left to suffer unnecessary in-

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vestment losses.

Hopefully, the panel will see its way toward recommending a full overhaul of the current model. But such broad scope is belied by the dim wording of the panel's consultation paper, which also includes fence-sitting statements like "efforts are underway by multiple bodies and authorities to improve enforcement." The worst case for retirees in this situation: if the panel primarily consults the same parties that have failed so miserably in the past at protecting investors and the public interest.

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