Excessive Regulation or Overdue Reform?

As we wrote our inaugural column in mid-July, the Canadian securities regulators are working overtime slogging through a mound-boggling 270-plus letters responding to the registration reform proposals of proposed National Instrument 31-103 published earlier that year. Writers from all over Canada have contributed many thousands of comments; each with their own unique perspective. Given that the regulators are moving quickly to finalize the reform proposals by the official, but unrealistic, deadline of mid-2008, we expect that they will not be able to respond in depth to the comments. We have read the comment letters and offer up our predictions on the expected response to some of the most common comments.

Drop the exempt market dealer concept! Virtually all writers commented on the concept of a new national dealer category of “exempt market dealer,” with its requirements for capital, insurance and proficiency. Particularly firms and investors based in Western Canada protested about “irrelevant burdensome controls,” “money grabs” (presumably by the regulators), “invasive” and “excessive” regulation. Two aggressive letter-writing campaigns were mounted by those who deal in exempt securities and another by investors who wish to invest in them – have as their central theme the belief that the exempt market and a level playing field among market participants will trump these concerns. We also know that regulators question whether all investors participating in the exempt markets are indeed so sophisticated as to warrant the current lack of regulatory oversight.

Allow mutual fund dealers to trade in exempt securities! Many writers didn’t understand how the exempt market dealer proposals would affect mutual fund dealers – can they or can’t they also deal in exempt securities with their mutual fund dealer license? And what about managers of pooled funds – do they need to be registered as exempt market dealers, in addition to their registration as portfolio managers? And if so, why?

“Too much regulation, particularly if prescriptive and inflexible, will not be embraced.”

Given that mutual fund dealers are subject to substantial regulatory oversight over all of their securities-related business, we believe there is no need for them to also be registered as exempt market dealers. Similarly, portfolio managers are already subject to significant regulatory requirements, hence there is little value to be gained by additional dealer registration. We suspect the regulators will agree.

Get the compliance rules right! Many commented on the proposals that would require a registered firm to set up a compliance system that will ensure compliance with securities regulations and that “manages the risks associated with its business in conformity with prudent business practices.” Proficiency requirements for, and the description of the roles of, the Ultimate Designated Person and the Chief Compliance Officer, received particular attention, with many commenting that the regulators have the rules backwards and the proficiency requirements wrong.

We think that the writers will win on this one – the UCC and CCO regime needs revision and compliance expectations need to be clarified. We hope that the CSA will look to the established compliance rule that applies to industry participants in the United States for guidance. Given our proximity with those markets, this would be useful from a cross-border perspective.

Give us a long transition period to the new rules! The lack of proposals for a transition to the new rules garnered forceful comment. Many suggested that transitions of several years were necessary to allow individuals and firms to adapt to the new requirements. Others commented that individuals and firms that carry on business in the securities industry already should be grandfathered and not be required to comply with the new requirements, ideally forever, but certainly for a substantial period of time.

We suspect we will have to get real on this one. The regulators will allow for some transition, perhaps a year or two, but it won’t be forever and current industry participants won’t be grandfathered.

Reflect the reality of independent contractors and incorporated reps! Many commented on what was not dealt with by the regulators – including the notion of principal and agent status for all registered firms and their representatives and incorporated representatives.

We agree that this area is in dire need of regulatory reform. Whether the regulators will have the energy to develop an appropriate regulatory framework that will embrace these concepts is another question. We suspect that nothing in this area will be implemented on the same timeline as the reform proposals.

And there are many more comments. It is obvious that these proposals have touched a nerve.

Our predictions for what will happen next? The securities regulators will move forward quickly, perhaps too quickly for thoughtful reflection, but there will be a second publication of the proposals for comment. The reforms will not come into force by mid-2008. The connotations of the new regime will remain, with the biggest unknown being whether the securities regulators will keep the rules uniform on a national basis, which we believe is the most positive aspect of the present proposals. Finally, the securities regulators cannot ignore the overarching theme of the comments: too much regulation, particularly if prescriptive and inflexible, will not be embraced by today’s securities industry.

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Not Arm’s Length

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found that despite the CRA’s delay, the assessments under section 160 were still valid.

IMPLICATIONS

While this decision did not come as a surprise to many tax practitioners, it does serve as an important reminder to taxpayers that they need to tread carefully in this area. Specifically, section 160 makes a “non-arm’s length” recipient (e.g., spouse, partner, relative, shareholder) of property personally liable for money or property transferred to them by a non-arm’s length individual or corporation that owns the property.

Under this section, the “transferor” is personally liable for the value of what he or she received, less any amount paid in return for the property, up to the tax liability of the “transferor” as of the year in which the property was transferred.

According to senior tax litigator Al Meghji of Olper LLP, who has successfully argued past tax cases in the highest court, “the Supreme Court was clearly aware that the absence of a limitation period in section 160 results in very harsh consequences, but they chose to argue the case one way because it is up to Parliament to amend the provision and put in a limitation period if it sees fit.”

The SCC’s decision reinforces the principle that there really is no time limit on the assessment. In addition, based on prior cases, the recipient of the property can still be held liable even if they had no intention to avoid, or knowledge of, a tax debt.

Adda Meghji, “While the decision has serious implications in such cases where there is little or no assessment when it comes to section 160 assessments, nothing in the Supreme Court’s decision takes away from a taxpayer’s right to challenge such assessments on their merits in the Tax Court.”

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