

**Summary of CSA Harmonization Efforts - What Has Been Done
and What Remains to Be Done**

Update of CSA Initiative Relating to Internal Controls

Address by

Bill Rice

Chair, Alberta Securities Commission

The Canadian Institute

Securities Conference

September 27, 2007

Montreal, Quebec

I. Summary of CSA harmonization efforts - what has been done and what remains to be done

What has been done

Harmonization efforts before HHSL

- Harmonization has long been a goal for securities regulators. Examples of earlier harmonization efforts are:
 - Harmonization of continuous disclosure (CD) requirements: Although NI 51-102 *Continuous Disclosure Obligations* has only been in place since 2003, its predecessor, National Policy 40 *Timely Disclosure*, also contained a set of national requirements and, had been in place for decades.
 - Harmonization of prospectus requirements: Since 2000, most securities regulators had agreed to use, through local implementing rules, the OSC's long form prospectus rule (OSC Rule 41-501 *General Prospectus Requirements*) resulting in effective harmonization of those requirements. The short form prospectus requirement rule (NI 44-101 *Short Form Prospectus Requirements*) has also been in place since 2000.

- Harmonization of Prospectus and registration exemptions: these used to be contained in the various provincial securities acts and general rules but in 2003 most were moved to MI 45-103 *Capital Raising Exemptions*.
- Harmonization of securities acts (USL project 2002-2004): This draft uniform act has been a resource for various harmonization projects and provided a template for the YK, NU, NW, and PEI who are drafting new *Securities Acts*.
- To reiterate, the goals of the HHSL project are:
 - with respect to the acts, to:
 - propose act amendments to securities legislation to harmonize: key provisions; substantive requirements; and "legislative hooks" directing users to the rules;
 - remove unnecessary requirements in the acts; and
 - expand rule-making authority in the acts so that detailed requirements can be moved into national rules.
 - with respect to the rules, to:
 - continue to develop harmonized and streamlined national rules;
 - repeal unnecessary local rules; and

- remove, to the degree practicable, carve outs and opt outs by various jurisdictions in national rules.

HHSL projects completed to date

- Act Amendments aimed at Harmonization:
 - harmonization of key definitions;
 - repeal of detailed provisions in areas such as (i) continuous disclosure (now contained in NI 51-102 *Continuous Disclosure Requirements*), (ii) take-over bid/issuer bid (soon, with the unfortunate exception of Ontario to be contained in NI 62-104 *Take Over Bids and Issuer Bids*), and (iii) insider reporting (soon to be contained in amended NI 55-101 *Insider Reporting Exemptions*);
 - expansion of rule-making authority respecting matters such as governance of investment funds, take-over bids/issuer bids and insider reporting;

[Note: the above amendments have been enacted by most jurisdictions (AB, BC, SK, ON, QC, NB, NS, NL). MB expects to enact them in the fall 2007 or spring 2008 (they were interrupted by an election). NU, NT, YK, PEI expect to enact them in the fall 2007 as they jointly develop a new *Securities Act*.]

- enactment of new civil liability provisions for secondary market disclosure similar to those adopted in Ontario in 2005;

[Note: the SMCL regime has been enacted by ON, AB, MB, NB, NS, NL and SK. BC introduced a different civil liability regime before its Spring legislature adjourned. QC and NWT expects to enact in the fall 2007 and the remaining jurisdictions in 2008.]

- amendments supporting the proposed registration rule (NI 31-103 *Registration Requirements*);

[Note: to date these have been enacted in AB only. BC has introduced them but their legislature adjourned before the amendments were finalized. Others expect to enact them later (MB-partly enacted-interrupted by the election, QC fall of 2007 or spring 2008, NS spring 2008 or later, NL fall 2007, ON 2008 at the earliest), while NU, NT, YK, PEI again expect to enact these provisions along with their new *Securities Act*].

- act amendments concerning a reciprocal enforcement order provision¹ designed to facilitate issuance of public interest orders against market participants who have been sanctioned in another jurisdiction. These amendments address very effectively the criticism that under our current disjointed regime bad actors simply move from the jurisdiction where they have been sanctioned and set up in another jurisdiction.

[Note: AB, SK, NB, NS, NL have enacted this provision (again BC introduced it but its legislature adjourned before enacting it). MB has targeted this for the fall 2007 or spring

¹ In AB, for example, s. 1981.1 The Commission may, after providing an opportunity to be heard, make an order under subsection (1)(a) to (h) in respect of a person or company if the person or company

- (a) has been convicted in Canada or elsewhere of an offence
- (i) arising from a transaction, business or course of conduct related to securities or exchange contracts, or
- (ii) under laws respecting trading in securities or exchange contracts,
- (b) has been found by a court in Canada or elsewhere to have contravened laws respecting trading in securities or exchange contracts,
- (c) is subject to an order made by a securities regulatory authority in Canada or elsewhere imposing sanctions, conditions, restrictions or requirements on the person or company, or
- (d) has agreed with a securities regulatory authority in Canada or elsewhere to be subject to sanctions, conditions, restrictions or requirements.

2008, QC for the fall 2007-the 4 smaller jurisdictions expect it to be adopted along with their new *Securities Act*.]

- Rules and Practices - Amendments aimed at Harmonization:
 - NI 45-106 *Prospectus and Registration Exemptions* (completed Sept/05): This was more of a consolidation project than a harmonization project as the rule still contains a number of material carve-outs (e.g., ON does not allow the offering memorandum exemption). Previously, exemptions were contained in MI 45-103 *Capital Raising Exemptions*, MI 45-105 *Trades to Employees, Senior Officers, Directors and Consultants*, various provisions of the act and general rules.
 - Efforts were made to reach agreement among CSA members in respect of exemptions, but it was not possible. Rather than seeing this as a deficiency under our current system, I would argue that it evidences a strength. Where local considerations demand different treatment, there is sufficient flexibility to permit differences that do not impact the fundamental principles of the regime.
 - Amendments to NI 44-101 *Short Form Prospectus Distributions* (completed Dec/05): These amendments

harmonized the rule with NI 51-102 *Continuous Disclosure Obligations* and expanded the eligibility of the short form system to many more issuers.

- Amendments to NI 43-101 *Standards of Disclosure for Mineral Projects* (completed Dec/05): These amendments dealt with issues that had arisen since the implementation of the rule in 2001 and resulted mainly in reducing the regulatory burden on mining exploration issuers while still maintaining high disclosure standards.
- Amendments to NI 51-102 *Continuous Disclosure Obligations* (completed Dec/05): These amendments and changes to other related disclosure rules (NI 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*, NI 71-102 *Continuous Disclosure and Other Exemptions Relating to Foreign Issuers*) were made to:
 - clarify certain provisions that had been confusing to issuers;
 - codify discretionary exemptions that the CSA members found they were regularly granting; and
 - streamline requirements.

- Harmonization of the interpretation of "default". The CSA published Notice 51-322 *Reporting Issuer Defaults* on December 15, 2006 which sets out a harmonized list of deficiencies that will generally result in a reporting issuer being noted in default of the securities laws of a particular jurisdiction.

- Harmonization of requirements and practices for revoking cease trade orders. The CSA adopted National Policy 12-202 *Revocation of a compliance-related cease trade order* on July 27, 2007 which, as the title suggests, harmonizes the requirements an applicant must meet when applying to revoke a compliance related cease trade order (e.g., failure to file financial statements).

What remains to be done

- with respect to acts:
 - As noted above, there are a number of outstanding legislative amendments aimed at harmonization that still need to be passed in several jurisdictions.

 - Act amendments relating to registration have been passed by AB and introduced by BC but they are not totally harmonized. For example, BC will not have the business trigger in its act.

Other jurisdictions expect to enact some version of the registration act amendments in fall 2007 or spring 2008 to support NI 31-103 but those amendments have not been finalized.

- The securities acts are not completely uniform, except possibly for the new securities act being drafted for PEI, YK, NW, NU, but are expected to have harmonized key provisions and harmonized "hooks" to the relevant rules where detailed provisions have been moved out of the acts and into national instruments.

- with respect to rules and practices:
 - NI 31-103 *Registration Requirements*: The Rule is a product of the *Registration Reform Project (RRP)*, a CSA initiative to harmonize, streamline, and modernize registration across the country. The registration area was the one where arguably the least had been historically achieved by way of harmonization. NI 31-103 proposes to:
 - consolidate and harmonize in a single national instrument, requirements and restrictions governing registration and registrants that exist in various acts, regulations, rules,

notices and administrative practices across all the CSA jurisdictions;

- streamline and harmonize registration categories for both firms and individuals; and
- consolidate exemptions from the dealer and adviser registration requirement that are currently contained in the various statutes, regulations, rules and discretionary orders.
- The currently anticipated schedule is: republication for comment in December 2007 and final implementation in July 2008.
- NI 41-101 *Prospectus Requirements*: Proposed NI 41-101 sets out the general requirements that will govern all prospectus distributions, a form of prospectus for long-form issuers and a form of prospectus for investment fund issuers. Proposed NI 41-101 is the last rule in the Prospectus and Continuous Disclosure realm to be updated and made into a national rule.
- The currently anticipated schedule is: final rule publication in December 2007 and implementation in March 2008.

- NI 62-104 *Take-over Bids and Issuer Bids*: The CSA's main objective was to harmonize the requirements and restrictions governing take-over bids and issuers bids and related early warning requirements across all Canadian jurisdictions, including the four jurisdictions that do not currently regulate bids (namely, Prince Edward Island, N.W.T., Nunavut, and Yukon).

While Proposed NI 62-104 was originally intended to harmonize the take-over bid legislation in all jurisdictions, it will now be implemented as a multilateral instrument in all jurisdictions, except Ontario. In Ontario, the Proposed NI 62-104 will be implemented as amendments to Part XX of the *Securities Act (Ontario) (OSA)* via Bill 187 and proposed OSC Rule 62-504 *Take-Over Bids and Issuer Bids* (collectively, the "OSC Take-Over Bid Rules").

However, MI 62-104 and the OSC Take-Over Bid Rules are virtually identical and minor differences are only the result of different drafting conventions and the structure of the OSA.

- The currently anticipated schedule is: final rule publication by November 2007 and implementation in early 2008.

- Further amendments to NI 51-102 *Continuous Disclosure*: NI 51-102 will soon include consolidated disclosure requirements respecting forward-looking information which is currently contained in a number of rules and policies, including NP 48 *Future-Oriented Financial Information* (slated for repeal).
- The currently anticipated schedule is: publication of final materials in October 2007 and implementation by the end of December 2007.
- Amendments to NI 55-101 *Insider Reporting Exemptions*: NI 55-101 will:
 - contain consolidated insider reporting exemptions;
 - require fewer and more appropriate reporting from insiders;
 - require more timely disclosure; and
 - and provide a more effective response to late filings.
- The currently anticipated schedule is: publication for comment in May 2008 and implementation in May 2009.
- Removal of carve outs: All jurisdictions are working to eliminate carve outs from rules. For example, in April 2007,

AB enacted rule making authority "respecting any matter necessary or advisable to regulate auditors of reporting issuers" which will enable AB to eliminate carve outs in NI 51-102 *Continuous Disclosure Obligations* and NI 52-108 *Auditor Oversight*.

- Harmonize approach to fees: the CSA is addressing this issue and securities commissions have been asked to contemplate adopting a uniform fee model. A recurrent criticism of the Passport initiative is that it has yet to address the issue of multiple fees, the assumption being that under a single national regulator, fees would be significantly reduced. I do not think that participants should anticipate, under the Passport, single regulator or any other system, any significant reduction of aggregate fees. Compliance oversight, policy development, enforcement and adjudication cost what they cost and it is unreasonable to expect that one system or another will bring about dramatic changes in that respect.

II. Internal Controls - NI 52-109

- I have been asked to provide you with a brief status update regarding our progress on the amendments to Multilateral (or what will be National) Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*.
- I'll give you a high-level look at the proposal as published for comment followed by a brief summary of some of the feedback we've received.

The Published Proposal

- On March 30 of this year, the CSA published for comment a revised 52-109.
- The proposal largely reflects the approach to reporting on internal control over financial reporting (ICFR) that we previously announced in March of 2006 at the time that we determined to abandon 52-111 (the auditor attestation piece that roughly paralleled SOX 404).
- Essentially, the March 30 proposal made one key change to existing 52-109 and a number of other amendments that the CSA felt were required in order to make that key change operate effectively.

- The major change was that all reporting issuers would be required to
 - evaluate Internal Control over Financial Reporting (ICFR); and
 - provide disclosure regarding the results of that evaluation in the MD&A.

NB: Depending on the particular circumstances of a given issuer, the proposal would allow the certification to contain one or more qualifying statements to be more fully explained in related MD&A disclosure.

The first of these potential qualifying statements relates to "reportable deficiencies".

- A "RD" is defined in the rule as a deficiency in the design or operation of a particular control that would cause a reasonable person to doubt that the issuer's ICFR provides reasonable assurance regarding the reliability of financial reporting.
- The term was developed to link the concept of a RD with the existing definition for ICFR which also incorporates a standard of reasonableness in assessing the reliability of final reporting.

In the rule, any deficiency that is determined to be a RD will result in a qualification of the representation in the certification relating to the design of ICFR AND related disclosure in the issuer's MD&A (that related MD&A disclosure would include a description of the RD; the remediation plan to address the RD; and the proposed completion date for the remediation plan).

The remaining qualifications contemplated in the proposed revisions to the rule were included in an effort to provide practical solutions to deal with challenges faced by venture issuers, newly listed issuers and issuers facing access to information difficulties relating to joint ventures or recent acquisitions.

Qualification 1: ICFR Design Accommodation for Venture Issuers

- Proposed rule requires issuers remediate any RD relating to design of ICFR.
- Concern: smaller issuers, particularly those with very few employees, may face challenges designing ICFR (primarily due to lack of personnel or expertise). Requiring remediation of such an RD, in many cases be disproportionately expensive.
- To address this, the rule provides that if a Venture Issuer can't remediate a design deficiency relating to ICFR, the certifying officers may file a qualified certificate with associated disclosure

in the MD&A (which would identify the RD, indicate why it can't be remediated, outline the risks associated with that RD, and indicate whether and how those risks have been mitigated).

Qualification 2: Scope Limitation

- In order to address the challenges for issuers with interests in proportionately consolidated entities (joint ventures), variable interest entities, or recently acquired businesses, the CSA is proposing to permit a scope limitation when the certifying officers do not have sufficient access to these entities to design and evaluate the required controls.
- In these circumstances, it has been proposed that a qualification may be included in the certification and additional disclosure would be required in the MD&A (describing the scope limitation and providing summary financial information relating to the joint venture, variable interest entity or acquired business).
- Note: for acquired businesses, we proposes that CO's may only take advantage of the scope limitation for recently acquired businesses for a period of 90 days from the acquisition.

Qualification 3: IPO / RTO Exemption

- The third relaxation proposed relates to IPO's and certain reverse take-overs.

- This would allow the first certification filed by a new reporting issuer to exclude any reference to the design or evaluation of ICFR.
- Again, we proposed to limit this exemption to reporting periods ending on or before the 90th day after becoming a reporting issuer.

Request for Comments

The CSA is currently in the process of reviewing the comments.

- We have received 53 written comment letters
- Commenters included reporting issuers, law firms, accounting firms as well as other professional bodies.
- Based on our experience we have found that few smaller issuers respond with written comments but we felt it imperative to find a way to hear their views. As a result, in addition to requesting written comment we held roundtables in Ontario, Quebec, Alberta and British Columbia with smaller issuers in order to obtain their feedback.

The following appear to be the areas of greatest concern as expressed in the written submissions and at the small issuer roundtables:

Reportable Deficiency

- More than half the written submissions expressed views on the proposed definition of reportable deficiency. Of those who commented:
 - Approximately one third agreed with the definition of reportable deficiency as published;

- Approximately one third preferred that the CSA adopt the US regime's term "material weakness" rather than creating a new reporting threshold in Canada;
- The remaining one third noted concern with the proposed definition published, but suggested that modifications or additional guidance could address their concerns. In particular the following items were noted:
 - There was a request for further guidance on the interpretation of "reasonable person" [*the threshold for disclosure is what "would cause a reasonable person to doubt that the design or operation of ICFR provides reasonable assurance"*].
 - A request for further clarity on the term "reliability of financial reporting", which is used in the definitions of both ICFR and RD.
 - Commenters were concerned that there was no explicit concept of "materiality" included in the definition of RD.
 - A request for clarity on the relationship between the terms RD & Material Weakness, including an explanation of what differs when using the two definitions.

- General request for further guidance for determining a RD (including examples)

Design Accommodation

- Less than half the written comments provided views on the proposed design accommodation for venture issuers, but we did receive a significant amount of feedback on this issue at the roundtables.
- Of those who provided written comment:
 - Approximately two thirds of commenters expressed general support for the proposed accommodation.
 - One third of commenters had general concerns with the accommodation as published. The two concerns identified were that:
 - The proposal only provides an accommodation to venture issuers. Some commenters believe the accommodation should also be provided to small TSX issuers since there are a number of small issuers on the TSX who also cannot reasonably remediate RD relating to design.

- The other concern we heard was that, in general, requiring venture issuers to comply with the proposals, even with the accommodation, is inappropriate because the requirements pose too high a cost without corresponding benefit.

Use of a Control Framework

- In our proposal we do not require issuers to use a control framework for design or evaluation of ICFR but we do require disclosure as to whether one is used, and if so which one.
- Although there was no specific request for comment on our proposal not to require use of a control framework, we received comments recommending such a requirement.
 - Concern was expressed that with the absence of an audit requirement, if a control framework or at least the key components of a control framework were not used in the design of ICFR, there would be a much greater risk of inappropriate and inconsistent judgments.
 - Concern was raised about the comparability of assessments made by certifying officers.

Reasonableness of Scope Limitations

- In general, commenters conceptually agreed with each of the proposed scope limitations. However some concerns were expressed with either the proposed time that a scope limitation is available or the amount of disclosure required as a result of using the scope limitation. In particular we have heard the following comments for each scope limitation:
 - Several commenters expressed concern with the 90-day scope limitation available for newly acquired businesses. Many feel that 90 days is not adequate. Many have requested that the scope limitation be expanded to either six months or one year in order to provide an appropriate amount of time.
 - Concerns were also expressed with the 90-day scope limitation for IPOs and RTOs, although an IPO or RTO involves significantly different circumstances than those in the case of a business acquisition since there is no concern about access to, or knowledge of, the issuer's operations.
 - For the scope limitation on investments there was general agreement with the limitation, but there were requests for clarity on when issuers need to disclose scope limitations. In particular, commenters questioned what disclosure would

be expected in the case of multiple investments using the scope limitation.

Nature and Extent of Guidance

- Overall there was a lot of positive feedback on guidance included in the companion policy especially pertaining to the "top down - risk based" approach and the amount of guidance offered for the design and evaluation of DC&P and ICFR.
- Nature
 - Some commenters believe that the guidance is too prescriptive which made it appear to be more "rule-based" - they felt that the tone was too strong in some areas.
- Extent:
 - Additional guidance was also requested for other topics including:
 - Use of a service organization
 - Use of a specialist or expert
 - Guidance on fraud controls
 - Mitigating procedures vs. compensating controls

- Guidance on what should be disclosed for "changes in ICFR"
- Sufficiency and retention of evidence

We are still in the process of reviewing the comments, and hope to complete that process in the near future. The comments are material and have highlighted practical problems. Resolution of all issues is not proving to be an easy task.