

Canadian Securities Transition Office releases transition plan

On July 12, 2010, the Canadian Securities Transition Office (the “CSTO”) released its Transition Plan for the Canadian Securities Regulatory Authority (the “Plan”). The Plan follows the May 2010 release of the proposed *Securities Act* (the “National Act”), and is the next step in the Canadian government’s creation of a single national securities regulator.

In our last Derivatives Law Bulletin, we noted the wide scope for regulation of derivatives under the National Act. Unfortunately, the Plan only hints at further details to come, stating that new regulations will need to be developed and that, “The most significant area will be derivatives, for which the [National Act] provides a new, flexible framework”.

“risk-based, outcomes-focused”

While the Plan does not contain specific information concerning how derivatives will be regulated under the National Act, it does provide insight into the larger regulatory scheme envisioned by the CSTO. The Plan describes a “risk-based, outcomes-focused” approach, based on identifying and responding to threats to investors and the stability of capital markets. To implement this risk-based approach, the Plan envisions that the regulator established pursuant to the National Act, the Canadian Securities Regulatory Authority (the “Regulator”), will monitor market data and trends to form leading risk indicators, intervening when “market forces are judged insufficient to remedy an existing or anticipated market failure”. The Plan envisions the Regulator being able to use temporary orders and urgent regulation-making powers under the National Act to respond quickly to market developments.

While the Plan does not specifically identify derivatives markets as being likely targets of market interventions, the context of the ongoing financial crisis, largely blamed on complex, insufficiently-regulated derivative products, suggests that derivatives markets are likely to receive disproportionate scrutiny.

a tough sell in Quebec

In Quebec, concern about the impact of a national securities regime on the future of its derivatives industry rests on a widely held suspicion that national regulation will cause a shift of expertise out of the province. Although the Plan envisions a key role for local offices throughout the country, many fear that national regulation will mean centralized decision-making based in Toronto. Jean St-Gelais, president and CEO of the Quebec Financial Markets Authority (the “AMF”), has estimated that hundreds of highly-skilled jobs, including some within the AMF itself, are at stake in the derivatives sector in Montreal, claiming a national securities regulator would render many of the AMF’s activities “functionally or legally obsolete”. He is not alone in his criticism.

Opponents of national regulation from within Quebec, including notables from “Quebec Inc.” such as Groupe Jean Coutu, Quebecor and Molson Coors Brewing Company, have banded together to oppose the Plan. Calling their group the *Coalition Against the Federal Government’s Securities Commission Project*, they have released a joint statement alleging that the establishment of a national securities regulator would strip the province of its ability to introduce innovative structures, such as those that enabled the development of its derivatives sector. The group instead advocates continued collaboration between federal and provincial authorities to strengthen the existing securities regulatory framework, as exemplified by the passport system.

In our view, a greater risk presented by Quebec opting out of the national regime would be the potential inability of the national regulator to harness the AMF’s unique expertise in the regulation of derivatives. The National Act treats derivatives in much the same way as the Quebec *Derivatives Act*. Both regulatory regimes dispense with uniform prospectus requirements and rigid classification of instruments in favour of a flexible approach. As Quebec moves forward in developing and applying workable and responsive methods for regulating derivatives markets, its importance in the proposed national regime grows. If the National Act becomes law, and Quebec opts out, the result may be a lose-lose situation. The national regime would be forced to develop its own expertise in derivatives from the ground up, while Quebec’s derivatives regulators would not be able to draw on the federal government’s expertise in managing systemic risks caused by activities in the derivatives sector. Whether or not Quebec can be brought to the negotiating table will be a key factor in the move toward uniform securities regulation in Canada, and is a development we will continue to track.

stay tuned

Admittedly, evaluation of the impact of the proposed regime on the derivatives marketplace in Canada can only be general and speculative at this point, as details of anticipated regulations have yet to be released. The CSTO will release a technical commentary on the National Act sometime in the coming weeks. We expect to gain greater insight into the mechanics of the proposed regulation of derivatives from this publication. Our analysis of the technical commentary will form the subject of a future Derivatives Law Bulletin.

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a cautionary note

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