BANKING ON CORPORATE

BY NEILL MAY

Walking the securities regulatory tightrope

So much about law relates to "balance" that those of us practising or studying law take it for granted. When faced with an enthusiastic debate about an issue at a cocktail party, neither side may be impressed by the emphatic declarations of a lawyer guest asked to settle the dispute that both sides are right; the lawyer, on the other hand, will likely be delighted at her wisdom and even-handedness at having *balanced* the competing perspectives (I arbitrarily used the female gender in that example, but truthfully this is my own rationalization for rarely being invited to parties, confounded legal training).

The nature-versus-nurture debate as to whether the legal profession attracts those given to negotiation and compromise, or whether the practice trains and instils those attributes, is beyond the scope of this article — the reality is it's probably a little of both, vividly illustrating the point. Balancing is a sensitive and dynamic art, contorted by the pressure for quick solutions that is clearly increasing in an age of constantly multiplying forms of media, exponentially quickening pace of communication, and shortening attention spans.

Canadian securities regulation is no different in this regard — it's all about balance, which can only be achieved (weighing the costs imposed by regulation with the regulatory benefits) through sensitivity to relevant factors. In the Canadian experience, this has historically (and appropriately) meant consideration of the unique characteristics of our markets: the generally lower capitalization of our issuers (which cannot, at the smaller end of the spectrum, realistically bear the full panoply of regulatory compliance costs), the relatively higher degree of closely controlled companies, the focus of significant segments of our market on the resources sector, and similar factors. Securities regulation has reflected recognition of these considerations; a good example is Canada's version of the American Sarbanes-Oxley corporate governance reforms, which imposed a lesser degree of regulation (often referred to as SOX-lite), recognizing the generally smaller size of Canadian issuers.

That is not, however, the end of the analysis. In particular, there are two other fundamental dynamics. First, there is the change that comes with the passage of time. Focusing again on the example of corporate governance reforms, in the few years since the SOX-lite rules were implemented there have been significant changes, including a much higher degree of shareholder activism, significant maturation in the securities litigation area, and more active regulatory enforcement. At the time of adoption of the new rules, the addition of a requirement for personal certification of financial statements might have given an executive meaningful pause before taking an aggressive position in financial disclosures. Today, there may be other very significant disciplines on those judgments that neuter the practical effect of the regulatory compliance measures. This dynamic requires ongoing reconsideration of the cost-benefit of regulatory obligations.

The second dynamic is enforcement. This is critical not only because the manner in which securities laws are enforced has obvious and direct effects on the regulatory balancing act, but because a key motivating factor for securities regulation to begin with is not only to be taking steps to protect the integrity of the capital marketplace, but to be seen to be doing so. Here again the unique dimension of being in a smaller market plays a role — there must always be concern that high profile regulatory failures in our system will stain and cause disproportionate and enduring damage to our markets on a broader scale. Put differently, we may need to work harder to try to avoid those failures and to be seen to be actively addressing them when they inevitably occur.

While awareness of the unique aspects of our markets, as well as the evolution of external disciplinary forces, is key for regulators, enforcement is today likely the most critical arena for seeking balance. As headlines of companies failing and breaches of securities law continue to be published regularly, it is difficult to argue against assertive enforcement, and the important signalling and potential deterrent effects of active regulatory oversight and intervention. Nevertheless, the countervailing cautions are important — there is (ironic) risk that regulators will undermine confidence in the market by getting involved directly and in haste. For example, if there is a rush to judgment that in the fullness of time is not supported, or if the regulators' involvement extends to the point where they end up "wearing" a business failure. Over-aggressive enforcement will inevitably have a chilling effect on public financings. I would be thrilled to discuss this further at the cocktail parties I will no doubt be invited to following the publication of this issue. CL

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