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The Mobius strip of securities reform

By Neill May

Sometimes, securities regulation is like a Mobius strip (the strip of paper that is flipped at one end and then connected back to the other end to form one continuous loop): If you look at any single isolated part, there are two sides, but, sometimes, when you take a step back, you seem to be going in a continuous loop.

A better contemporary analogy may be the fast-food salad options: The contents seem to be healthier and they must be more dietetic, but, wait, they have more calories than saucy burgers and other not great nutritional features, but, then again, they offer the advantages of fast food and do provide a more varied diet, and on it goes.

What put the Mobius strip in my mind (I don't need prompting to think about fast food) is the recent consultation paper (51-404) published by the Canadian Securities Administrators identifying areas of securities regulation that could benefit from a reduction of undue regulatory burden. Specifically, though the analysis focuses on securities regulation generally, taking into account changing market conditions, investor demographics, technological innovation and globalization, among other things, many of the proposals predictably contemplate reducing the regulatory burden for smaller enterprises, which are often the types of issuers that we're conditioned to believe are riskier for investors.

At a high level, proposals of this nature make abundant sense. It is challenging to argue that facilitating capital formation for earlier-stage enterprises, removing unwarranted regulatory costs and taking into consideration the evolving characteristics of the marketplace in general is not worthwhile. However, to torture my earlier analogy a bit, these types of earlier-stage companies can sometimes be the fast-food salad with appealing characteristics but hidden calories.

The proposed reforms fall into five categories. The first extends the scope of rules that streamline disclosure requirements for "venture issuers" (issuers that do not have securities listed on senior stock exchanges such as the TSX); for example, permitting longer filing deadlines for financial statements, fixing higher thresholds for significant acquisition reporting and eliminating some requirements (such as the annual information form) entirely. The less onerous requirements would instead be applied to those issuers that fall below size-based criteria (based on market cap or issuer revenue, for example).

The second category focuses on the offering process; the proposals range from reductions in the required disclosures (e.g., fewer years of audited financials and streamlining of disclosure requirements generally) to more dramatic reforms such as alternative prospectus models and rules that better facilitate straightforward at-the-market continuous offerings.

The other categories are in a similar vein. The third contemplates narrowing of various ongoing disclosure requirements, such as removing or narrowing the requirement for detailed business acquisition reporting, removing repetitive disclosure line items and considering permitting semi-annual (instead of quarterly) reporting for all, or possibly just smaller, issuers. The fourth concerns the elimination of overlapping regulatory requirements, and the fifth focuses on new paths to better permit electronic delivery of materials.

Many of these proposals are not new but are restatements or refinements of a (properly) continuing process of weighing the costs and benefits of securities regulatory requirements. Viewed from a distance, there is a consistent cyclicality to the process. The natural reaction to public issuer failures is to enhance disclosure requirements (since the entire framework is predicated on enhancing transparency so that market participants can properly evaluate investment alternatives); bad outcomes often result in initiatives requiring additional process and disclosure to avoid recurrence. Then, after the market lives with the new requirements for a time, and as other factors (such as technology and the characteristics of the market) evolve, a cost-benefit analysis is undertaken.

In this way, this cyclical pattern that can seem (again, like the Mobius strip) to be endless is actually a natural evolutionary process. There was a time when a guy named Mobius twisted a piece of paper and became forever remembered by elementary school teachers and corporate law columnists. In contemporary times, the process is more iterative and Darwinian.

More specifically, there is logic to reduced requirements for smaller issuers. At the offering stage, relaxation of requirements for smaller issuers has often been accompanied by requirements for starker warnings, so that investors acquiring riskier securities were informed bluntly about the risks, like the newly required calorie disclosure for chain restaurants. The analogy falls down, though, when you consider streamlining of the continuous disclosure requirements, as you have to imagine that consumers are out there trading fast-food burgers without sharing the restaurants' nutritional information.

When I was a young lawyer, I assumed that senior lawyers over time come to know the law comprehensively. Now that I'm more senior, I acknowledge that, given the pace of regulatory change (and perhaps other aspects of seniority), I had to leave comprehensive knowledge behind, like Wilson bobbing on the ocean surface. What I hope for now is that, like the Mobius strip, the endless continuous line comes back to a comprehensible place, where local poutine resides. **CL**

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