



Investing in Change: The Transformation of the Canadian Securities Industry

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Check against delivery

Good afternoon and thank you Marilyn for that kind introduction.

I am delighted to be with you today, and to see many industry colleagues in the audience and friends at this distinguished head table.

I'm honoured by the invitation of the Canadian Club, which has, for more than a century, been Canada's premier forum on issues of economics and public policy.

In the resolution establishing the Canadian Club movement, the founders adopted a mission statement "to deepen and widen the regard of Canadians for their land of birth or adoption, and to increase their interest in matters affecting the welfare of their country."

Over the past century, the Canadian Club has been a platform for ideas that have brought transformational change to our country, from a rural society of 4 million people at Confederation, to a leading industrialized democracy of 31 million citizens.

Today, I want to describe a transformation brought about by globalization and new technologies, forces that are impacting all industries. But it's a transformation that is also due to new demands and new needs of the Canadian investing public.

During the past decade, new demographic, economic and technological forces have fundamentally changed the investment process.

The shift of Canadians savings away from traditional products like Canada Savings bonds and bank deposits to stocks, bonds and mutual funds ; an aging population ; the growing awareness that individuals must rely on their own financial resources to provide for their retirement ; the increase in disposable income ; the democratization of information and access to markets : all these forces have converged to create a newly empowered consumer.

Just how empowered? How involved?

Well, today one in two Canadians is invested in the markets, either individually or institutionally. That's twice as many as a decade ago.

Over the last decade, investments in stocks, bonds and mutual funds have grown three times faster than bank deposits.

During the same period, mutual fund investment has increased ten fold and at over \$400 billion is equivalent to the annual output of Ontario.

Over the past decade, securities trade in Canada grew by 350%, while the value grew by 750%.

And on-line trading, which did not even exist five years ago, now accounts for four in every ten trades. Our customers execute their own transactions through hand held devices on the wireless Internet. Then they follow the action in real time on cable channels at lunch while they work out at their health club.

A nation of savers has been transformed into a nation of investors.

Today's retail consumer is confronted with an expanding and complex array of market investments, each with varying degrees of risk and return possibilities.

They include conventional stocks and corporate and government bonds, as well as a broadening array of managed fund products, from conventional mutual funds to proprietary and third party WRAP accounts. I could also mention complex debt securities, such as debt derivatives. And the growing interest in exchange traded funds.

More trading. More customers. More --and more complex-- products. Add to this the impact of new technologies, and the scope of change is clear.

As Ontario Securities Commission Chairman David Brown recently said to a Canadian Club audience : "There is almost no aspect of the capital markets today that is not undergoing rapid change".

It's a challenge the Canadian securities industry is ready to meet.

Our business benchmarks and regulatory standards are evolving to respond to the new marketplace realities.

The regulation of Canada's securities industry is changing in response to this massive influx of retail investors, the impact of technology and the increasing trend to globalization.

One of the key players bringing about this change is the Investment Dealers Association of Canada, the national self-regulatory organization for the Canadian securities industry. I'm delighted that our President and CEO Joe Oliver and IDA staff have joined us this afternoon and I want to take this opportunity to thank them in a very public way for the good work they do on behalf of our industry association and for Canadian investors.

The IDA regulates and represents an industry that employs 39,000 Canadians and directly touches many people and businesses, either as investors or as issuers of various types of securities.

Our 190 Member firms include 7 bank affiliated full service firms, as well as a range of institutionally focussed or retail service firms, full service or discount, each contributing in a significant way to the dynamism of the industry and the health of the Canadian economy.

Our role is to protect investors and ensure the integrity of the marketplace.

Over the past four years our responsibilities have increased, as we have taken on the Member Regulation responsibilities of the Toronto Stock Exchange and the Vancouver and Alberta exchanges. The increased levels of market activity that I have just described have also increased our work load. Our budgets and staffing have expanded so we can meet our increased regulatory responsibilities. In fact, on the enforcement front alone we've doubled our staffing and budgets.

And when I say, we, I do mean we. The IDA is a self-regulatory organization, which means that the industry, not the consumer and not the government, funds it. It's a true user pay system.

A self-regulatory organization is one in which the members of an industry regulate or police themselves under government oversight and public involvement that ensures that the public interest is paramount.

Let me cite the Ontario Securities Commission's summary of the advantages and merits of self-regulation.

- An industry organization will often set higher ethical and business practice standards for its members than a public agency**
- Rule making can be more flexible and responsive to market developments**
- Industry expertise is available to deal with specialised technical issues.**

The OSC also offers a rationale that I would describe as enlightened self-interest, and that is : public confidence in the

industry depends upon the good business conduct of all its members.

We all benefit from a well-regulated industry, one that enjoys the public trust, one that sets and adheres to high standards of integrity.

That's why our ongoing efforts at the IDA are focussed on creating fair markets.

Now, what does a fair market depend on? First, it depends on investor protection, which in turn rests upon appropriate rules and tough penalties for non-compliance.

We take investor complaints seriously. If our investigation demonstrates violation of our regulations, we impose penalties that can include a permanent ban from working in the industry or fines up to a maximum of \$1 million per charge.

Last year, out of 56 million market transactions that took place in Canada, the IDA received some 1000 complaints. That's a very small percentage, but to the client who has been treated unfairly, it's still too many.

A fair market requires new ways to settle financial disputes, ways that are faster, less expensive and less confrontational

than the courts. That's why the IDA established an independent arbitration program for clients of Member firms. If the client decides to go the arbitration route, the IDA member firm must participate. It's the client's choice.

A fair market requires well trained, qualified professionals.

Education and training of securities professionals has always been a key ingredient in investor protection and confidence in the integrity of our capital markets. Today, globalization and new technologies are making high standards of professionalism more important than ever to the investing public. Moreover, as the traditional distinctions between products have blurred, investors have come to expect professional advice based on multiple competencies across a range of skills and expertise.

At the IDA, we are advancing this goal in several ways. We continuously work to enhance the proficiency standards for investment professionals, in partnership with the Canadian Securities Institute (established some 30 years ago by the IDA and other Canadian SROs).

We have introduced a mandatory Continuing Education program for professionals who work directly with the public. They must take required compliance and professional development courses during each three-year cycle. And we are

working with industry groups and the securities commissions to develop a common standard for registrants who want to hold themselves out as financial planners.

Equal access to information levels the playing field, creating a fair marketplace for all investors. Quality, independent research is also a key element in ensuring fairness and the integrity of markets.

This brings me to the Securities Industry Analyst Standards Committee, better known as the Crawford Committee, which issued its preliminary report some three weeks ago.

First of all I want to thank Purdy Crawford for his dedication and diligence on a very difficult file. Purdy is perhaps Canada's foremost advocate of corporate governance.

The IDA participated in the creation and work of the Crawford Committee along with the TSE and the Canadian Venture Exchange. We support its work and, by and large, its preliminary recommendations. Indeed, of the 28 recommendations in the preliminary report, the IDA will eventually be responsible for implementing 17 of them.

Mr. Crawford recommends mandatory disclosure of conflicts of interest as between research analysts and the investment

banking side of our business. In other words, if a firm banks a company or does its IPO, or holds a significant amount of its stock, that relationship should be stated up front in any analyst's report.

If disclosure does not successfully mitigate a potential conflict, then the Committee recommends other approaches, including outright prohibitions on analyst coverage.

Mr. Crawford recommends posting analysts' buy-hold-sell recommendations, as a way of keeping track of their forecasting accuracy. The analyst community is far from being infallible, but they do make courageous calls. Hugh Brown, an analyst at my firm, BMO Nesbitt Burns, recently downgraded our own bank. Clearly, that took independence and speaks volumes about the professionalism of Hugh and his industry colleagues. This is not a popularity contest.

The Crawford recommendations build on disclosure requirements that are already in place for IDA Member firms, including Pro-Group disclosure and statutory disclosure related to conflicts of interest.

They are also consistent with developments in the United States. The rules recently adopted in the US by the SEC, the Securities Exchange Commission, will lead to improved quality and

timeliness of research. Under Regulation FD, for Fair

Disclosure, information communicated to analysts by the heads of companies will be available in the public domain at the same time.

The Canadian Securities Commissions are making a concerted effort to develop a similar policy of timely fair disclosure. Here, too, as with the Crawford Committee recommendations, the IDA is working with regulatory organizations throughout Canada to create a fair market for Canadian investors.

Let me briefly tell you about some other important initiatives that the IDA is involved in, particularly new regulatory responses that directly address the impact of technology and globalization.

The Suitability and Know your Client rules were introduced to protect investors who made their decisions based on their adviser's recommendations-- an adviser who then usually completed the recommended transaction. Do we really need to determine suitability when investors are doing their own research and executing their own trades, on line?

During the past 18 months, the industry and the IDA have worked with the securities commissions and we've successfully developed new rules that ensure appropriate protection for the

consumer while providing enough freedom to make their own investment choices.

I said earlier that we are now dealing with a newly empowered investor. Empowerment is fine in theory but it has to mean more than mere access to trading. True empowerment involves access to knowledge, the acquisition of skills and an understanding of investing.

In a recent OSC survey, one in four Ontarians said they did not understand the relationship between risk and reward. That's why the regulatory community and industry have worked hard in recent years to enhance investor education activities.

Each year, the Canadian Securities Institute teaches some 10,000 Canadians about the marketplace, either in their classrooms or through their extensive Internet based offerings. Their non-profit sister organization, the Investor Learning Centre, is working with the schools developing curriculum to educate young Canadians so they can become informed adult investors. Their storefront Investor Learning Centres offer resources and information to the investing public.

Technology and globalization are also transforming our equity and debt markets. The new trans-border nature of stock exchanges and the emergence of new electronic trading

platforms have rendered our regulatory framework obsolete. Our reform efforts now underway include the development of new trading rules, and the consolidation and integration of markets to ensure the transparency of prices and best execution across all markets (traditional and electronic).

Canadian investors are also going global, buying foreign stocks, notably American shares, to diversify their portfolios and improve their revenues. Foreign mutual fund investments now constitute the largest single element of investment funds in the country.

It's the same global thrust for Canadian businesses. Last year about half the \$62 billion involved in equity issued by Canadian business was raised in foreign markets. Canadian businesses are moving to list their shares on foreign stock exchanges: there are three times as many inter-listed stocks as two decades ago. As well, an increasing number of mergers and acquisitions are being done on a cross border basis. Indeed, two thirds of the \$164 billion in Canadian M and A activity last year was done on a cross border basis.

The Canadian securities industry is responding. We're taking steps to improve foreign market access for Canadian issuers and investors.

On the regulatory front, we've had considerable success in getting a safe harbour for RRSPs of Canadians resident in the United States, the retention of MJDS, a system which recognizes Canadian disclosure documents for offerings in the United States, and exemptive relief from state regulation for Canadian listed securities.

On the business side, the industry is building a global platform through the acquisition of foreign businesses, notably in the US, to meet the needs of our Canadian clients and to build a global business.

I want to conclude on a personal note.

With the sharp downturn in markets, many Canadians have suffered reversals in their investment portfolios. Many people I meet ask when markets will get better, when their investments will recover, and whether they should even stay in the market.

We are looking to restore investor confidence against a background of losses that have inflicted in some cases personal anguish and pain.

The stock market is not a casino, though during the recent tech/media and telecom run-up, many people evidently thought it was. Companies that didn't even have a business plan, let

alone a path to profitability, were bid up into the stratosphere and just as quickly fell to earth. Suddenly, dot.com was dot.gone.

The consequences of the 'tech wreck' are still being felt in markets. And the disappearance of the wealth effect has shaken consumer confidence and spending intentions in a way that is only now being measured in the retail sector and elsewhere in society.

However, the return of normal valuations has also resulted in the re-asserting of business rules in markets, of top line sales and bottom line profits, of reasonable price-to-earnings ratios, and realistic targets for return on equity.

There aren't two sets of rules, one for the old economy and one for the new. There are, as always, only the fundamentals.

We need to begin again at the beginning. We need to get back to basics, to get a better sense of long-term trends and real value based on time tested methods of research and analysis.

There is a safe haven in all this turmoil, and that's in the balanced investment portfolio you can create with the advice of professional advisers, members of the IDA.

While exposure to various asset classes should vary, depending on ones circumstances, over the long-term the stock market is the best place to invest because, over time, investment in equities will bring the best return. For your family, and for your future. And for the prosperity of Canada.

I appreciate the opportunity to talk to you today about an industry that I believe is one of the most stimulating and rewarding professions to work in. On the one hand, it permits us, as professionals, to help people grow the value of their investment portfolios. On the other, it puts us in daily contact with the entrepreneurs of our society and enables us to contribute directly to their obtaining the financial means they need to create wealth and improve the quality of life.

And although the pace of change is dizzying at times, the core values of this industry remain the same. The Canadian securities industry is unchanged in its commitment to generate capital, create jobs and provide investment opportunities for all Canadians.

Thank you very much.

