

GUEST COLUMN

Overcoming securities regulation lock-in

Canadian financial regulators are hampered by the gridlock that comes with fragmentation. Independent oversight could promote new ways of thinking

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AS CANADIAN SECURITIES REGULATORS become more fragmented, the tendency to “lock-in” to policy choices based on previous decisions has increased.

This tendency is natural where individuals working in teams are often less equipped to act on key information than when there is more accountability. The gridlock is exacerbated by a complex and rapidly evolving market environment, contributing to oversimplification and “tunnel vision.” Many of us tend to see the world in a particular way when it serves our self-interest to do so. It’s easy to ignore “inconvenient” facts or analysis to promote a desired outcome. And yet in today’s world, “normal” paradigms rarely hold up.

Likewise, there is a proclivity for “conservatism bias,” where information is interpreted to confirm prior expectations. There is also perceived safety in the status quo, even when available evidence suggests a different course of action. This is particular-

ly so when consensus is difficult to achieve or there is much uncertainty over the consequences of a particular action.

Each of these biases are a disincentive to engage in independent, analytical thought. Efforts are made to avoid such conduct through accountability mechanisms (e.g., review by third parties, independent auditing). But these mechanisms no longer work as effectively as they should with Canadian securities regulators.

The challenge is particularly acute with respect to the reform of existing rules, where inertia becomes an obstacle to the adjustments required to ensure competitive and well-functioning markets and to address the inevitable, unintended consequences of regulation.

Examples of Canadian securities regulators being slow to respond to the need for regulatory reform abound. Extended, often multiple comment processes when implementing new rules, and delayed reform of existing ones, have added unnecessary costs to investing and capital allocation.

Securities regulators have taken steps to address this inertia problem. They have consulted with market professionals to help them better understand the need for new rules, the revision of existing rules and how these rules should be structured. Likewise, the securities commissions should recognize the comparative advantage of self-regulatory organizations (and the courts) and defer to them when appropriate. Responsibility for the rule-making exercise should be clearly delineated to ensure the efficient deployment of industry resources.

Efforts are also underway to take accountability more seriously. The **Ontario Securities Commission’s** year-old investor advisory panel (which recently tabled an outstanding annual report) and the recent OSC strategic plan consultations (coupled with the reinstatement of the OSC “dialogue” process after a multi-year hiatus) are laudable initiatives. More is required to encourage specific short-term and measurable objectives and to ensure more transparency and due process in the resolution of real-time issues. There must

Bank of Canada governor Mark Carney.

But if the regulators themselves comprise the oversight body, it is likely to reinforce existing biases and will not necessarily bring new ideas to the table. Instead, the overseers could become advocates for existing agendas and defenders of their turf.

But what if the leadership and staff of such an oversight body were composed of individuals independent of the institutions that breed the biases? A truly independent group of individuals — drawn from around the globe, chosen on merit, adequately fund-

ed and protected against retaliation — might offer unique and relevant perspectives. It would also offer those who despair of having new ideas fully considered a platform for thinking “outside the box.”

The U.S. Congress is currently considering the

SEC Regulatory Accountability Act, which would require the Securities and Exchange Commission to review its regulations periodically to determine if they are “outmoded, ineffective, insufficient or excessively burdensome, and to modify or repeal them in accordance with such review.” It’s time to consider similar measures in Canada. ■

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A truly independent group of individuals from around the globe might offer unique and relevant perspectives on new approaches to financial markets regulation

also be a greater commitment to evaluate performance and outcomes on issues previously identified by market participants.

An idea that is gaining traction elsewhere is that, just as independence is mandated for corporate audit committees, it may make sense to set up independent oversight for financial regulators. Such a body could help to evaluate past actions and provide guidance on (and help prioritize) future initiatives. One example of such an initiative is the Financial Stability Board, the international body recently established to co-ordinate the work of national financial authorities and headed by