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Fix System before Enron Happens Here: Stromberg

U.S. debacle has added fire to need for change but hardly anyone agrees on how to better protect investors in Canada.

By Anne Papmehl

SPECIAL TO THE STAR

The former commissioner of the Ontario Securities Commission hopes it will not take an Enron-like catastrophe to drive regulatory reform in Canada.

Glorianne Stromberg said she believes that public confidence in the current system is low, "especially if they've been in contact with it. It's much like health care right now: you just hope you never have to use it."

While Canada has not had the likes of Enron, the current system is very piecemeal, with gaps that leave investors vulnerable.

Though the majority of stakeholders – investors, securities issuers, advisors, standard-setters, analysts and accountants – agree that change is needed, getting it to happen is another story.

In Canada, where securities regulation is a provincial matter, one of the main roadblocks is lack of consensus on what regulatory reform should look like. Bodies like the Toronto Stock Exchange, the Investment Dealers' Association and the Ontario Securities Commission have been pushing for a national regulatory system. The provincial regulators in B.C., Alberta and Quebec are dead set against it.

Stromberg, who initially recommended the adoption of a national regulator in her now-famous Stromberg Report 1995, sees this resistance largely as a turf war. "They keep trotting out the same old tired arguments of how it's different in each of their provinces."

In addition, "There's a very natural reluctance to give up what they know for something they don't know," says Stromberg, who believes the regulatory changes would have more bearing on what is being done than on who was doing it. "They still need people on the ground in the provinces doing the work that regulation involves."

Some feel that Canadian regulatory reform would move faster were it not for Ottawa's reluctance to get involved. On the other hand, in the U.S., where financial accounting reform currently occupies centre stage, over-involvement at the federal level has been deemed a major obstacle to reform.

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“We certainly think that politics has intervened in setting financial accounting standards,” says Patricia Walters, senior vice-president of professional standards and advocacy at the Association for Investment Management and Research (AIMR). “Through the Securities Laws, Congress has ultimate authority over markets and their sub-categories, including financial reporting which they delegate to other bodies. It’s one thing to enact due diligence and another to interfere unduly with processes that I think are actually quite reasonable. On some of the more controversial financial reporting rules, I think things would have been different here if there hadn’t been such political interference.”

Though U.S. reform efforts also tend to be labelled as lethargic, Walters points out that things are not always what they seem. “Often what appears to be slowness to the public is a result of the way accounting standards and securities regulations are set.

“Both the Financial Accounting Standards Board (FASB) and the Securities Exchange Commission (SEC) in the U.S. have very stringent due process requirements for public comment periods, for review of the public comments and for hearings if necessary. All of this takes time.”

In addition, transactions are considerably more complicated than they were 50 years ago. “You’re trying to develop a system that accounts for something correctly and provides supplemental disclosures so people can understand what’s going on,” explains Walters.

“It’s quite easy to set a standard that becomes problematic simply because you don’t anticipate some of the complications such as how a company would interpret a rule in a particular circumstance.”

Does that mean Walters doesn’t feel things could move faster? “No, I think they could move faster. Something shouldn’t take ten years, but I think it’s unrealistic to expect a good standard to emerge in six months.”

So what’s the solution? For Canada, Stromberg recommends integrating the separate existing “four-pillar” regulators (securities, banking, insurance and trust regulators) into a single, national, integrated regulatory body that would operate throughout the country.

This body would combine functional, prudential and institutional regulation, all of which need to be integrated to ensure the effective, efficient operation of the capital markets and the protection of investors.

This idea is shared by Patricia Walters: “We respond to a wide variety of regulatory initiatives in Canada and our opening mantra is usually, ‘we think you should begin to develop a national securities regulatory function.’”

Walters also emphasizes that need for improved disclosure of information to the investing public on both sides of the border.

“In some sense I think the bull market we had gave investors false confidence that their investment decisions were good ones. We have expressed our concern on many occasions

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about communicating simple ratings or recommendations to the investing public. A responsible investment professional would never make a decision based on a company's earnings by itself. In the same way, we wouldn't recommend that an individual investor make a decision based simply on a recommendation to buy, hold or sell."

Regulatory reform is a daunting task, but Stromberg is optimistic that it will eventually come about in Canada. "My proposals are ideas whose time has come and we're beginning to see their implementation. Things have a way of seeming so impossible, but the darkest times are often just before a significant breakthrough."

That breakthrough may have already emerged in the US., where the combination of September 11 and Enron have spurred Congress to expedite bills directed at securities fraud, energy derivatives and protection of employee pension plans, especially those containing employer stock.

While Stromberg can't say what the breakthrough will be in Canada to move the reforms along, she is hopeful that common sense will eventually override the impediments."