

**Submission to the Standing Committee
on Government Agencies**

**Response to the Stakeholder Presentations
made to the Standing Committee on February 23, 2009**

**David Wilson, Chair
Ontario Securities Commission
April 7, 2009**

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Executive Summary

The Ontario Securities Commission (OSC, Commission, we) welcomes the opportunity to appear before the Standing Committee on Government Agencies to respond to questions that were raised during stakeholder presentations made to the Standing Committee on February 23, 2009. The next section provides a detailed response to the comments made by stakeholders.

The executive summary highlights the Commission's response in four key areas: accountability, investors, enforcement and response to the global financial crisis.

The responses reflect our statutory mandate, which is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. Everything we do is measured against this dual mandate.

Accountability

We are accountable to the Legislature through the Minister of Finance. We have a transparent and robust accountability framework in place that includes an MOU with the Minister, an annual statement of priorities that is published for comment, an annual report and audited financial statements (that are delivered to the Minister and required to be tabled in the Legislature), operational budgets and business plan that outline priorities, strategies, risks and performance measurements. Our processes, policies and practices are transparent and accountable – we meet or exceed Management Board directives.

The process for making securities rules involves consultations, cost-benefit analyses and a rigorous public comment process before any rules are submitted to the Minister for his consideration. We have advisory committees and special project committees which provide feedback on our proposed rules and policies.

The Commission is subject to a robust corporate governance charter. The roles and responsibilities of our Board of Directors, committees of the Board and Commissioners are set out in our governance charter and posted on our web site. There is a transparent and public process administered through the Public Appointments Secretariat for appointing Commissioners. The process ensures that Commissioners have the integrity, competence and capability to discharge complex governance, policy and adjudicative responsibilities.

Investor Focus

The Commission's mandate, operations and initiatives reflect the importance of investors. We recognize the importance of effectively engaging investors, especially retail investors, in obtaining input on securities-related matters, particularly initiatives that directly affect investors. We have been seeking innovative ways to obtain input from investors. We have hosted an Investor Town Hall and an Investor Forum. We set up an investor advisory committee with a two-year mandate. We also created a Joint Standing Committee on Retail Investor Issues with the investment industry SROs that we oversee

(IIROC and MFDA) and the Ombudsman for Banking Services and Investment (OBSI) to focus on retail investor issues in a more coordinated way. Each of these initiatives has enabled us to make progress in engaging and obtaining input from investors.

We are actively engaged in a rigorous exercise to identify the most effective ways to obtain investor input and to address investor interests. For example, we are establishing an *Investor Secretariat* as a coordinating body within the Commission to better identify and address issues of concern to investors, particularly policy implications that regulatory initiatives may have on investors, and to better promote internal awareness of investor issues being developed at the OSC. As part of this new Secretariat, we are also assessing the best way to encourage and facilitate investor input recognizing the challenges investors face in commenting on regulatory proposals.

Investor education is essential to financial literacy, which equips investors to make more informed investment decisions. We are working with Canadian regulators, SROs, the Financial Consumer Agency of Canada and the Ministry of Education to advance financial literacy. Over the past eight years, we have given financial support to the Investor Education Fund (IEF) to support investor education and financial literacy initiatives in Ontario, including programs for publicly funded schools and colleges.

We continue to work with other Canadian regulators and SROs to improve investor protection through important initiatives such as:

- Strengthening and improving complaint handling and dispute resolution across Canada;
- Improving the disclosure regime for mutual funds, through the point of sale project, so that advisors provide meaningful and easy to understand written information to investors before they buy mutual funds or segregated funds; and
- Registering investment fund managers (which includes hedge fund managers) as part of the registration reform initiative, as well as requiring that all advisors meet high proficiency, capital and other standards for registration and participate in complaint handling and dispute resolution services.

Although significant efforts have been made and continue to be made to improve the complaint handling and dispute resolution mechanisms in Canada, we continue to explore options to compensate investors more quickly and with less cost. We also believe that many of the recommendations of the Expert Panel on Securities Regulation relating to complaint handling and the compensation of wronged investors merit further consideration.

Enforcement

Enforcement is a high priority for the Commission. We are working cooperatively and constructively within the enforcement “mosaic” which consists of regulators, Justice Departments and police to strengthen enforcement.

One of the reasons the Commission supports the creation of a national securities regulator is that it represents a way of further strengthening both regulatory and criminal enforcement in Canada. In the interim, the Commission has initiated dialogue with the Ministry of the Attorney General with the objective of identifying opportunities for cooperation and assistance, particularly in the area of sharing resources, expertise and information. At the federal-provincial/territorial level, OSC Chair, David Wilson co-chaired the Securities Fraud Working Group which made recommendations to Ministers of Justice and Attorneys General for improving the investigation and prosecution of securities fraud.

We were asked on several occasions by members of the Standing Committee whether the Commission needs new regulatory tools to strengthen its enforcement efforts. The Minister has also asked the same question. We are pleased with the recent amendment that enhances the Commission's power to reciprocate enforcement orders made by courts or securities regulators in other jurisdictions. Reciprocal orders enable the Commission to act more quickly in certain enforcement matters.

The Commission has broad investigative and enforcement powers, including the ability to prohibit trading, ban persons from the market, impose financial penalties, and freeze assets and, in court proceedings, to seek stiffer penalties including prison terms and broader remedies including compensation. We continue to assess these tools in light of the global financial crisis, the complexity of financial products and the usefulness of new regulatory tools introduced in other jurisdictions. We are considering new regulatory tools that would strengthen our ability to protect investors and we will be bringing forward to the Minister some new proposals for his consideration. Some of these proposals may require legislative amendments to:

- Provide a framework for regulatory oversight of credit rating agencies;
- Strengthen our ability to preserve assets during the conduct of an investigation;
- Broaden the definition of illegal insider tipping; and
- Clarify the Commission's jurisdiction over companies operating in the U.S. over the counter market that carry out manipulative and illegal market activities such as "pump and dump" schemes on unsuspecting Ontario investors.

Response to the global financial crisis

The issues relating to the current market turmoil are complex and global in nature. Since the beginning of the financial crisis, the Commission has taken action to foster confidence in the integrity of our markets. We have:

- In conjunction with the SEC, temporarily banned the short selling of certain inter-listed financial sector stocks to avoid any potential for regulatory arbitrage;
- Closely monitored the continuous disclosure filings by public companies with a particular emphasis on the banking and financial services sector and highly leveraged public companies; and
- Undertaken compliance reviews of money market mutual funds, exchange-traded funds and closed-end funds to assess potential exposure to toxic assets. We are

currently completing compliance reviews of hedge funds to assess any unusual risks to investors.

The Minister has also responded by proposing amendments to the *Securities Act* and the *Commodity Futures Act* that would give the government and the OSC additional authority to respond to extraordinary circumstances involving a major market disturbance.

The commission is actively participating in both domestic and international initiatives relating to the non-bank ABCP market, credit rating agencies, unregulated financial entities (such as hedge fund managers), derivatives, short selling and corporate governance.

In October 2008, the Commission, together with the other Canadian securities regulators, issued a consultation paper outlining proposals in response to the turmoil in the credit markets in Canada, particularly in relation to the non-bank ABCP market. The proposals outlined in the paper are part of a collective response by regulators in Canada and around the world. A key recommendation in the paper is the implementation of a regulatory framework for credit rating agencies that would require compliance with the recently amended code of conduct for credit rating agencies established by the International Organization of Securities Commission (IOSCO) – the code sets the benchmark for standards for credit-rating agencies world-wide. In addition, the consultation paper considers whether regulators should amend the short-term debt exemption to make it unavailable for sales of asset-backed short-term debt including ABCP.

International leaders and organizations, including G20 members and IOSCO, are also calling for regulation of hedge funds and hedge fund managers. The OSC, through its leadership role in the proposed registration reform project, is proposing to implement registration requirements for investment fund managers, including hedge fund managers. The government introduced amendments in Bill 126, *Budget Measures Act, 2009* that would enable the Commission to implement these reforms.

Our Canadian financial sector and our regulatory structure is sound, particularly in comparison to other international jurisdictions. The securities regulatory framework and the Commission's operations and performance have recently been the subject of an intensive and detailed International Monetary Fund review. The strengths and weaknesses of our regulatory system were under scrutiny. The results were very positive – the IMF concluded that the Canadian financial system is mature, sophisticated and well-managed. Furthermore, the IMF noted that in most respects the securities framework for securities regulation in Canada implements the IOSCO principles – a benchmark of international best practices for securities regulation. That said, the IMF noted that there would be advantages to moving towards a single securities regulator, as it would allow policy development to be streamlined, reduce compliance costs and improve enforcement.

OSC Response to Stakeholders

Presentations to the Standing Committee on Government Agencies were made on February 23, 2009 by the following stakeholders:

- Pamela Reeve
- Stephen Griggs, Canadian Coalition for Corporate Governance (CCGG)
- Kris Birchard, Advocis
- Ermanno Pascutto, Canadian Foundation for Advancement of Investor Rights (FAIR)
- Michael Code and Anita Anand, Faculty of Law, University of Toronto
- Diane Urquhart and Gary Logan

1. Oversight and Accountability

Oversight by the Legislature – Review of Annual Report

A Standing or Select Committee of the Ontario Legislature should review OSC annual reports and oversee OSC operations.

Pamela Reeve

OSC annual reports should be automatically referred to a Committee of the Legislature which should have appropriate resources and powers including the ability to compel witnesses.

Ermanno Pascutto, FAIR

Response

The OSC is an independent and self-funded agency that is responsible for securities regulation within Ontario's capital markets. It has a governing board and is responsible to the Legislature through the Minister of Finance. The Commission has a robust accountability framework that includes:

- MOU with the Minister that sets out the respective roles and responsibilities of the Minister and the Chair and the accountability relationship between the Commission and the Minister and Ministry
- Requirement to provide the Minister business plans, operational budgets and plans for proposed significant changes in the operations or activities of the Commission
- Requirement to deliver an annual report and audited financial statements to the Minister for tabling in the Legislature. The standing orders of the Standing Committee on Finance and Economic Affairs (SCFEA) give it authority to review the OSC annual report once it has been tabled

- Publication of the annual Statement of Priorities for public comment and delivery to the Minister
- Publication of policies and rules for public comment (and subsequent re-publication of policies and rules if there are any material changes) and delivery of proposed rules to the Minister for his consideration
- Ministerial approval of Commission by-laws

The Legislature plays a significant role in the oversight of government agencies. The Standing Committee on Government Agencies is empowered to review and report to the House its observations, opinions and recommendations on the operation of all agencies, boards and commissions.

The Minister appointed a review committee chaired by Purdy Crawford that conducted a comprehensive review of securities regulation. On March 21, 2003, the review committee released its final report, *Five Year Review Committee Final Report – Reviewing the Securities Act (Ontario)*. The review committee made 95 recommendations to strengthen investor protection and confidence in the integrity of Ontario’s capital markets. The recommendations covered legislation, rules, and structural and operation issues.

The Standing Committee on Finance and Economic Affairs (SCFEA) reviewed the recommendations in the Five-Year Review Report, heard opinions of stakeholders and presented a report with recommendations to the Legislature on October 19, 2004.

Many of the recommendations of the Five-Year Review Committee, including the SCFEA recommendations, have been implemented. As part of this process, the Act was amended in 2004 to enable the Minister to appoint a standing or select committee of the Legislature to review the Commission’s annual report.

Regulatory Audit

Committee should commission (or recommend to the Legislature the commissioning of) a regulatory audit of the OSC by securities regulation experts retained by the Legislature and reconvening the Committee once the experts have reported to the Committee.

Ermanno Pascutto, FAIR

Response

The securities regulatory framework and the Commission’s operations and performance have recently been the subject of an intensive and detailed International Monetary Fund (IMF) review. From 2007 to 2008, the OSC participated in an IMF-led Financial Sector Assessment Program update (FSAP) initiative. The purpose of the initiative was to assess the strengths and weaknesses in Canada's financial sector, with a focus on securities, banking, pensions and insurance. The results, which were published in February 2008, generally found that Canada's financial system is mature, sophisticated

and well-managed. The IMF also noted that in most respects the regulatory framework for securities regulation in Canada implements the International Organization of Securities Commission (IOSCO) Objectives and Principles of Securities Regulation – a benchmark of international best practices for securities regulation.

We don't believe that an additional regulatory audit is necessary or would provide any improvement in existing oversight. The OSC strives to ensure transparency and accountability in its policies, practices and operations. There are both statutory and operational processes that enable the Commission to effectively discharge its mandate to provide protection to investors and to foster fair and efficient capital markets in a transparent and accountable manner.

The Commission publishes annually its Statement of Priorities which outlines strategic goals and identifies specific initiatives under each goal. We also report publicly on the progress of our goals and initiatives.

We developed a business plan that sets out the key strategies and priorities for the years 2008 to 2012 and describes how the Commission plans to accomplish its priorities. The business plan also details our performance measurements and risk assessment. We recently updated our business plan, consistent with the Management Board requirements, and submitted the plan to the Ministry of Finance for review by Management Board.

Our rules and policies are subject to a very robust public comment process in which we publicly respond to comments received.

We have advisory committees comprised of securities regulatory experts, market participants and other stakeholders that regularly provide comments and critique of our regulatory initiatives. Current advisory committees include:

- Chair's Industry Advisory Group
- Continuous Disclosure Advisory Committee
- Enforcement Advisory Committee
- Investment Counsel/Portfolio Managers
- Mining Technical Advisory and Monitoring Committee
- Registration Advisory Committee
- Securities Advisory Committee
- Senior Securities Legal Advisory Group

2. Representation on the Commission

Retail investors and shareholders should be adequately represented on the OSC. One of the current Commissioner vacancies should be expressly allocated for a retail investor representative.

Ermanno Pascutto, FAIR

OSC should consider appointing a financial advisor to fill one of the current Commissioner vacancies.

Kris Birchard, Advocis

Response

The Commission is aware that its own governance practices and procedures should adhere to the highest principles underlying regulatory rules and policies. The integrity, competence, capability and commitment of the members of the Commission is vital to the discharge of the Commission's mandate to provide protection to investors from unfair, improper and fraudulent practices and to foster fair and efficient capital markets and confidence in those markets.

The Commission is subject to a robust corporate governance charter. The roles and responsibilities of our Board of Directors, committees of the Board and Commissioners are outlined in our governance charter and posted on our web site. The members (Commissioners) perform two key roles. Acting as the Board of Directors, members oversee the operations of the Commission, including the Commission's strategic planning, resource allocation, risk management, financial reporting policies and procedures, and effectiveness of internal controls and management information systems.

Acting in their regulatory capacity, members handle complex policy and adjudicative matters. Members approve and oversee the implementation of the Commission's regulatory initiatives and priorities, set enforcement priorities and review enforcement practices and procedures. Members also serve on adjudicative panels that independently preside over administrative regulatory proceedings.

The *Securities Act* provides that the Commission is to be composed of at least nine and not more than 14 members, appointed by the Lieutenant Governor in Council. When vacancies arise, the Commission complies with the Government Appointees Directive and the publicly transparent process of appointments implemented by the Public Appointments Secretariat (PAS). All member vacancies on the Commission, together with a description of the duties of a member and the required qualifications, are advertised on the PAS website. Individuals interested in being appointed as members are required to submit their application to the PAS. Only applications made to the PAS are reviewed by the Commission's Governance and Nominating Committee. Following the interview process, the Committee provides a list of recommended nominees to the Board for consideration by the Minister and appointment by Cabinet.

The Commission regularly reviews the individual qualifications, attributes, skills and experience of the members to ensure that members, individually and collectively, meet the standards necessary to exercise their responsibilities effectively. A member profile is used to identify any gaps in attributes, skills and qualifications that might arise as a result of an upcoming vacancy on the Commission.

The Commission's Governance and Nominating Committee seeks to find individuals who, in the aggregate, have expertise in retail and institutional investment as well as a number of areas, including accounting/auditing, finance, investment management, investment banking, banking or insurance, and legal and adjudication.

All Commissioners are sensitive to investor issues. It is inconsistent with our statute and our corporate governance charter to allocate Commission positions to particular representation. We note, however, that Vice-Chair Lawrence Ritchie is the Executive sponsor and strong advocate for retail investor initiatives at the Commission. He is actively engaged in investor initiatives involving the Canadian Securities Administrators (CSA) and the Joint Forum of Financial Market Regulators. He is also the Chair of the Joint Standing Committee on Retail Investor Issues.

3. Investor Input in Securities Regulation

Investor Panel

OSC should establish an independent investor panel modelled on the FSA financial services consumer panel (UK Investor Panel) as recommended in the Expert Panel on Securities Regulation Report.

Pamela Reeve

OSC should implement an independent investor committee as part of its consultative committee structure along the lines of the UK Investor Panel including adequate financial resources and support and compensation for the members of the committee.

Ermanno Pascutto, FAIR

Response

The Commission's mandate, operations and initiatives reflect the importance of investors. We recognize the importance of effectively engaging investors in obtaining input on securities-related matters, particularly initiatives that directly affect investors. We have been seeking innovative ways to obtain input from investors. We know that more needs to be done in this area.

We are actively engaged in a rigorous exercise to identify the most effective ways to obtain investor input and to address investor interests. For example, we are establishing an *Investor Secretariat* as a coordinating body within the Commission to better identify and address issues of concern to investors, particularly policy implications that regulatory initiatives may have on investors, and to better promote internal awareness of investor issues being developed at the OSC. As part of this new Secretariat, we are also assessing the best ways to encourage and facilitate investor input recognizing the challenges investors face in commenting on regulatory proposals. The input from investors would

be directed to the appropriate branch at the OSC or other organizations (IIROC, MFDA or OBSI).

Input from investors

The Commission's mandate, operations and initiatives reflect the importance of investors to the Commission's work. The OSC has been exploring innovative ways to obtain input from investors, especially retail investors. We jointly hosted with IIROC, MFDA and OBSI an Investor Town Hall in 2005 and an Investor Forum in 2007. We also created an Investor Advisory Committee with a 2-year term to provide input on investor issues.

Following the Investor Town Hall, a committee made up of executive and senior representatives from IIROC, MFDA, OBSI and the OSC was struck to monitor and work on retail investor issues. The coordinated efforts of the four organizations put in place a strong foundation for ongoing dialogue and collaboration between the organizations on projects relating to retail investor issues. The four organizations created a permanent Joint Standing Committee on Retail Investor Issues (JSC).

The purpose of the JSC is:

- To provide an effective forum in which retail investor issues can be discussed and considered among the four organizations, and
- To identify opportunities and approaches to address, in a coordinated manner, ongoing and newly emerging issues that have an impact on retail investors.

The JSC focuses on such matters as enhancing investor education, promoting greater transparency of investment products offered for sale to retail investors and strengthening the effectiveness of retail investor protections. The JSC seeks input from retail investors and parties with retail investor perspectives, including investor advocates, consumer affairs journalists, legal counsel and financial advisors.

The JSC conducted its first consultative process in the fall of 2008 to obtain investors' views on issues relating to suitability of investment products. Members of the public, as well as organizations such as CARP, FAIR, Small Investor Protection Association (SIPA), Consumers' Association of Canada and the Consumers' Council of Canada were invited to participate. A report was published in December 2008. The next phase of the project will involve assessing the quality of information investors receive from their investment advisors and how it is used to make investment decisions.

Other investor-related initiatives

The Commission has been working with its CSA, Joint Forum and SRO partners on a number of high profile initiatives to benefit investors. These include:

- Initiatives to improve complaint handling and dispute resolution, including changes to SRO standards and deadlines under SRO rules and policies to improve how firms deal with investor complaints.

- Implementation of a Canadian dispute resolution framework across financial sectors.
- Development of a point of sale disclosure document for mutual funds that, if adopted, will provide meaningful and easy to understand information (about a fund’s performance, risk and cost) to investors before they make their initial investment decisions.
- Reform of registration requirements that, if adopted, will require registration of investment fund managers (including hedge fund managers) – a significant investor protection initiative that has been advocated by the IMF and other international regulators. The proposed rule will also modernize, streamline and increase proficiency and other “fitness-for-registration” requirements across Canada and require registrants to be part of complaint handling and dispute resolution services.

4. Complaint Handling and Investor Redress

The Commission has been working with Canadian regulators, the SROs (IIROC and MFDA), and the Ombudsman for Banking Services and Investments (OBSI) to improve complaint handling and dispute resolution mechanisms in Canada.

The OSC, IIROC, MFDA and OBSI have developed a “user friendly”, two-page guide to assist investors in making a complaint, identifying options for redress, and reporting wrongdoing. The guide is available on the website of the four organizations.

As a specific resource for investors, the OSC has also created an Investor Assistance area within the OSC Contact Centre to provide investors with access to a team of knowledgeable professionals. This group specifically responds to investor complaints and inquiries and helps investors understand and navigate the different organizations, their roles in our regulatory system and how to effectively make a complaint and seek redress.

Although significant efforts have been made and continue to be made to improve the complaint handling and dispute resolution mechanisms in Canada, we acknowledge that investors continue to raise concerns about the process of complaint handling and redress. We agree that there is a need to better streamline and simplify the resolution of retail investor complaints and to make the system more understandable and “user friendly” for investors. We also need to continue to explore ways to obtain compensation for investors more quickly and with less cost. The Expert Panel on Securities Regulation has made many recommendations relating to complaint handling and the compensation of wronged investors. We agree that many of these recommendations merit further consideration.

Registrant participation in dispute resolution body

<p><i>Government and OSC should consider [adopting recommendation of Expert Panel on Securities Regulation] requiring participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.</i></p>
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Ermanno Pascutto, FAIR

Response

We agree with this recommendation. This issue is being addressed in proposed National Instrument 31-103 *Registration Requirements*, an important regulatory initiative of the Canadian Securities Administrators led by the OSC. If approved by the Minister, the rule would require all registrants to participate in independent dispute resolution services. In order to allow for greater flexibility, NI 31-103 does not specify the method of dispute resolution to be used, but it does state that the dispute resolution service chosen must not be related to the registrant. An existing independent dispute resolution service is the Ombudsman for Banking Services and Investments (OBSI). Registrants will not necessarily have to be a member of OBSI to comply with the proposed requirement.

IIROC and MFDA member firms are required to participate in the OBSI dispute resolution services and to cooperate fully with OBSI in the resolution of client complaints. This requirement has been in place since 2002.

Review of IIROC arbitration program and SRO enforcement powers

OSC should ask IIROC to review its arbitration procedure with a view to making it more helpful and less costly to investors and more transparent. IIROC arbitration program should be changed to raise maximum claim amount.

Proposed improvements to SRO (IIROC) enforcement powers:

- *ensure jurisdiction over former IIROC members,*
- *expand powers of investigation similar to OSC*
- *power to collect fines*

Ermanno Pascutto, FAIR

Response

The Investment Industry Regulatory Organization of Canada (IIROC) is a national SRO which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. The trade association function was separated from the SRO (formerly called the IDA) in 2006, creating the Investment Industry Association of Canada (IIAC).

IIROC's Arbitration Program

The OSC supports IIROC's arbitration program and its ongoing review to improve the program, including review of the maximum claim amount.

Clients of IIROC-regulated firms have access to an independent binding arbitration service available across the country. In addition, IIROC (and the MFDA) requires member firms to participate in the Ombudsman for Banking Services and Investments

(OBSI) dispute resolution program, and to cooperate fully with OBSI in the resolution of client complaints. Currently, investors appear to favour the OBSI program which, while not binding, involves a more informal process at no cost to the investor and deals with a higher maximum claim of \$350,000.

To improve its own program and better serve investors, IIROC is in the process of undertaking a broad review of the arbitration program to determine how it is working and to explore what changes might be appropriate. The review has focused on concerns identified by investors, member firms and other stakeholders, including the need to reconsider the monetary threshold. IIROC CEO and President Susan Wolburgh Jenah indicated in an October, 2008 speech that IIROC is “in the process of reviewing this monetary threshold, with a view to matching the OBSI maximum”.

IIROC intends to seek public input on the issues identified and the various options that may be available to address them.

In addition to the review of its arbitration program, IIROC released in mid-February, 2009 proposed amendments to complaint handling requirements for its member firms, setting out specific standards and timelines for acknowledging, investigating and responding to complaints alleging misconduct in the handling of client accounts. The proposed rule would also require Dealer Members to establish policies and procedures to deal effectively with all client complaints, and to inform clients of all available options if they are dissatisfied with the Dealer Member’s final response. The MFDA is proposing similar changes to its complaint handling policy.

Jurisdiction over former IIROC members

IIROC currently has a by-law in place which provides that IIROC maintains jurisdiction over a former member for a period of 5 years after the member resigns. This by-law was recently challenged in the *Taub* case. The Ontario Divisional Court held in that case that IIROC lacked jurisdiction to discipline former members. The BC Court of Appeal came to the opposite conclusion in a similar case. *Taub* is currently under appeal and the Ontario Court of Appeal has reserved judgment.

A legislative amendment may be necessary to remedy this situation, depending on the outcome of the case. The Ministry of Finance has raised this issue with us and we understand they are following the *Taub* case closely. The draft legislation proposed by the Expert Panel on Securities Regulation contains such an amendment.

SRO powers

SROs (IIROC and MFDA) play a significant role in promoting investor protection and market integrity. They regulate the operations, standards and conduct of their members. SROs have the authority to impose sanctions on their members – fines, reprimands, suspensions and permanent membership bans. SROs discharge their responsibilities, subject to oversight by securities regulators. The SROs requests for additional enforcement powers were reviewed as part of the CSA’s SRO Oversight Project, the purpose of which was to review and improve the current system of reliance on SROs.

The project committee did not support many of the SRO requests due to concern that additional enforcement powers could alter the legal nature and obligations of the SROs.

OSC Authority to order compensation

Government and OSC should consider [adopting recommendation of Expert Panel on Securities Regulation] giving OSC the authority to order compensation in cases of securities law violation.

Ermanno Pascutto, FAIR

Response

We agree that ways to compensate investors more quickly and with less cost should be explored.

The OSC currently uses its statutory authority to get court orders to freeze assets when there is a case of suspected wrongdoing. We move as quickly as possible to freeze assets in order to maximize the prospects of compensation for investors who have been harmed by wrongdoing. Unfortunately, in some cases, assets are not always available from wrongdoers with which to compensate investors.

The Portus case, involving approximately \$730 million in investor assets, is an example where this worked well, due to vigilant efforts by OSC compliance and enforcement staff. A routine compliance check by another provincial commission raised suspicions and an investigation began. The OSC quickly obtained temporary orders, including orders to prohibit redemptions and other risks to the assets. Thereafter, the Commission applied to the Superior Court for an order appointing a receiver. Following those efforts, and the work of the Court appointed Receiver, in February 2009, Portus investors were informed that they will receive as much as 92 cents on the dollar plus commissions paid.

Courts in Ontario have the authority to order compensation for aggrieved investors, and the Commission may apply to the court to seek such an order. Commission staff have been considering on a case by case basis making more use of this power to apply to the court in appropriate cases.

Investor Compensation Fund

Government and OSC to consider [adopting recommendation of Expert Panel on Securities Regulation] establishing Investor Compensation Fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law.

Ermanno Pascutto, FAIR

Response

We agree that, as part of the discussions relating to a single regulator, an industry-funded compensation fund to compensate investors for violation of securities laws merits consideration. We have heard the complaints of investors who are angry and frustrated about the cost and complexity of making complaints against registrants and pursuing legal action. Legislative amendments would be required to create such a fund.

We note that, in the event of an insolvency of an investment dealer or a mutual fund dealer, Canadian Investor Protection Fund (CIPF) coverage or the MFDA Investor Protection Corporation (MFDA IPC) coverage may be available to the customers of the investment dealer or a mutual fund dealer.

5. Investor Outreach Initiatives and Financial Literacy Strategy

Financial literacy strategy

Government should develop and implement a provincial financial literacy strategy.

Ermanno Pascutto, FAIR

Response

We fully agree with this recommendation and we are engaged in discussions with government officials to advance this recommendation.

Financial literacy is an important part of investor protection. We consider financial literacy as part of our ongoing efforts to champion investor protection. We are working with Canadian regulators, SROs, the Financial Consumer Agency of Canada and the Ministry of Education to advance this priority. Over the past eight years, we have given financial support to the Investor Education Fund (IEF) to support investor education and financial literacy initiatives in Ontario, including programs for publicly funded schools and colleges.

The IEF was founded by the OSC in 2000 to promote investor education in Ontario. It hosts one of the most comprehensive and independent financial websites in Canada at www.investored.ca. The IEF promotes financial literacy in the school system with educators and students, as well as adult financial literacy through direct partnerships in the community. This year, over 320,000 people will use the website for financial assistance and over 3,000 educators have been trained to use their material in schools.

The IEF website is an investor-centric tool that provides Ontario investors with information, calculators and instruction on how to manage their investments and finance. This year, over 1.3 million pages of the site were downloaded and traffic grew by over 40% (as of March 31, 2009). Journalists regularly cite it as a go-to source for investors.

The IEF is also very active in the school system. Through its 'Taking Stock' program, it has trained over 3,000 Ontario teachers (since the inception of IEF) and trains a further 600 teachers per year about financial matters and how to teach financial literacy in the classroom. Over 2,000 teachers annually use its financial literacy tools that it developed with the Globe and Mail and Toronto Star. The IEF gives financial presentations to 50,000 high school students every year.

In addition to the IEF initiatives, the OSC is very active in investor education and investor outreach programs. For example, the OSC staff ambassadors participate in community seminars and trade shows to educate investors and to promote informed investing and fraud prevention. The OSC was awarded the 2008 North American Securities Administrators Association Investor Education Outreach Award for its work in this area.

National financial literacy strategy

Government should work with other jurisdictions to develop a national financial literacy strategy.

Ermanno Pascutto, FAIR

Response

We support this recommendation and we are doing our part, working with other regulators across Canada to support national initiatives in the area of financial literacy.

The federal government has recently announced that it will create a Task Force to make recommendations regarding a financial literacy strategy. We support this initiative. We look forward to initiating dialogue with the new Task Force.

The OSC actively participates on national investor education and financial literacy initiatives. The OSC works closely with the Canadian Securities Administrators to facilitate access to objective investment information, and help consumers, particularly youth, boomers and seniors, make informed investment decisions.

Recent CSA initiatives include:

- Financial Fitness Challenge – an online interactive contest to raise youth awareness of financial concepts.
- Plain language investor education brochures and online content on the CSA website.
- Research to understand how Canadians invest their money, gauge their investment knowledge and skills, and understand the social impact of investment fraud.
- Cooperation with other financial regulators, government and law enforcement agencies to promote informed investing during Investor Education Month (October) and Fraud Prevention Month (March).

As a member of the Joint Forum of Financial Market Regulators, the OSC worked with the Financial Consumer Agency of Canada (FCAC) and Social and Enterprise Development Innovations (SEDI) to organize and participate in *Reaching Higher: Canadian Conference on Financial Literacy*. The event brought together more than 260 Canadian and international representatives from the government, private and voluntary sectors to discuss Canadian and international experiences in developing, delivering, measuring and evaluating financial literacy programs, products and services. The report *Moving Forward with Financial Literacy* summarizes the participants' views and ideas for future action to improve financial literacy in Canada, including creating a national financial literacy strategy.

In addition to the above, the Investor Education Fund is working closely with the FCAC to co-sponsor projects and to consider further opportunities to work together on national projects. The IEF and the FCAC partnered in a pilot education program at George Brown College in 2008. The program addresses the needs of young adults to take better control of their finances. This program is in the process of being expanded across Canada. The IEF has also partnered with IIROC to nationally launch a financial speaking series that is aimed at high school students to communicate lessons about budgeting, debt and long-term saving.

Mandatory financial literacy curriculum

Government should make financial literacy mandatory in all Canadian high schools.

Ermanno Pascutto, FAIR

Response

We agree with this recommendation and we are currently engaged in discussions with Ministry of Education officials to see how we can assist in advancing this initiative in Ontario.

The Investor Education Fund is also working in partnership with the Canadian Foundation for Economic Education, to support the Ministry of Education in developing financial literacy materials and to advance the issue of increased financial literacy in the school curriculum.

Testing effectiveness of financial literacy initiatives

Government, OSC, and educators should test the effectiveness of existing adult financial literacy initiatives and not simply assume their effectiveness.

Ermanno Pascutto, FAIR

Response

We strive to measure the effectiveness of our initiatives. The following provide some examples:

- We track outputs such as attendance, website visits, brochure requests.
- We follow up with investors to assess the effectiveness of our campaigns – for example, after the OSC ran the *Protect Your Money* seminars, we followed up with seniors to ask if they could recall the three red flags of fraud and to assess whether they retained information on how to protect their money.
- We continually solicit feedback on quality, usability, and practicality of our investor brochures, using an anonymous print survey provided with orders.
- We are currently engaged in document testing on our investor complaints guide with retail investors.

To effectively measure long-term changes in investment behaviour, we conduct behaviour-focused research over several years. In partnership with our CSA colleagues, we conduct research to understand how Canadians invest their money, gauge their investment knowledge and skills (2006 Investor Index), and assess the social impact of investment fraud (2007 Investor Survey). We are planning another Investor Index for 2009.

The Investor Education Fund (IEF) is also actively engaged in assessing the effectiveness of its initiatives. In supporting the IEF's programs through the allocation to it of settlement funds, the Commission requires that the IEF quantify the results of its programs.

So far, the best return on investor literacy initiatives has been to provide plain language tools to help people understand complex financial questions. The IEF website has become a leader for offering simplified, jargon-free information on most financial topics. The numbers from the website, including a 70% increase in traffic in 2008-09, show that the public is finding this material to be effective and worth passing on to others. Though demand may not be the perfect way to measure the utility of these financial literacy initiatives, it is a very cost-effective way to gauge how the public perceives the effectiveness of this material.

The IEF is developing more broadly based testing with schools to measure the impact that a combination of their programs would have on students over a one-year period. Further, they will be conducting research to benchmark the financial literacy of Ontarians and to see if there is any change in their levels of financial literacy over time. The goal is to develop sophisticated research, much of which hasn't been done elsewhere, to quantify effectiveness.

Financial literacy test for accredited investor exemption

OSC should be asked to revisit the "accredited" or "sophisticated" investor exemption and require objective evidence of financial literacy so that responsibility is shifted back to financially sophisticated market participants who manufacture and sell financial products.

Ermanno Pascutto, FAIR

Response

Canadian securities regulators continually review exemptions. It should be noted, however, that exemptions do not relieve registrants from the obligation to ensure that client recommendations are suitable and that risks are understood by clients.

In the Canadian securities regime, accredited investors are presumed to be able to make informed investment decisions or have the means to secure appropriate advice on investment decisions without the disclosure required in a prospectus and to withstand the risk of loss of an investment. In the aftermath of the credit crisis, the CSA has commenced a policy review to consider the appropriateness of the income and net financial asset thresholds applicable to the accredited investor exemption. The CSA has also initiated a more general review of the exempt market.

Responsibilities of registrants

Market participants should be required to establish that the consumer truly understands the products before buying them.

Ermanno Pascutto, FAIR

Response

Investment advisors are subject to existing “know your client” and product suitability obligations set out in securities regulation.

The “know your client” obligation requires an investment advisor to obtain detailed information about the client, including the client’s circumstances, investment experience, and risk tolerance. In addition, the investment advisor is required to recommend investment products that are suitable for the client. Registrants must also understand the attributes and associated risks of the products they are recommending to clients (“know your product”). Suitability means that the characteristics of the product match the investment objectives and risk tolerance of the investor.

In addition to these obligations, all advisors have a general duty to ensure that risks are disclosed and properly explained to their clients.

The Commission is also working to make more meaningful the product disclosure provided to investors. For example, the point of sale disclosure project, an important investor protection initiative, is aimed at ensuring that advisors provide investors with meaningful and easy to understand information about a mutual fund (including information about the fund’s performance, risks and costs) before the investor makes an initial investment decision to purchase the fund, allowing investors to make more informed investment decisions.

6. Enforcement

Strengthen criminal enforcement

Capital markets misconduct has both criminal and regulatory components. The OSC has regulatory powers; it is not a criminal prosecutor. We need to invigorate the enforcement of the criminal side of capital markets fraud. The Canadian regulatory system is picking up the slack from the criminal law side of enforcement and being forced to treat fraud cases as if they were regulatory problems.

Michael Code

Enforcement needs to be a priority. There needs to be significant improvement in criminal enforcement of capital markets fraud.

Stephen Griggs, CCGG

OSC should place more emphasis on investigation and enforcement of regulatory policies and rules, and on punishing bad behaviour.

Kris Birchard, Advocis

Response

Enforcement is a priority for the Commission.

The OSC has broad investigative and enforcement powers, including the ability to prohibit trading, ban persons from the market, impose financial penalties, freeze assets and seek terms of imprisonment. By identifying contraventions of securities laws or conduct in the capital markets that is contrary to the public interest and by imposing appropriate sanctions, the OSC deters wrongdoing, provides protection to investors and fosters fair and efficient capital markets and confidence in the integrity of those markets. The OSC has also developed two specialized units to tackle insider trading and boiler rooms.

However, the OSC is only one player in Canada's securities enforcement framework. We agree with the presentations made by the stakeholders that more needs to be done to strengthen both regulatory and criminal enforcement. This is one of the reasons the Commission supports the creation of a national securities regulator as a way of further strengthening both regulatory and criminal enforcement in Canada.

Responsibility for securities enforcement in Canada is divided among a number of entities that together make up what is known as the "enforcement mosaic". The OSC works in coordination with self-regulatory organizations, exchanges, governments, police forces and other provincial securities regulators to achieve complementary goals. Cooperation among Canada's enforcement bodies takes several forms, including intelligence sharing, inter-jurisdictional assistance with an investigation, joint

enforcement action and reciprocal enforcement orders. The enforcement mosaic is, in its way, very Canadian, complex, collaborative and cooperation-based.

In criminal enforcement, securities regulators cooperate with law enforcement agencies to fight economic crime. The OSC works with the RCMP Integrated Market Enforcement Teams (IMETs) and houses a Joint Securities and Intelligence Unit that includes staff from the OSC, RCMP and IIROC. In addition, we offer assistance to foreign regulators and police investigating cross-border scams.

The Commission has also initiated dialogue with the Ministry of the Attorney General with the objective of identifying opportunities for cooperation and assistance, particularly in the area of sharing resources, expertise and information.

The OSC supports the efforts of federal, provincial and territorial ministers responsible for justice to develop recommendations to continue to improve the enforcement regime in Canada for securities fraud and other economic crimes. OSC Chair, David Wilson co-chaired the Securities Fraud Working Group, which was created by the federal, provincial and territorial ministers responsible for justice. The Working Group has delivered its recommendations for improving the investigation and prosecution of securities fraud to the ministers, who have expressed broad support for the proposals. A national association of prosecutors has been established to serve as a forum for discussion of strategy and to foster consistency at the national level in combating fraud and economic crime.

We were asked on several occasions by members of the Standing Committee whether the Commission needs new regulatory tools to strengthen its enforcement efforts. The Minister has also asked the same question. We are pleased with the recent amendment that allows the Commission to reciprocate enforcement orders made by other jurisdictions. Reciprocal orders enable the Commission to act more quickly in certain enforcement matters.

We continue to assess our regulatory tools in light of the global financial crisis, the complexity of financial products and the usefulness of new regulatory tools introduced in other jurisdictions. We are considering new regulatory tools that would strengthen our ability to protect investors and we will be bringing forward to the Minister some new tools for his consideration. Some of these tools may require legislative amendments to:

- Provide a framework for regulatory oversight of credit rating agencies;
- Strengthen our ability to preserve assets during the conduct of an investigation;
- Broaden the definition of illegal insider tipping; and
- Clarify the Commission's jurisdiction over companies operating in the U.S. over the counter market that carry out manipulative and illegal market activities such as "pump and dump" schemes on unsuspecting Ontario investors. The Commission is studying a new BC rule that imposes disclosure requirements and gives authority to the BC Securities Commission to take enforcement action in this area.

We are also conducting a policy review to consider the appropriate approach to regulation of derivatives such as credit default swaps.

National securities regulator and enforcement

Support for more vigorous criminal enforcement through the creation of a national securities regulator with an enforcement division that possesses criminal and administrative enforcement powers.

Michael Code

Response

The Commission supports the creation of a national securities regulator. We also support many of the Expert Panel on Securities Regulation recommendations as a good starting point for discussions and negotiations with interested jurisdictions.

We agree with the comments of the stakeholders that a national regulator will provide opportunities to further strengthen both regulatory and criminal enforcement in Canada.

Canadian Securities Crime Unit

Government to establish Canadian Securities Crime Unit responsible for the intake, assessment and referral of complaints to the appropriate local fraud squad.

Diane Urquhart and Gary Logan

Response

This is a matter for consideration by the government.

Non-bank ABCP

OSC and SROs should take action in response to the non-bank ABCP turmoil and law enforcement to launch criminal investigation.

Unfair treatment of the 36 investors with over \$1 million in non-bank ABCP.

Diane Urquhart

Response

The Commission is pleased that an agreement was reached for the restructuring of non-bank ABCP. The agreement reflects a private sector resolution that was developed by the Pan-Canadian Committee, chaired by Purdy Crawford, as a result of complex negotiations that lasted more than a year.

The vast majority of retail investors in the non-bank ABCP have been made whole, with interest. Others, primarily those holding more than \$1 million of ABCP, were given longer term notes on the same basis as corporate and institutional holders of ABCP.

Addressing wrong-doing in relation to the non-bank ABCP is a high priority at the Commission. While the OSC does not have the authority to pursue criminal charges, investigations into possible securities law violations are ongoing. Our enforcement branch is in the process of reviewing the activities and conduct of manufacturers and distributors of ABCP, working in close co-operation with IIROC and the AMF, our counterpart in Quebec. It is not appropriate for us to speculate at this time whether there was a breach of securities or other laws in the sale of non-bank ABCP.

The Commission is also working with other Canadian securities regulators to develop proposals to help prevent a similar crisis from happening again (see response to the global financial crisis, page 23).

7. Corporate Governance

The Commission has made rules and adopted policies regarding corporate governance obligations of public companies. National Instrument 58-101 *Disclosure of Corporate Governance Practices*, National Policy 58-201 *Corporate Governance Guidelines* and National Instrument 52-110 *Audit Committees* set out the regulatory requirements and policy guidance that public companies need to consider in developing and disclosing their corporate governance practices.

The CSA published for comment proposed National Policy 58-201 on December 19, 2008. The CSA proposes to replace the “comply or explain” disclosure regime of the current governance policy with a more principles-based approach that is broader in scope. The current governance policy contains a list of specific corporate governance guidelines. The proposed policy contains core principles, guidance and examples of corporate governance practices in applying the principles.

The core corporate governance principles are:

- Create a framework for oversight and accountability
- Structure the board to add value
- Attract and retain effective directors
- Continuously strive to improve the board’s performance
- Promote integrity
- Recognize and manage conflicts of interest
- Recognize and manage risk
- Compensate appropriately
- Engage effectively with shareholders

The Commission is also in the process of a significant review of shareholder democracy and will be considering the views of stakeholders and investors in that review.

At the international level, Vice-Chair James Turner is chairing an IOSCO Corporate Governance Task Force. The Task Force is comprised of securities regulators from 18 IOSCO member jurisdictions and is working in consultation with the Organization for Economic Cooperation and Development (OECD) to finalize a report that summarizes the results of a survey completed by the 18 jurisdictions on the protections afforded to minority shareholders in listed public companies. The report will provide useful insight into the corporate governance regimes of the 18 participating countries. The Task Force's objective is to publish the report in June 2009.

Voting

The current "slate voting" system should be abolished. Public companies should be required to give shareholders the right to vote for each director and institute a "majority voting" mechanism so that shareholders can effectively vote "for" or "against" each director.

Stephen Griggs, CCGG

Response

Corporate and securities laws currently give management a great deal of latitude in conducting director elections. While the majority of Canadian companies elect a slate of directors, there is no legal prohibition against individual director elections. In fact, a significant number of major public companies voluntarily provide individual director proxies.

The introduction of a binding majority vote requirement would require amendments to securities law and to Ontario corporate law. (Currently Ontario corporate law requires that the form of proxy provide a means for the shareholder to specify that their shares are to be "voted or withheld from voting" in respect of the election of directors. Federal corporate law requires the form of proxy to comply with the requirements of securities law.)

We have initiated discussions with federal and Ontario corporate regulators on the issue with a view to determining whether there should be a move to mandatory majority voting.

As the CCGG noted, some Canadian companies have voluntarily instituted majority voting policies. These policies provide that any "withheld" vote is treated as a vote against. While the results of these elections are not legally binding under corporate law, the director candidates standing for election agree to abide by the policy.

Shareholder approval for major transactions

Public companies should be required to obtain shareholder approval for all transformational transactions (e.g., large acquisition or highly dilutive share issuance).

Stephen Griggs, CCGG

OSC should be asked to direct the TSX to bring its rules up to international best practice particularly as it relates to shareholder approval for major transactions.

Ermanno Pascutto, FAIR

Response

We recognize that highly dilutive share issuances can significantly impact the voting, distribution and residual rights of shareholders. The TSX, in consultation with the OSC, is currently undertaking a public review process to determine whether to require shareholder votes for highly dilutive transactions and the appropriate threshold for approval.

Access to proxy circulars

Shareholders should be given the same right of access to the proxy circular as management so they can propose alternative directors.

Stephen Griggs, CCGG

Response

We believe that the current regime is reasonable. Federal and Ontario corporate laws contain rules governing shareholder access to the management proxy circular. Governments and securities regulators have recently liberalized the shareholder solicitation requirements so that it is easier for shareholders to propose and solicit votes for their own nominees as directors, using their own information document. (See response below.)

Regulation of proxy voting system

OSC should regulate and enforce the proxy voting system.

Stephen Griggs, CCGG

Response

We recently completed a review of the proxy voting system and have identified areas where the system's integrity and efficiency can be improved. The proxy voting system is extremely complex, and involves many participants. Therefore, we are consulting extensively with stakeholders, including shareholder representatives, on our proposals.

Shareholder solicitation rules

Shareholder solicitation rules should be amended to permit broader solicitation of other shareholders.

Stephen Griggs, CCGG

Response

We recently amended securities rules to permit shareholders to solicit votes without having to prepare and send a dissident proxy circular. The solicitation is made to the public by broadcast, speech or publication. The shareholder then files with us certain basic information, including information about any nominees the shareholder is proposing for directorship.

Separation of CEO and Chair

Public companies should be required to separate Chair and CEO roles.

Stephen Griggs, CCGG

Response

In proposed National Policy 58-201 *Corporate Governance Practices*, which was published for comment in December, separating the roles of the chair and CEO is cited as an example of a practice that will contribute to the principle of structuring a board to add value. We do not, however, believe that this should be mandated.

In our discussion of the purpose of our proposed governance policy, we recognize that there is no single model of good corporate governance and that the structures and practices that are most appropriate will vary among issuers. We specifically point out that corporate governance practices of issuers may differ from the examples set out in the Policy, but be equally good practices provided they achieve the objectives of the principles.

Reporting of proxy voting results

Public companies should be required to improve their reporting of proxy voting results.

Stephen Griggs, CCGG

Response

We support the principle that companies should disclose the underlying proxy votes for all meetings, regardless of whether the vote was taken by ballot or show of hands. We are in discussions with our CSA colleagues on whether to adopt such a requirement.

Regular meetings between shareholders and directors

OSC to provide guidance on prohibition against selective disclosure so that regular meetings can occur between shareholders and directors.

Stephen Griggs, CCGG

Response

It can be beneficial for shareholders to have meetings with directors.

To assist this process, we have provided guidance on how companies, which would include the directors as well as management, can dialogue with shareholders without breaching prohibitions against selective disclosure. In National Policy 51-201 *Disclosure Standards*, we state: “Companies should not disclose significant data, and in particular financial information such as sales and profit figures, to analysts, institutional investors and other market professionals selectively rather than to the market as a whole. Earnings forecasts are in the same category. Even within these constraints there is plenty of scope to hold a useful dialogue with analysts and other interested parties about a company’s prospects, business environment, management philosophy and long term strategy.”

Prescribing accountability to shareholders

OSC should have a role in prescribing the level of public companies’ accountability to their shareholders.

Stephen Griggs, CCGG

Response

In proposed National Policy 58-201 *Corporate Governance Practices*, which was published for comment in December, one of the core governance principles is:

The board should endeavour to stay informed of shareholders’ views through the shareholder meeting process as well as through ongoing dialogue. [Principle 9]

Commentary also elaborates on the principle as follows:

An issuer’s relationship with its shareholders is an important aspect of corporate governance. One of the most significant ways that shareholders can express their approval or disapproval of matters relating to the issuer is through exercising their right to vote at shareholder meetings, including the election of board members. Within the parameters of applicable corporate and securities law, the board should promote a voting process that:

- (a) is understandable, transparent and robust; and
- (b) facilitates the board obtaining meaningful information on shareholder views.

8. Response to Global Financial Crisis

Regulation of the entire capital market is a global issue that should be considered in light of recent events in the unregulated/exempt markets (e.g., ABCP, CDOs and CDSs) which demonstrate that unregulated activities pose systemic risk to the Canadian capital markets. Ontario needs to be at the forefront on this issue.

Stephen Griggs, CCGG

Response

The issues related to the current market crisis are complex and global in nature, and involve many different factors and forces, including the collapse of the U.S. real estate market, the increasing use of leverage and the development of very complex investment products.

Since the beginning of the financial crisis, the Commission has taken action to foster confidence in the integrity of our markets. We have:

- In conjunction with the SEC, temporarily banned the short selling of certain inter-listed financial sector stocks to avoid potential for regulatory arbitrage (the order expired on October 8, 2008);
- Closely monitored the continuous disclosure filings by public companies, with a particular emphasis on the banking and financial services sector and highly leveraged issuers; and
- Undertaken compliance reviews of money market funds, exchange-traded funds and closed-end investment funds to assess potential exposure to toxic assets. We are currently completing compliance reviews of hedge funds to assess any unusual risks to investors.

The Minister has also responded by proposing amendments to the *Securities Act* and the *Commodity Futures Act* that would give the government and the OSC additional authority to respond to extraordinary circumstances involving a major market disturbance. This amendment corresponds with the legislative approach taken in the U.S. and the U.K., as well as with the recommendations contained in the report of the federal Expert Panel.

It is important to note that the Commission is a market conduct regulator and not a financial stability regulator. We work cooperatively with domestic and international regulators to coordinate our actions. At the domestic level, the Chair of the OSC is an active member of the Heads of Agencies, a body chaired by the Bank of Canada, that meets quarterly or more frequently as needed, to discuss and coordinate issues of mutual concern relating to the regulation and oversight of Canadian financial markets. Representation on the Heads of Agencies also includes the Office of the Superintendent of Financial Institutions (OSFI), the federal Department of Finance and the Chairs of the BC, Alberta and Quebec securities commissions.

The Commission is also actively participating in both domestic and international initiatives relating to non-bank ABCP market and unregulated financial entities.

In October 2008, the Commission, together with the other Canadian securities regulators, issued a Consultation Paper outlining proposals in response to the turmoil in the credit markets in Canada, particularly in relation to non-bank ABCP market. The proposals outlined in the paper are part of a collective response by regulators in Canada and around the world. The comment period closed on February 16, and 22 comment letters are currently being reviewed by OSC staff.

The Consultation Paper contains proposals and solicits comments on a number of questions related to the proposals for:

- Implementing a regulatory framework applicable to credit rating agencies that would require compliance with the recently amended code of conduct established by the International Organization of Securities Commissions (IOSCO);
- Improving disclosure with respect to ABCP;
- Amending the short-term debt exemption to make it unavailable for sales of asset-backed short-term debt including ABCP. This would require issuers who sell these products to do so by way of prospectus, or under another exemption;
- Addressing the roles played by dealers and advisers with respect to ABCP; and
- Reviewing specific issues regarding mutual fund investments in ABCP.

The OSC is continuing to work closely with the international community, and is an active participant in IOSCO task forces dealing with matters relating to the credit market turmoil. The Commission was actively engaged in updating the IOSCO Code of Conduct for Credit Rating Agencies – a framework that sets standards for credit rating agencies world-wide. Most recently, the IOSCO Credit Rating Task Force published:

- A report reviewing the implementation of the IOSCO Code by 21 credit rating agencies;
- An examination module to be used by IOSCO members that regulate and inspect credit rating agencies; and
- A process for international cooperation in oversight of credit rating agencies.

International leaders and organizations including G20 members and IOSCO, are also calling for regulation of hedge funds and hedge fund managers. The OSC, through its leadership role in the proposed registration reform project, is proposing to implement registration requirements for investment fund managers, including hedge fund managers.

The OSC's participation on the IOSCO Task Force on Unregulated Financial Entities (hedge funds) assisted the Task Force to recommend the regulatory oversight of hedge fund managers. The Task Force recently issued a consultation report that describes recommended principles and actions to mitigate regulatory risks, including:

- Greater transparency

- Stronger regulatory action
- Enhanced regulatory cooperation, and
- Development of a consolidated set of industry best practice standards.

9. Policy-making Process

Consultation

The government should develop policies and procedures for the OSC and the SROs to ensure that all stakeholders that are likely to be directly affected by regulatory proposals are consulted at an early stage in the policy development process.

Kris Birchard, Advocis

Response

As part of the policy-making process, the OSC conducts extensive consultations with stakeholders. Input from stakeholders is an essential part of the regulatory process and assists regulators achieve the appropriate balance between protecting investors and fostering efficient capital markets.

The OSC regularly consults with stakeholders that are likely to be affected by regulatory proposals at an early stage of the policy development process. In addition to the Commission's advisory committees, the OSC establishes project-specific consultative committees and working groups, particularly on important initiatives, to obtain stakeholder input in developing initiatives, assessing the impact on market participants and understanding the concerns and issues faced by stakeholders.

The OSC also receives feedback on its policy proposals through its public comment process. All interested parties, including investors, are encouraged to provide comment. As part of this process, the Commission receives comments from a variety of perspectives.

We have described below two recent examples of extensive consultations involving two important reform initiatives – registration reform and point of sale project.

Registration Reform

The registration reform project, led by the OSC, is one of the largest rule-making initiatives undertaken by the CSA. The proposed rule, National Instrument 31-103 *Registration Requirements*, harmonizes, streamlines and modernizes registration requirements for dealers, advisers and investment fund managers across Canada. The initiative will reduce the regulatory burden for about 2,000 firms and 130,000 individuals registered in Canada (about 1,700 firms and 70,000 individual registrants in Ontario).

The registration reform working group engaged in consultations with industry even before it published a series of three consultation papers (published in 2005 and 2006)

inviting comment on a broad range of registration reform issues, including such core elements as registration of investment fund managers and the adoption of a business trigger for dealer registration. The working group published its rule proposals twice, and each time, took into consideration over 260 comment letters. A registration advisory committee, with representation from industry, was also created to provide input.

Point of sale project

The point of sale project is another example of an important regulatory initiative that continues to involve extensive stakeholder consultation and input. Consultations involving both securities and insurance stakeholders began at an early stage of policy development. Focus groups and industry advisory committees provided feedback during the different phases of the project, including input on the concept proposal, draft framework and the 2-page fund fact document. Stakeholders, industry representatives, SROs and investors were consulted and continue to be consulted.

The CSA will be publishing its rule proposals on the point of sale for comment shortly and we will be requesting additional input.

Statement of purpose

The government should impose requirements on the OSC and the SROs to ensure that before implementing any new major regulatory requirement that it develop a clearly articulated statement of the problem that the regulation is meant to address.

Kris Birchard, Advocis

Response

The OSC has a statutory requirement that each notice contains a statement of the substance and purpose of the proposed rule. We strive to be transparent in all of our notices and to clearly communicate the objective the regulation is intended to achieve.

The notice must include:

- the proposed rule
- a statement of the substance and purpose of the proposed rule
- a reference to the authority under which the rule is proposed or a statement that the Commission is seeking legislative amendments to make the rule
- a discussion of all alternatives to the proposed rule that were considered by the Commission and the reasons for not proposing the adoption of the alternatives considered
- a reference to any significant unpublished study, report or other written materials on which the Commission relies in proposing the rule
- a description of the anticipated costs and benefits of the proposed rule.

Burden of regulation

The government should direct the OSC to ensure that regulatory initiatives do not place an unfair burden of regulation on small business, professional financial

advisors, and that regulation does not result in an uneven playing field that favours very large dealers and firms.

The government should make it a priority to ensure that small business, professional financial advisors and planners continue to be a vital segment of the financial services sector.

Kris Birchard, Advocis

Response

The Commission strives to balance investor protection with market efficiency. We consider the needs of investors, capital markets and the securities industry in developing policies. We take into consideration that investors rely heavily on dealers and advisers for investment advice. For this reason, we continue to monitor compliance with our requirements and ensure that dealers and advisers, regardless of their size, meet high standards. While the same standards apply to all registrant firms, we take a practical approach to assess compliance and recognize that firms will develop and implement compliance programs that are tailored to a firm's operations and may vary based on the size and structure of the firm.

Small business

The Commission recognizes the importance of small business in our economy. We have a significant number of smaller securities firms in Ontario. There are 1,700 firms registered in Ontario, many of which are small dealers and advisers. In connection with its regulatory initiatives, the OSC conducts cost-benefit analysis to take into account the regulatory burden placed on stakeholders, including small dealers and advisers.

Canada also has a very significant junior capital market. There are more than 400 small Ontario public companies that are listed on the TSX Venture Exchange. The CSA recognizes that the junior markets have unique characteristics that require a different, although not necessarily less robust, regulatory regime. In recognition of the needs of the junior market, the CSA has applied a tiered approach to issuer regulation that, in many cases, differentiates between issuers listed on the Toronto Stock Exchange and those listed on the TSX Venture Exchange. For example, Venture Issuers have more time to file their financial statements, are not required to prepare and file an Annual Information Form and are subject to less-onerous audit committee requirements.

Cost-benefit analysis

The OSC should also conduct robust cost-benefit analysis, to assess the likely investor protection benefits and the costs to market participants and to consumers.

Kris Birchard

Response

The *Securities Act* and the *Commodity Futures Act* require that the OSC takes into consideration the costs of compliance with regulation. The Commission is required to publish a notice of every proposed rule or any amendment to a rule. The notice must include:

- A discussion of all alternatives to the proposed rule that were considered by the OSC and the reasons for not proposing the adoption of the alternatives considered, and
- A description of the anticipated costs and benefits of the proposed rule.

The OSC recognizes the importance of conducting a thorough review (discussion and analysis of the consequences) of changes in regulatory policy. We include a cross section of appropriate cost and other impacts when assessing a proposed rule or rule amendment where it is feasible to do so.

However, the benefits of securities regulation can be challenging to quantify. It is particularly difficult to measure the benefits of investor protection from fraud. Nevertheless, we attempt to conduct analysis that assists the Commission in making decisions. This analysis goes beyond simple monetary implications and incorporates issues relating to fairness, investor protection, confidence and market integrity.

The elements we consider as part of our review include, but are not limited to:

- one-time and ongoing costs of compliance
- the impact of policy changes on different stakeholder groups
- how the impacts are distributed across geographic region and firm size
- the effect of regulatory change on the competitive environment (i.e., promoting a level playing field)
- potential unintended consequences of changes in policy
- the availability of products and services for consumers
- the impact on the prices and the volume of transactions
- whether the anticipated costs are balanced with the regulatory objective sought

Review of capital requirements

Whether the OSC needs to review regulation of capital requirements of capital market participants.

Stephen Griggs, CCGG

Response

The Commission has reviewed existing capital requirements of market participants as part of proposed National Instrument 31-103 *Registration Requirements*. Under the proposed rule, the CSA is proposing to increase minimum capital requirements for most non-SRO registrants. Increasing minimum capital requirements will help ensure that registered firms can meet their obligations to their clients, enhance the financial solvency of market participants, and thereby enhance the financial integrity of the capital markets.

Investment dealers and mutual fund dealers are already subject to strict capital requirements through IIROC and the MFDA, respectively. IIROC and MFDA recently reviewed the capital requirements for their member firms and they are not considering changes at this time.

Regulatory role of the TSX

OSC should be asked to review and report back to the Committee on the regulatory role of the TSX in light of the conflict of interest between its regulatory function and the profit mandate of the TSX and international best practice for exchanges that have demutualized and became "for profit" public companies.

Ermanno Pascutto, FAIR

Response

The OSC has reviewed the regulatory role of TSX in light of its for-profit operations. When the TSX demutualized and became a for-profit exchange in 2000, it separated its regulatory functions from its for-profit operations by creating a separate division, TSE Regulatory Services.

In 2002, Market Regulation Services (RS) was created as an SRO to perform market regulation for the equity market. The TSX contracted with RS to perform these functions on its behalf. In 2008, RS was combined with the Investment Dealers Association to create IIROC. The TSX continues to contract with IIROC to perform market regulation. TSX continues to perform issuer regulation and is subject to oversight by the OSC.

In November 2006, the International Organization of Securities Commissions (IOSCO) published a report entitled "*Regulatory Issues Arising from Exchange Evolution*". The paper describes the regulatory role of exchanges, the issues raised by the evolution and the various ways in which securities regulatory authorities have addressed these issues. The report notes that most regulators have focused on governance arrangements as the primary means of ensuring that exchanges have robust arrangements for maintaining a proper balance between the exchange's commercial interests and its regulatory responsibilities. The TSX, for example, is required by the terms and conditions of its recognition to have 50% independent directors.

In general, regulators have intensified their oversight of for-profit exchanges and taken greater interest in areas such as financial resources. The TSX is subject to oversight including by-law approval, on-site reviews and review of information. There are also special oversight arrangements to address the potential conflicts of interest that may arise as a result of the TSX listing its own securities on the TSX. In particular, TSX is required to report to the Commission potential conflicts of interest and there is a process for the Commission to monitor decisions made by the TSX.

10. Principles-based Approach to Securities Regulation

The OSC and the two SROs should consider a principles-based approach to regulation, before imposing any new prescriptive, rules-based regulation.

Kris Birchard, Advocis

Response

The use of both principles and rules is necessary in the formulation of effective securities regulation – there must be an appropriate balance. When making rules, we need to determine the right balance between predictability and certainty (which implies rules) and flexibility (which implies principles).

Both principles and rules work together in our regulatory system. We have general principles and specific rules and policies. Examples of principles-based approaches in our Act include:

- The Commission may intervene in circumstances where it is in the public interest.
- The anti-fraud provision requires market participants to act with integrity.
- All registered dealers and advisors should deal fairly, honestly and in good faith with their clients.
- All disclosure documents should not be misleading to investors.

IIROC's existing rules incorporate similar principles. IIROC is in the process of reviewing all its rules. A key component of this review includes clearly articulating the objectives underlying each rule.

Similarly, the MFDA's rules articulate the principles behind its rules. For example, the MFDA rules set out general expectations that mutual fund dealers deal fairly, honestly and in good faith with their clients, that they observe high standards of ethics, or that they do not engage in business conduct that is unbecoming or detrimental to the public interest.

In light of the financial market turmoil, international jurisdictions, such as the U.K., are re-evaluating their principles-based approach to regulation. Hector Sants, Chief Executive of the Financial Services Authority (FSA) in the U.K., recently acknowledged the limitations of a pure principles-based regulatory regime. The FSA signalled that it is moving away from principles-based regulation towards a more “outcomes-based” approach.

Glossary of Terms

Asset Backed Commercial Paper (ABCP)

A short-term debt (maturity of less than one year) that is generally serviced or backed by a pool of assets or securities. It is typically distributed on a prospectus exempt basis under the short-term debt exemption in section 2.35 of National Instrument 45-106, *Prospectus and Registration Exemptions*.

Collateralized Debt Obligation (CDO)

A securitized interest in a pool of assets usually comprised of loans or debt instruments. Investors bear the credit risk of the collateral. Multiple tranches of securities are issued offering investors various maturity and credit risk characteristics.

Credit Default Swap (CDS)

A contract designed to provide the buyer of the CDS credit protection. The seller of the CDS guarantees the credit worthiness of the security by paying the buyer a predetermined amount in the event of default.

Canadian Securities Administrators (CSA)

A forum for the 13 provincial and territorial securities regulators to coordinate and harmonize regulation of the Canadian capital markets.

Financial Consumer Agency of Canada (FCAC)

An independent body established by the federal government to protect and inform consumers about their rights and responsibilities when dealing with financial institutions, and provide timely and objective information and tools to help consumers understand a variety of financial products and services.

Investment Industry Regulatory Organization of Canada (IIROC)

National SRO which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. IIROC was created in 2008 through the consolidation of the Investment Dealers Association of Canada (IDA) and Market Regulation Services Inc. (RS)

Joint Forum of Financial Market Regulators (Joint Forum)

The membership of the Joint Forum consists of representatives from Canadian pension, securities and insurance regulators. The Joint Forum was established to co-ordinate, harmonize and streamline the regulation of financial products and services in Canada.

Joint Standing Committee on Retail Investor Issues (JSC)

The membership of the JSC consists of representatives from IIROC, MFDA, OBSI, and OSC. The JSC focuses on matters relating to retail investors and strengthening the effectiveness of retail investor protections.

Joint Securities Intelligence Unit (JSIU)

An intelligence gathering and enforcement unit consisting of representatives from the OSC and RCMP. The JSIU targets criminal activity in the capital markets.

Investor Education Fund (IEF)

The IEF was established by the OSC, and is funded by OSC enforcement settlements. It operates separately from the OSC with its own Board of Directors. The IEF helps people make effective use of financial information.

Integrated Markets Enforcement Teams (IMETs)

IMETs are composed of police, lawyers and other investigative experts and are located in Canada's major financial centers. The teams are jointly managed by the RCMP, Justice Canada and partner departments and agencies. IMETs work closely with securities regulators and other federal and provincial authorities on major capital markets fraud cases.

Mutual Fund Dealers Association of Canada (MFDA)

National self-regulatory organization (SRO) for the distribution side of the mutual fund industry. The MFDA is responsible for regulating the operations, standards of practice and business conduct of its members and their representatives.

Ombudsman for Banking Services and Investments (OBSI)

OBSI is an independent dispute resolution service available to customers of participating banking services and investment firms not satisfied with the outcome of the participating firm's internal complaint resolution process. The claim limit is \$350,000.

Self-regulatory Organization (SRO)

The two SROs recognized by Canadian securities regulators to establish and enforce rules governing the conduct of their members are IIROC and the MFDA.