"OSC Strategy in Action"

Maureen Jensen

Executive Director, Ontario Securities Commission

Remarks to the Institute of Corporate Directors

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Thank you Tom Corcoran of the Institute of Corporate Directors (ICD) for inviting me here today.

I'm delighted to talk to the ICD's Ontario chapter. I am an ICD member and have attended a number of these seminars – being on this side of the microphone gives me a whole new perspective on these events.

We have reason to celebrate today because this is the first day of Spring. We can finally put the long dark days of the non-winter behind us, with all its mild spells and snowstorms that didn't happen. "Spring is the time of plans and projects," as Leo Tolstoy once said.

That's certainly true around the OSC this year.

The OSC is headed in a new strategic direction. As the global capital markets undergo transformational changes, we also have to change our direction. Market structures are evolving around the world as technology revolutionizes how securities are traded. New innovative

investment products continue to come to market. The capital markets are moving faster and are more interconnected and they affect the financial well-being and future of many more people.

In addition, the ambit of securities regulation continues to widen and the regulation of OTC markets and some systemic risks are now core functions we must undertake. The risks are many and the scope has broadened and, of course, the resources are somewhat fixed.

So we recognized that the OSC had to become a more strategic regulator. We had to enhance our expertise and institutional capacity in order to better anticipate and respond to significant developments in the markets.

Our strategic plan is our road map for moving forward. Our strategic plan will help us execute on our vision to be a leading, proactive and high-performing securities regulator… a regulator with a strong knowledge and understanding of the evolution of the markets and one who delivers focused and timely regulation.

OSC Strategic Direction

When I was appointed Executive Director last May, one of my first big responsibilities was to lead our strategic planning process. As directors, you have responsibilities to ensure that the management of your corporations has a strong strategic view.

The OSC's Board has a similar responsibility, although in a different context, and both the Board and the Chair looked to me to spearhead the development of a three-year strategic plan.

So we embarked on a planning process to better position the OSC as a 21st century securities regulator, whether we existed as a provincial commission or as part of a national entity. Of course, in December, the Supreme Court ruled that the proposed *Canadian Securities Act* was unconstitutional, which stalled the recent CSTO initiative to establish a national regulator. We were disappointed in the ruling… but this as an opportunity for us to use our plan to make strategic improvements to securities regulation in Ontario.

And that's what we are doing.

The OSC strategic plan contains six major strategies that will influence programs and operations throughout the organization, including compliance and enforcement. The key strategies are to:

1. Expand the OSC's research and analytical capability;
2. Engage investors more effectively;
3. Improve internal policy coordination and priority-setting;
4. Align operations and programs with our goals and priorities, and develop and report on key performance indicators;
5. Improve risk identification and management; and
6. Deliver excellence in execution of programs.

On their own, each of these strategies would not achieve the kind of change we needed. That's why we launched them as part of a comprehensive plan. The strategies are meant to interact with and complement each other and change the way we work and respond to issues.

For example, our new Research and Analysis Group will support the strategy to engage investors, which will support policy prioritization. The research group will take the lead in producing focused research on current issues in Canada's capital markets. This research will shape our thinking on issues and allow us to make more informed policy choices. Our stronger commitment to using evidence-based decision-making, in addition to our commitment to active consultation, will result in future policy choices that rely much more on both qualitative and quantitative evidence.

The Research and Analysis Group will also support our efforts to improve the identification and management of risk. An Emerging Risk Committee will be created within the OSC to collaborate with the operating Branches to develop a forward-looking framework to identify emerging risks and not to wait until these risks become large problems in the marketplace.

The implementation of our strategic plan is underway and will be completed in stages. As we move forward, all of these six strategies will support and complement the OSC's 5 organizational goals to:

1. Deliver responsive regulation;
2. Deliver effective enforcement and compliance;
3. Deliver strong investor protection;
4. Run a modern, accountable and efficient organization; and
5. Support and promote financial stability.

Most of these goals are not new, but we did add the 5th goal to support and promote financial stability, which has become a priority for all securities and prudential regulators after the credit crisis. We are working closely with the Bank of Canada on this. The new Emerging Risk Committee will also strengthen our internal capabilities as we co-operate with other regulators and agencies to mitigate systemic risk and promote financial stability.

I hope this gives you an indication of how much is going on at the OSC. We will publish our draft Statement of Priorities for comment in April. It will set out which strategic plan initiatives will be addressed in the 2012-13 fiscal year, as well as other important priorities and activities. I invite the I-C-D and its members to read it and submit comments.

So that is the background, but I also want to talk about four significant initiatives we have underway:

1. Emerging Markets Issuer Review;
2. Maple's bid for TMX Group;

3. Shareholder democracy; and
4. Shareholder rights plans.

Emerging Markets Issuer Review

This morning, the OSC will release a Staff Notice (51-719) that details our concerns and recommendations formulated as a result of our Emerging Markets Issuer Review. As public concerns rose about several emerging market issuers, we initiated a review to assess the quality and adequacy of the disclosure, board and audit committee practices of selected Ontario reporting issuers that are listed on Canadian exchanges and have significant business operations in emerging markets. We examined 24 reporting issuers whose "mind and management" are largely outside of Canada and whose principal active operations are in emerging markets. We also reviewed the adequacy of the gatekeeper role played by their auditors, underwriters and by the exchanges.

OSC staff have now assessed the quality and adequacy of the issuers' disclosure and corporate governance practices, and examined the vehicles through which they accessed Ontario's markets.

The objective was to identify both broader policy issues as well as any entity-specific concerns. We dealt directly with the issuers and their advisers and consulted with the Canadian exchanges, the Canadian Public Accountability Board (CPAB) and other provincial securities commissions.

Much of the information that we examined is protected by confidentiality provisions in the *Securities Act* and, therefore, cannot be disclosed in public. However, we are releasing the report to discuss, in general, our concerns that need to be addressed for public protection.

One of our central concerns was the apparent “form over substance” approach to compliance with applicable standards for disclosure, issuer governance, board oversight, audit practices and due diligence practices. Quite frankly, we found that the level of rigor and independent-mindedness applied by boards, auditors and underwriters in carrying out important duties – such as management oversight, audit and due diligence on offerings – should have been more thorough.

From our view, it appears that some boards and audit committees had an inadequate level of engagement in their oversight of management and their sense of responsibility for the stewardship of the issuer. For example, we found cases where boards appeared to have little contact with senior management in the emerging market jurisdictions and were not addressing the risks or key issues in the companies.

We have concerns about the extent of knowledge of some boards and audit committees of the key cultural and business practices impacting the issuers in the jurisdictions in which the issuer operated. In certain situations, it appeared that the board was not aware of environmental factors

that could have a significant impact on the issuer disclosure, reporting and ownership, such as banking practices and legal title to assets.

We also observed situations in which board members apparently relied solely on a member of management to provide overviews of key business documents in another language and did not question or obtain appropriate translations into English in order to read and assess the documents themselves.

There are 24 recommendations flowing from the review, and many of them relate to governance and auditing practices. I encourage you to read the Staff Notice on our website. The emerging market issuers, their auditors and underwriters, and the exchanges will be expected to take action to address these concerns.

The next steps will also require us to tackle various issues while working with other regulators and gatekeepers. On the listing recommendations, we are already talking to the exchanges. On the auditing recommendations, we are consulting with CPAB. We will start discussions with the Investment Industry Regulatory Organization of Canada (IIROC) on the underwriter recommendations. And as for our governance recommendations, we may deal with the concerns by releasing additional guidance to issuers with the Canadian Securities Administrators (CSA) and by working with groups such as ICD Everyone in this room understands that the governance

practices of an issuer must be tailored to its distinct business and should never be a "form over substance approach".

Let me be clear. We want our markets to remain open and attractive to issuers from all jurisdictions. It's the future of our markets. But the OSC expects the boards and management of all issuers, including emerging market issuers, to discharge their responsibilities in a way that promotes investor protection and fosters confidence in Ontario's markets. This is also true for all gatekeepers who have a special relationship with issuers and in securities legislation and in market-rule frameworks.

We expect all of these important protections to be exercised properly and effectively and we will use our authority to protect investors to the fullest extent of our jurisdiction.

Our Emerging Markets Issuer Review is a good example of the OSC's strategy in action, specifically our stronger commitment to research and analysis, our focus on investor concerns and timely responses to risk identification. The research we completed in this review has given us a deeper understanding of market developments and the risks facing investors, market participants and other regulators. We have an opportunity to integrate these specific issues and concerns into our broader policy and operational activities.

Maple-TMX

I will now briefly discuss the proposed Maple application to acquire TMX Group.

The Maple bid was launched in the wake of a global trend of increased consolidation to create vertically-integrated exchange and clearing entities. Consolidation has created larger exchange/clearing groups that can take advantage of economies of scale to better compete in the evolving market landscape.

The creation of a vertically-integrated exchange and clearing entity in Canada, as proposed by Maple, would fundamentally transform our financial infrastructure. This is particularly true with the proposed integration of the Canadian Depository for Securities Limited (CDS) into TMX, which would change the current post-trade, or back-office, landscape and have a major impact on our capital market entities.

As you know, the proposed transaction is being reviewed by multiple regulators. The OSC has conducted an extensive review of all of the regulatory issues to ensure that any changes are in the public interest.

Our staff are developing draft recognition orders with detailed terms and conditions, as was announced last week. There are a number of issues that need to be satisfactorily addressed through enhanced regulation and the imposition of terms and conditions.

When the recognition orders and terms and conditions are ready, they will be published for a 30-day public comment period. The terms and conditions will be substantive and extensive. They will deal with issues that all market participants have raised with us, including governance, conflicts of interest, fair access and fees. After reviewing the comments received, the Commission will make a final decision regarding the recognition orders with appropriate terms and conditions.

You are aware that the Autorité des marchés financiers (AMF) also announced its intention to finalize its recognition orders. Both B.C. and Alberta are working on their next steps as well. This important transaction for Canada has now taken a step forward, with the regulators outlining important terms and conditions to protect investor interests and market participant access and ensure fairness in the marketplace.

Shareholder Democracy and Shareholder Rights Plans

Finally, I want to talk about the role of securities regulators in the debate about the proper allocation of authority between boards and shareholders of issuers in our capital markets. This debate has focussed on shareholder democracy issues and on the role of the board in adopting a shareholder rights plan in response to a hostile bid.

I will begin with shareholder democracy, which refers to the increasing influence and engagement of shareholders in the governance of public issuers. As a result, we are seeing increasing demands for regulatory intervention to:

- facilitate shareholder empowerment;
- reform the proxy voting system through which shareholder rights are exercised; and
- address potential risks of the increasing influence of third-party proxy advisers over voting decisions by shareholders.

These are important issues for the integrity of our markets even though they are matters of corporate governance that have traditionally been dealt with under corporate law. However, securities regulators have been willing to regulate in such matters to further our mandate of investor protection and fostering efficient markets. A clear example is our regulation of related-party transactions.

While shareholder empowerment and engagement is an important governance mechanism to make directors accountable to shareholders for their conduct, securities regulators have a direct interest in facilitating responsible and effective shareholder engagement.

We indicated our intention to consider shareholder democracy issues in a Staff Notice published in January 2011. Our Notice identified three areas of shareholder democracy that we were considering:

- whether we should mandate individual director elections and majority voting for directors;
- whether we should mandate shareholder advisory votes on executive compensation (say-on-pay); and
- the effectiveness of the proxy voting system.

We received over 60 submissions from a range of commentators who addressed these issues and identified others, such as concerns about the role of proxy advisors and proxy solicitors. Today, I will focus on some specific issues that we have been explicitly considering.

First, we are working with the TSX to address concerns about the director election process. The TSX has proposed that:

- directors of listed issuers be elected individually and not by slate; and
- listed issuers disclose whether they have adopted a majority voting policy for the election of directors.

Our staff and the TSX are discussing the comments received on the proposal relating to the adoption of a majority voting policy for TSX-listed issuers. This is an important issue that goes to the legitimacy and accountability of boards. We would encourage all reporting issuers to adopt a majority voting policy.

Second, we have decided to take a leadership role in addressing concerns that market participants identified about the proxy voting system. We will empirically investigate these concerns about the transparency, efficiency and accountability of our voting system and design an appropriate regulatory response. We have been active participants in the stakeholder discussions that have occurred since our Notice was published and continue to encourage market solutions, where feasible. But we believe there is a need for greater regulatory involvement in the review of the proxy voting system.

Third, we have heard concerns about the role of proxy advisors in influencing shareholder voting, and the CSA will soon be formally soliciting stakeholder feedback about these issues. Proxy advisors have an important role in the capital markets as they facilitate investor participation in issuer governance. This role has become more significant as more complex governance, transactional and compensation matters are voted upon at shareholder meetings. It is time to review the role of proxy advisors.

It may come as a surprise to some that I am addressing the issue of shareholder rights plans in the context of a discussion of shareholder democracy, but it is clearly an issue that goes to the heart of how decision-making authority is allocated between the board and shareholders.

The CSA's regulatory approach to rights plans is based on Commission decisions interpreting the national policy on defensive tactics.

This interpretation has effectively meant that the role of target boards in responding to a hostile bid is limited to using a rights plan to solicit a better offer, usually through an auction. We think that this approach needs to be revisited in light of the significant market, governance and regulatory developments that have occurred since the policy was adopted in 1986. These developments include the increased shareholder engagement discussed earlier in my remarks.

As a result, the OSC is working with the CSA on creating a transparent framework for rights plans that allows target boards more latitude in responding to hostile bids if shareholder approval of the rights plan has been obtained. We believe that it's important that the decision on how to respond to a hostile bid be left to an issuer's board and its shareholders, rather than be made by regulators in hearings on an *ad hoc* basis. That's a big change. In our view, this is how shareholder democracy should work in the context of hostile bids.

Conclusion

We have a full regulatory agenda and these comments cover just five initiatives we have underway… just the tip of the iceberg. Our staff are also working on significant investor-protection proposals in cost disclosure and performance reporting and investment fund disclosure, as well as policy proposals to change the regulation of OTC derivatives, dark pools and high frequency trading. Enforcement has intensified its activity and taken on important and complex international files. We are focused on investor protection and will continue providing a strong deterrent to fraud and investor harm.

The OSC is headed in an exciting new direction. Our Board, management and staff are working together to achieve our vision to be a proactive and agile 21st century securities regulator. We are ready for the challenge of moving forward to regulate Ontario's capital markets in the best interests of investors, market participants and the provincial economy.

Thank you. I look forward to our discussion.