

6.1.2 OSC Statement of Priorities for Fiscal 2003/2004 – Request for Comments

THE ONTARIO SECURITIES COMMISSION

STATEMENT OF PRIORITIES FOR FISCAL 2003/2004

March 2003

Request for Comments

Introduction

The *Securities Act* requires the Ontario Securities Commission (OSC) to deliver to the Minister, and to publish in its Bulletin by June 30 of each year, a statement by the Chair setting out the proposed priorities for the Commission for its current financial year. The OSC remains committed to delivering its regulatory services in a businesslike manner and to working closely with its CSA colleagues and market participants to ensure that the regulatory system remains relevant to the changing marketplace. The Statement of Priorities articulates the business strategy and priorities the OSC has set for 2003/2004 to accomplish these goals.

Our Vision Canadian financial markets that are attractive to domestic and international investors, issuers and intermediaries because they have integrity and are cost efficient.

Our Mandate To provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity.

Our Approach We will be:

- Proactive, innovative and cost effective in carrying out our mandate,
- Fair and rigorous in applying the rules to the marketplace, and
- Timely, flexible and sensible in applying our regulatory powers to a rapidly changing marketplace.

Key Challenges

The OSC recognizes that it must address a number of key trends and changes affecting our business environment, capital markets, market participants and the global regulatory framework.

Enhancing Public Confidence in Capital Markets

Public confidence in capital markets around the world has declined significantly. Trust and confidence in financial reporting, auditing and corporate governance structures have been damaged by U.S. corporate accounting failures and bankruptcies. Geopolitical events as well as significant declines in personal portfolio values have also hurt confidence levels. In response to advances in U.S. investor protection regulation Ontario has passed *Keeping the Promise for a Strong Economy Act (Budget Measures)*, 2002 to enhance investor confidence. The statute provides new powers that will help the OSC to carry out its mandate. However, the use of these powers will also increase external focus on our accountability.

Streamlining the Securities Regulatory Process

The costs and complexities associated with doing business with many different regulators with differing rules and regulations across Canada is generating increasing dissatisfaction with the structure of financial services regulation, and in particular, securities regulation, in Canada. This fragmented regulatory environment is cumbersome, costly and frustrating for stakeholders. It is having a negative impact on the competitiveness of our capital markets and ultimately the cost to our market participants of raising capital.

Global Integration of Markets and Market Participants

Financial markets are global. Borders no longer serve as barriers to capital flows. Those seeking to invest and those seeking capital go where they see the opportunity for the best returns for the risks assumed. As capital flows become global, so do the market intermediaries and infrastructure servicing the business. Many of the largest intermediaries are global conglomerates combining banking, insurance and securities services in one entity.

Changing Investor Demographics

The past decade has seen significant growth in the investor community in Canada. Institutional investors are becoming larger and more sophisticated, while investment in the markets by retail investors has grown explosively - both directly and through the purchase of investment funds. Both groups need to have confidence in the integrity of the capital markets, but their informational and educational needs may be very different.

Rapid Pace of Innovation

Competition is driving market innovation and the creation of ever more sophisticated financial products, trading techniques and strategies. Technology facilitates these changes, making innovative products and services easier and cheaper to design, market and deliver to the consumer. The functions of intermediaries are changing. Trades can be executed directly from any location. The emergence of direct links into existing trading platforms, bypassing investment dealers, and the proliferation of alternative marketplaces has fundamentally altered the structure of the financial environment.

What This Means for the OSC

For Canadian financial markets to be attractive to all market participants, they must be, and be seen to be, fair and efficient while maintaining protection for investors. Given the trends and challenges outlined above, we need to find creative and innovative solutions to new issues, be willing to re-evaluate existing practices in light of changing circumstances and operate in a transparent and accountable manner. In particular, we need to focus on:

- Making decisions at the pace at which our markets are changing,
- Insisting that investors receive the understandable, accurate and complete disclosure they need to make informed investment decisions,
- Maintaining a globally competitive regulatory regime that adequately addresses investor protection,
- Educating consumers so they can help protect themselves,
- Providing more client focussed service delivery,
- Fostering seamless regulation to minimize the burden on market participants,
- Enforcing clear rules in a consistent and visible manner,
- Building on our relationships in the regulatory community, both domestic and international, making use of the best lessons from each and relying on their expertise where practicable, and
- Facilitating the fair and efficient operation of exchanges, clearing and settlement functions and other elements of the market infrastructure.

Our Goals

The OSC is committed to achieving our vision. To do so, we have developed a four-year strategic plan. In implementing it, we will at all times act consistently with our mandate. The goals and initiatives are not presented in order of priority. Fundamentally, the OSC will focus on making our capital markets safer, more efficient and easier to access and use for market participants. Our plan calls for stepping up our efforts in the following areas:

- Promoting harmonization of regulatory systems both domestically and internationally, including the pursuit of a more effective national securities regulatory system,
- Undertaking prevention-oriented activities, including proactive public education,
- Taking a risk-based approach to regulation, and
- Being less prescriptive and more flexible in our regulatory approach wherever practical.

Across the planning horizon we will strive to achieve the following outcomes:

1. Ontario's capital markets and financial services regulatory system will be fully consolidated, harmonized nationally, and coordinated internationally.

We will continue the following key initiatives towards achieving this outcome:

- a) Complete the CSA project to propose Uniform Securities Laws,
- b) Work with regulators, governments and industry participants in moving towards a more effective national securities regulatory system,
- c) Participate actively in International Organization of Securities Commissions (IOSCO) and Council of Securities Regulators of the Americas (COSRA) initiatives and, where appropriate, provide leadership,
- d) Continue to work with the Financial Services Commission of Ontario (FSCO) on initiatives to coordinate our regulatory activities and on the proposed creation of a new regulatory structure,
- e) Initiate and foster initiatives which reduce the use of off shore trading to circumvent securities laws,
- f) Reduce inter-jurisdictional impediments to information sharing and enforcement support,
- g) With the Joint Forum of Financial Regulators, develop and implement harmonized financial services regulatory solutions,
- h) Continue development of national electronic information systems to facilitate the activities of market participants,
- i) In accord with the plan made in 2002, continue to work with industry through the Bond Market Transparency Committee to ensure implementation of ATS Rules with respect to application to fixed income markets that achieves effective regulation and also supports innovation and efficiency in the bond markets, and
- j) In accord with the plan for completion by 2004, develop a model to permit flexibility in the business models that registrants can use.

During 2003/2004 the OSC will focus resources on restructuring the registration system. As part of this process, the OSC will continue work towards harmonizing categories of registration and conditions of registration across Canada and to creating a passport system permitting a registrant in one province to trade or advise in another. The OSC will also work to effectively manage the start-up of the National Registration Database.

We will measure success by the following:

- Market participants will utilize one "window" to access the market conduct regulatory system in Canada.
- Impediments to investigation and enforcement initiatives created by international boundaries will be substantially reduced as a result of increased harmonization of international disclosure laws and procedures.

2. Market participants and investors will have confidence in the integrity of Ontario's capital markets.

We will implement the following key initiatives towards achieving this outcome:

- a) Work with the provincial government and our CSA colleagues on legislative initiatives to strengthen our regulatory system and improve investor confidence:
 - in response to the Report of the Five Year Review Committee, and
 - in response to U.S. initiatives (e.g., Sarbanes-Oxley and the new NYSE listing standards),
- b) Respond to the introduction of *Keeping the Promise for a Strong Economy Act (Budget Measures), 2002* including developing and proposing any necessary rules and enforcement protocols,
- c) Work with our CSA and SRO colleagues to develop and implement strategies to reduce unlawful insider trading in Canada,

- d) Coordinate with foreign regulators to identify and close “gaps” in regulation between jurisdictions that may be used to support illegal market conduct,
- e) Develop and propose a revised framework for regulating mutual funds and their managers that relies on independent oversight as a means to address conflicts of interest and focuses on the responsibilities of the fund manager in managing mutual funds, and
- f) Complete development of a Fair Dealing Model proposal.

During 2003/2004 the OSC plans to publish draft rules for comment to address the following issues:

- Auditor Oversight
- CEO/CFO Certification of Financial Information
- Composition and Responsibilities of Audit Committees

The OSC will also examine potential approaches to address issues related to Board independence including guidelines for committees (nominating, compensation etc.).

We will measure success by the following:

- Public surveys of market participants will show an increase in confidence.
- Other major securities regulators will exempt Canadian businesses from their investor confidence requirements in recognition that our regulatory regime is effective.
- Domestic and international investor confidence in the integrity of the Ontario regime will improve.
- The revised framework for regulating mutual funds will significantly update and simplify product regulation for mutual funds and clarify our approach to investment funds that are not conventional mutual funds.
- Investors, issuers and other market participants who use the Ontario capital markets will be afforded access, protection, education and information at levels similar or superior to those of the best of our peer group.

3. Regulatory interventions in Ontario will be balanced and merit based.

We will undertake the following key initiatives towards achieving this outcome:

- a) Make appropriate changes to our practices as a result of the recommendations of the Regulatory Burden Task Force,
- b) Assess the impact of “soft dollars” on market efficiency, analyst bias and competitiveness,
- c) Improve accountability through the use of rigorous Cost Benefit Analysis and risk based assessments for all proposed initiatives,
- d) Monitor changes in the regulation of the structure of investment banks and research units in other countries to determine the need (if any) for change in Canada.

We will measure success by the following:

- It will be clear to investors, issuers and intermediaries that the benefits of regulation appreciably outweigh the costs of regulation.
- There will be examples of our fostering and implementing non-regulatory alternatives where such action is supported by a better cost/benefit relationship than new regulation.
- The effective cost and burden of regulation will be competitive with our peers, without undermining investor protection and confidence.

4. The OSC will have superior and transparent governance and accountability mechanisms.

We will undertake the following key initiatives towards achieving this outcome:

- a) Adopt a more customer focused approach to our communications and service delivery,
- b) Improve the transparency of OSC corporate governance practices and accountability mechanisms, and
- c) Tailor the form and method of access to OSC communications to the needs of OSC constituents, including implementing predominantly electronic-based communications vehicles and redesigning the OSC Website.

We will measure success by the following:

- 100% of OSC communications will be accessible electronically by 2005.
- Public surveys of market participants will show improved ratings for OSC customer service.

2003/2004 Financial Outlook

The OSC has budgeted total 2003/2004 operating expenditures of \$57.8 million, a 4.3% increase over projected 2002/2003 expenditures. The key budget component is salaries and benefits costs, which are projected to rise by 8.3% to \$40.7 million. This increase reflects the annualized cost impact of previous hiring as well as higher pension costs as contribution rates have returned to normal levels. Total staffing is projected to remain at current levels. The budget includes a continued reduction in professional services costs reflecting greater reliance on internal resources. The OSC has budgeted \$3.2 million for professional services costs in 2003/2004, a 10.0% decrease from the 2002/2003 budget.

The OSC revenue forecast for 2003/2004 is \$65.0 million, which is 3% lower than the \$66.9 million projected in 2002/2003.

The OSC will implement a restructured fee schedule effective March 31, 2003. The new fee schedule is consistent with the commitment to more closely align the fees charged to market participants to the costs of the services they use directly and the benefits derived through participation in our markets. Under the previous fee approach the OSC initially used excess fee revenues to create a financial reserve. Currently, the OSC remits all revenues which are surplus to its operations to the Ontario government. Going forward the OSC plans to review its fee structure every three years. Any surplus net revenues generated across the three-year period will be used by the OSC in calculating future fee levels and would reduce the need for future fee increases. Through this approach the OSC will be able to ensure that the fees paid by industry participants do not exceed the actual costs of its regulatory activities.

Report on 2002/2003 Organizational Priorities

A summary of the performance of the OSC in meeting the goals and priorities identified in the 2002/2003 Statement of Priorities is provided below.

1. Ontario's capital markets and financial services regulatory system will be fully consolidated, harmonized nationally and coordinated internationally.

2002/2003 Initiatives

- a) Complete the CSA project to develop a proposed Uniform Securities Law,
- b) Develop legislative proposals to permit delegation of powers and duties among Canadian securities regulators and a comprehensive delegation model in support of it,
- c) Support implementation of the merger of the OSC and the FSCO,
- d) Participate actively in International Organization of Securities Commissions (IOSCO) and Council of Securities Regulators of the Americas (COSRA) initiatives and, where appropriate, provide leadership.
- e) With the Joint Forum of Financial Regulators (Joint Forum), develop and propose harmonized financial services regulatory solutions in the following areas:
 - proficiency standards for financial intermediaries,
 - common licensing requirements,

- capital accumulation plans, and
- individual variable insurance contracts and mutual funds.

2002/2003 Results

In March 2002, the CSA announced an initiative to develop uniform securities legislation for adoption across Canada. On January 30, 2003, the CSA published for comment a concept proposal, *Blueprint for Uniform Securities Laws for Canada*. Although the primary focus of the project is to achieve harmonization of legislation, efforts are also being made to simplify and streamline the regulatory system. The following are the most significant policy changes proposed in the concept paper:

- the ability for a securities regulator to delegate decision-making across all regulatory functions to another securities regulator
- a streamlined system for inter-jurisdictional registration of firms and individuals
- a civil liability regime for secondary market participants
- a streamlined securities act with details largely contained in rules to allow future changes to securities laws to be made in a timely and harmonized manner through the rule-making process.

The next phase of the project involves review and analysis of comments on the concept proposal, discussions with governments, SROs and industry participants, review of all rules and policies and drafting of a uniform act and uniform rules. The CSA objective is to have uniform legislation ready for consideration by each province and territory in 2004.

Significant progress was achieved towards completing the following major OSC rules and policies.

The following rules/policies came into force during 2002/2003:

11-201: Delivery of Documents by Electronic Means (amendments)
12-201: Mutual Reliance Review System for Exemptive Relief Applications (amendments)
41-601: Capital Pool Companies
45-502: Dividend or Interest Reinvestment and Stock Dividend Plans (amendments)
45-503: Trades to Employees, Executives and Consultants (amendments)
46-201: Escrow for Initial Public Offerings
51-201: Disclosure Standards
54-101: Communication with Beneficial Owners of Securities of a Reporting Issuer
62-501: Prohibited Stock Market Purchases of the Offeree's Securities by the Offeror during a Take-over bid
62-601: Securities Exchange Take-over Bids - Trades in Offeror's Securities (amendments)

The following rules/policies were published for comment during 2002/2003:

45-102: Resale of Securities (amendments),
45-105: Trades to Employees, Senior Officers and Consultants (Multilateral Instrument to replace local rule)
51-101: Standards of Disclosure for Oil and Gas Activities
51-102: Continuous Disclosure Obligations
55-201: System for Electronic Disclosure by Insiders (amendments)
61-501: Insider Bids, Issuer Bids, Going Private Transactions and Related Party Transactions (amendments)
72-502: Continuous Disclosure and Other Exemptions Relating to Foreign Issuers,

Staff issued Notice 55-308 to address stakeholder questions on insider reporting obligations.

During the year Frequently Asked Questions on New Rules were issued on the following rules:

- 43-101: Standards of Disclosure for Mineral Projects
- 45-102: Resale of Securities
- 54-101: Communication with Beneficial Owners of Securities of a Reporting Issuer

The applications Mutual Reliance Review System (MRRS) policy was amended in June. The amendments further refined the system and addressed some stakeholder concerns.

A reconsidered approach to revocation of cease trade orders was presented to the Commission in [March 2003].

The OSC worked with FSCO on various initiatives to coordinate our regulatory activities.

The OSC was accepted as a signatory to the IOSCO Multilateral Memorandum of Understanding concerning consultation and cooperation and the exchange of information (the "IOSCO MOU") and signed the IOSCO MOU on October 23, 2002. The IOSCO MOU recognizes the increasing international activity in the securities and derivatives markets, and the corresponding need for mutual cooperation and consultation among IOSCO members to ensure compliance with, and enforcement of, their securities and derivatives laws and regulations, and establishes an international benchmark for cooperation and information sharing among IOSCO members.

As part of the Joint Forum's effort to harmonize the regulation of segregated funds and mutual funds, a consultation paper *Rethinking Point of Sale Disclosure for Segregated Funds and Mutual Funds* was released for comment on February 13, 2003. The consultation paper recommends a streamlined disclosure system consisting of a foundation document, a continuous disclosure record, a short fund summary and a consumers' guide.

The Joint Forum has initiated a project to coordinate and harmonize the treatment of capital accumulation plans (CAPs) across Canadian jurisdictions and across the insurance, pension and securities sectors within each jurisdiction. Currently investors receive varying degrees of regulatory protection depending on the investment product they purchase and the regulatory framework that applies to it. The goal is to give similar protection to investors. The Joint Forum has developed regulatory principles for CAPs. Guidelines for the operation of capital accumulation plans based on the principles were completed by a task force of industry representatives and staff from members of the Joint Forum. The guidelines will be presented to the Joint Forum for approval to publish for comment in the spring of 2003.

Another accomplishment for the Joint Forum is the Financial Services OmbudsNetwork (FSON), an integrated complaint management and dispute resolution service for financial services consumers which became fully operational in November 2002.

2. Regulatory interventions in Ontario will be timely, balanced and proportionate to the risks involved.

2002/2003 Initiatives

- a) Initiate and foster initiatives which reduce the use of off shore trading to circumvent securities laws,
- b) Reduce inter-jurisdictional impediments to information sharing and enforcement support,
- c) Make appropriate changes to our practices as a result of the recommendations of the Regulatory Burden Task Force, and
- d) Work with the provincial government and our CSA colleagues to implement legislative changes that may be made as a result of the recommendations of the Five-Year Review Committee.

2002/2003 Results

The OSC has continued to develop new processes and procedures with law enforcement, Canadian financial regulators and international securities regulators to share information in an effective and timely manner.

The OSC has been successful in utilizing existing and new formal arrangements to obtain information and evidence from traditional bank secrecy jurisdictions that have lead to the initiation of proceedings in respect of allegations of insider trading or to assist in the ongoing investigation into certain other matters. Through our involvement in IOSCO we have made presentations to international organizations detailing the risks to capital markets in circumventing securities laws associated with the use of offshore accounts. The OSC has continued to provide recommendations to the Investment Dealers Association regarding proposed changes to their current by-laws in respect of the know-your-client rules and client identification requirements.

The Minister's Five Year Review Committee published its Draft Report for comment on May 29, 2002. The Committee's Draft Report represents a comprehensive survey of securities legislation in Ontario and its recommendations aim to ensure that securities legislation in Ontario is up to date and that the OSC is able to proactively enforce clear standards to protect investors and foster a fair and efficient marketplace. In December 2002, the Government of Ontario passed the *Keeping the Promise for a Strong Economy Act (Budget Measures), 2002* which introduces important amendments to the *Securities Act*, most of which were recommended in the Draft Report. Among the most significant changes being made to the *Securities Act* (once proclaimed in force) that are based on the Draft Report, are amendments to:

- Introduce a regime of statutory civil liability for secondary market disclosure.
- Increase the maximum penalties which a court can impose for breach of the Act to \$5 million and imprisonment for five years less a day.
- Give the Commission the power to impose an administrative penalty or to order disgorgement.
- Introduce prohibitions against fraud and market manipulation and making misleading statements.
- Give the Commission rulemaking authority relating to audit committees.
- Enshrine in the Act the concept of continuous disclosure reviews.

The comment period for the Draft Report expired in August 2002. The Committee received 45 comment letters and met 24 times between September 2002 and January 2003 to review the comment letters and finalize its Report. The Final Report is expected to be delivered to the Minister in Spring 2003.

3. Investors, issuers and other market participants who use the Ontario capital markets will be afforded access, protection, education and information at levels similar or superior to those of the best of our peer group.

2002/2003 Initiatives

- a) Foster the implementation of the Industry Analyst's Standards Report (Setting Analyst Standards: Recommendations for the Supervision and Practice of Canadian Securities Industry Analysts) recommendations, where appropriate.
- b) Foster the implementation of the Saucier Report (Beyond Compliance: Building a Governance Culture) recommendations, where appropriate.
- c) Tailor the form and method of access to OSC communications to the needs of OSC constituents, including implementing predominantly electronic-based communications vehicles and redesigning the OSC Website.

2002/2003 Results

Significant progress was achieved towards completing these initiatives. During the past year the OSC:

- Led a CSA issue-oriented review of executive compensation disclosures and communicated the results in CSA Notice 51-304; also carried out an issue-oriented review of non-GAAP earnings measures
- Completed continuous disclosure reviews of all Ontario-based TSX 100-based companies that had not been recently reviewed (plus some companies based in other provinces), including additional procedures relating to review of minutes, audit committee materials, etc.
- Established a website-based "Refilings and Errors" list to provide greater transparency of companies that refile or restate disclosure documents due to a regulatory review, and issued accompanying staff notice 51-711.
- Established the Continuous Disclosure Advisory Committee, the Small Business Advisory Committee and the NI 54-101 Advisory Committee.
- Commenced a "real time review" program as well as issue-oriented reviews of MD&A disclosure and of continuous disclosure filings of income funds.
- Finalized NP 51-201, which provides guidance on selective disclosure, corporate disclosure practices and related issues.
- Published for comment a draft national rule to harmonize and update continuous disclosure requirements across the CSA.

In early 2003, the OSC undertook steps to increase transparency in connection with its governance and accountability structure. The OSC's Website now contains a section entitled "Governance and Accountability" which discusses the structure of the OSC and identifies its committees, their mandates and members. Several steps were taken during the year to improve the electronic availability of OSC documents and other information, including:

- Several new features have been added to the OSC's web-site, including terms and conditions imposed on registrants and comments on drafts of concept papers, policies rules and other instruments;
- The National Registration Database was launched on March 31, 2003. Stakeholders interested in the launch of the National Registration Database (NRD) were kept up-to-date via a comprehensive e-mail campaign and the launch of a web-site dedicated to NRD. This approach will also be used to communicate other initiatives, such as SEDI.
- A re-launch of the OSC web-site, which includes a more accurate and powerful search capability and the use of content management software is planned for calendar 2003.

The OSC's Investor Communications team continued to implement initiatives with more emphasis on community outreach. The goal is to raise awareness of the OSC and deliver investor protection messages to audiences across Ontario by using OSC-trained volunteers to work with community groups. The following programs were delivered:

- *Protect Your Money*, is a joint project with the Ontario Senior Secretariat delivered by volunteers from the Volunteer Centre of Toronto. "Protect Your Money" presentations are hosted by Members of Provincial Parliament and are aimed at seniors.
- OSCAR (Ontario Securities Commission Agent Representative), is an investor education outreach program designed to engage community leaders who, on behalf of the OSC, speak to audiences in their community. OSCAR began as a pilot project in Aurora, Chatham, Kingston, Ottawa and Windsor and is being expanded to include London, Kitchener, Barrie, Peterborough and the GTA.