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M O V O L O R A N O E N I S T E M A L I Q U



Management's Discussion and Analysis

This MD&A was prepared as of May 21, 2013 and is intended to assist our readers in understanding key financial events and actions and how they have influenced the Ontario Securities Commission's (OSC) operations during the past year. An outlook on OSC 2013 – 2014 plans is also provided. Additional details on 2013 – 2014 plans are set out in the OSC Statement of Priorities and the OSC Strategic Plan at www.osc.gov.on.ca.

Certain statements in this MD&A are forward-looking and are therefore subject to risks and uncertainties. The financial performance or events forecast in these statements may differ materially from actual financial performance or events. Factors which could cause financial performance or events to differ from current expectations are described under "Risks and Uncertainties." The words "believe," "plan," "intend," "estimate," "expect" or "anticipate" and similar expressions, as well as future or conditional verbs such as "will," "should," "would" and "could" often identify forward-looking statements. The OSC has based these forward-looking statements on its current views of future events and financial performance. Any assumptions, although reasonable at the time of publication, are *not* guarantees of future performance.

This document should be read with the financial statements. The financial statements present the OSC's financial performance with 2012 comparatives as at March 31, 2013 and accompanying notes. Unless otherwise specified, references to a year, for example 2013, refer to the fiscal year of the OSC ended March 31 of that year. The factors which affected the OSC's operations during 2013, as well as the factors that reasonably may be expected to affect future operations and financial performance, are set out in this document.

All financial information in this MD&A related to 2013 and 2012 is in accordance with International Financial Reporting Standards ("IFRS") and all dollar amounts are expressed in Canadian dollars unless otherwise indicated.

Summary of Key Themes and Highlights of 2013

The OSC has prepared this high-level summary of key themes and highlights of its MD&A to enable readers to quickly review what we believe were notable developments during fiscal 2013. It is not intended as a substitute for the full MD&A but reflects the OSC's commitment to open and accessible communication.

Fiscal 2013 – Key Themes

In the year that passed, activities engaged in by the OSC reflected three themes:



Efficiency

The numbers show we are doing more with less. The OSC has assumed significant additional responsibilities for more complex work, as well as for critically important information technology projects. We have done so with the fewest possible additional staff: hiring from the outside only where specific expertise is required and reallocating activities efficiently among existing employees. The increment in fees and in required staffing should be compared with the additional activities the OSC is undertaking to respond to global pressures and industry needs and to provide enhanced investor protection.



Responsiveness

The OSC has reduced its financial surplus over the past few years and moderated its fee increases as part of its response to difficult market conditions for the securities industry and challenges in the broader economy. Drawing down the surplus was a responsible measure that has seen the OSC incur a financial deficiency in 2013, and we expect to see our surplus decline to \$3.4 million in 2014. The new fee model for the coming fiscal year has been targeted to address stresses faced by market participants, in particular to reduce the administrative burden on smaller firms.



Transparency

Readers who compare this MD&A with previous versions will find the OSC has provided additional financial detail that delivers greater transparency and reflects best communications practices. Included is new information about the Canadian Securities Administrators (CSA) cost sharing and systems development, more transparent information about enforcement assessments and collection processes, and improved fee setting process. We have also sought to offer an understanding of the alignment between costs and goals.



MD&A Highlights

- Following its plan to reduce its surplus, the OSC had a net deficiency of revenues over expenses of \$7.6 million, including \$1.2 million recovered in enforcement costs.
- The OSC amended its fee rules for fiscal years ending March 31, 2014, 2015 and 2016; the new rules took effect on April 1, 2013.
- The OSC made new staff additions specifically to establish the Office of the Investor, to provide analytical and research support, to improve adjudicative process timeliness and to address operational priorities.
- The OSC acquired more space to accommodate expanded hearing rooms and staff growth.
- The OSC renewed its revolving line of credit for another two years (expiring June 30, 2014) for \$35 million.
- The OSC will seek approval to increase its line of credit to \$60 million and to make it permanent. Subject to approval, it should succeed arrangements expiring in June 2014.
- As planned, the OSC expects to continue to operate at a deficit in 2013 – 2014, and the OSC accumulated surplus is projected to decrease to \$3.4 million as at March 31, 2014.

Overview

The OSC is a Crown corporation without share capital and is responsible for regulating Ontario's capital markets. In protecting investors and fostering fair and efficient capital markets in Ontario, the OSC seeks to strike an appropriate balance between facilitating timely access to the material information needed by investors to make informed investment decisions, while avoiding undue regulatory burdens on market participants. A member of the CSA, the OSC works with other Canadian securities regulators to improve, co-ordinate and harmonize the regulation of Canada's capital markets.

The OSC achieves its goals through various regulatory tools, including:

- Imposing requirements through rules and other regulatory instruments;
- Providing guidance to market participants;
- Assessing compliance and directing corrective action; and
- Taking enforcement action.

The OSC is also an administrative tribunal with quasi-judicial powers. Panels of Commissioners hear enforcement proceedings and contested applications and consider applications for discretionary exemptions from Ontario securities law requirements. Certain authorities are delegated by statute to OSC Directors and other staff as designated under the *Securities Act* (Ontario) and the *Commodity Futures Act*.

Selected Three-Year Annual Information

(Thousands)	2013	2012	2011
Revenue	\$ 87,278	\$ 85,638	\$ 72,955
Expenses	96,166	91,163	84,584
Deficiency of revenue over expenses (before recoveries)	(8,888)	(5,525)	(11,629)
Recoveries of enforcement costs	1,245	1,139	703
Deficiency of revenue over expenses	(7,643)	(4,386)	(10,926)
General surplus	5,842	13,485	17,872
Property, plant and equipment	\$ 7,775	\$ 1,877	\$ 1,321

Certain financial statement amounts have been rounded for discussion purposes; however, percentages are calculated from financial statement amounts. As a result, small differences in calculations may arise, but are not deemed material.

Analysis of Financial Performance

Revenues increased \$1.6 million or 1.9% from higher participation fee revenues. Expenses were \$5.0 million or 5.5% higher. Key drivers of the increase in expenses were costs for salaries and benefits (\$2.9 million), administrative (\$789,000) and occupancy (\$890,000). Employee compensation and occupancy costs account for 82.9% (2012 – 83.3%) of expenses (before recoveries).

Consistent with its plan to reduce its surplus, the OSC had a net deficiency of revenues over expenses of \$7.6 million (2012 – \$4.4 million). The deficiency was \$1.1 million more than budgeted because revenues were \$6.2 million lower than planned and spending was \$4.8 million under budget. The OSC's deficiency of revenues over expenses was reduced by recovering \$1.2 million in enforcement costs through settlements and orders.

The property, plant and equipment balance increased \$5.9 million (314.2%) through expansion and renovation of OSC facilities. The OSC acquired more space to accommodate staff growth and expand hearing rooms, create additional work areas for staff and for painting and re-carpeting its offices.

OSC Fee Structure

Securities market participants fund OSC operations through their fees. The fee structure under the *Securities Act* (Ontario) and the *Commodity Futures Act* was established in 2003. When the OSC implemented the fee structure, it committed to re-evaluate the fee levels every three years. Before amendments made in 2013 (described on the following page), OSC fee rules were last amended in April 2010 for fiscal years ending March 31, 2011, 2012 and 2013. The fee structure is intended to recover operating costs to fulfill the OSC's mandate, while allowing it to remain financially stable.

Payment of “activity fees” and “participation fees” are included:

Activity fees

- Reflect estimate of direct cost for OSC staff to undertake activities requested by market participants.
- Flat rates based on OSC's average cost to provide requested services.

Participation fees

- Based on cost of broad range of regulatory services that cannot be practically or easily attributed to individual activities or entities.
- Proxy for market participants' use of Ontario capital markets.
- Tiered structure: for issuers, based on average market capitalization across fiscal year; for registrants, based on revenues.
- As a market participant grows, it passes through tiers with increasingly higher fees.

The OSC amended the OSC fee rules for fiscal years ending March 31, 2014, 2015 and 2016. They were approved by the Minister of Finance on January 15, 2013, and took effect on April 1, 2013.

Under the OSC fee rules, participation fees for reporting issuers will increase over the three-year cycle 4.7% per year for registrants and 11.6% per year for issuers. The fee increases proposed for issuers and registrants differ to better align revenues generated from market participant groups with their participation levels in Ontario's capital markets. Most activity fees have increased to address greater work complexity and increased workload since they were last changed in 2010. The new fees will enable the OSC to recover its costs by the end of fiscal 2016. Under the fee proposal, revenues collected from the industry in 2013 – 2014 will rise by \$13.4 million.

Detailed Analysis of Fiscal 2013 Financial Performance

Revenue

(Thousands)	% of 2013 Revenue	2013	2012	Change	% Change
Participation fees	86.6%	\$ 75,310	\$ 71,694	\$ 3,616	5.0%
Activity fees	11.1%	9,616	10,728	(1,112)	(10.4%)
Late fees	2.3%	2,004	2,760	(756)	(27.4%)
Total fees	100.0%	\$ 86,930	\$ 85,182	\$ 1,748	2.1%
Interest income	–	237	344	(107)	(31.1%)
Miscellaneous	–	111	112	(1)	(0.9%)
Total revenues	–	\$ 87,278	\$ 85,638	\$ 1,640	1.9%

Figure 1 – Sources of the OSC's fee revenue



Revenues for the year were \$87.3 million, up from \$85.6 million in 2012 as a result of higher participation fee rates. The variance is explained below.

Participation fees increased \$3.6 million (5%).

In fiscal 2013, participation fee rates rose by 9% for registrants and 17% for issuers. The difference in fee levels is intended to better align revenues generated from each group with its participation level in Ontario's capital markets.

Issuer participation fee revenues increased \$2.8 million from higher fee rates; these were partially offset by year-over-year decreases in market capitalizations. Registrant participation fee revenues were higher by \$852,000 as year-over-year decreases in registrants' revenues almost offset higher rates.

Activity fees fell by \$1.1 million (10.4%). The lower issuer activity fee revenues resulted from a lower volume of filed applications for relief, preliminary short form prospectuses, and private placement filings than in fiscal 2012. Registrant activity fees declined from a decrease in applications for relief and in registrations of new representatives.

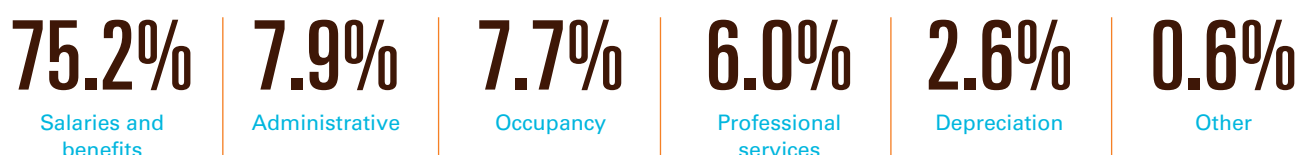
Late filing fees were \$756,000 (27.4%) lower than last year from a decrease in late filings of annual and interim financial statements and insider reports.

Investment income declined by \$107,000 (31.1%) from holding lower cash balances over the previous year. The average rate of return on cash balances was 1.22% (2012 – 1.25%). The average rate of return on reserve fund investments was 1.23% (2012 – 1.34%).

Expenses

(Thousands)	% of 2013 Expenses	2013	2012	Change	% Change
Salaries and benefits	75.2%	\$ 72,336	\$ 69,415	\$ 2,921	4.2%
Administrative	7.9%	7,607	6,818	789	11.6%
Occupancy	7.7%	7,434	6,544	890	13.6%
Professional services	6.0%	5,767	5,920	(153)	(2.6%)
Depreciation	2.6%	2,461	1,844	617	33.5%
Other	0.6%	561	623	(62)	(10.0%)
	100.0%	\$ 96,166	\$ 91,164	\$ 5,002	5.5%
Recoveries of enforcement costs	—	(1,245)	(1,139)	(106)	9.3%
Total expenses (net of recoveries)	—	\$ 94,921	\$ 90,025	\$ 4,896	5.4%

Figure 2 – OSC expenses by type





Total expenses (net of recoveries) for fiscal 2013 increased 5.4% to \$94.9 million (2012 – \$90.0 million). Key expenditure increase contributors were:

Salaries and benefits

- Costs increased 4.2% to \$72.3 million (2012 – \$69.4 million) and accounted for 75.2% (2012 – 76.1%) of total expenses.
- Full-year cost of staff hired during 2012, as well as costs for new staff were key increase drivers.
- Staff additions: to establish the Office of the Investor, to provide analytical and research support (so the OSC can reinforce a more fact-based regulatory approach), to increase enforcement and to improve adjudicative process timeliness. Other staff was added across various branches to address operational priorities.

The OSC operates in a competitive market for required skills and expertise, including legal, accounting, market and investigative capabilities. In addition to the increase in the number of staff, as noted above, salary increases, averaging 1.6% were introduced at the beginning of the fiscal year in compliance with Government guidelines. The increases totalled \$910,000 (2012 – \$887,000). They were partially offset by savings of \$712,000 on salaries and benefits recovered for staff seconded to the Canadian Securities Transition Office (CSTO). Severance costs were \$1.6 million, \$463,000 higher than 2012. Our focus on prudent and efficient cost control includes efforts to ensure that staff have the necessary talents and skills to meet and deliver on the OSC's goals.

Administrative costs

- Increased 11.6% to \$7.6 million (2012 – \$6.8 million) and accounted for 7.9% (2012 – 7.5%) of total expenses.
- Key drivers were a \$553,000 rise in information technology maintenance, additional products and services outsourced and expensed monthly, and higher Commission costs of \$330,000 due to the increased number of hearing days.

Occupancy costs

During fiscal 2013, the OSC renewed its lease and expanded its offices. The lease has been renewed for five years (expiring August 31, 2017). The new agreement includes an extension option for two more five-year periods to August 31, 2027. The OSC expects to exercise the first option. Total rentable area is 166,364 square feet.

- Increased 13.6% to \$7.4 million (2012 – \$6.5 million) and accounted for 7.7% (2012 – 7.2%) of the OSC's total expenses and result from higher lease costs and acquiring additional space to accommodate staff growth.

Professional services

- Accounted for 6.0% (2012 – 6.5%) of total expenses; essentially flat.

Depreciation costs

- Increased 33.5% to \$2.5 million and accounted for 2.6% (2012 – 2.0%) of total expenses; for facilities expansion and renovation during 2013.
- Multi-year renovation and expansion project will accommodate staff growth; provides expanded hearing rooms, additional staff work areas and overall refresh of paint and carpets.
- Renovation and expansion expenses will be depreciated over the term of the lease plus one option period for a total of 10 years. All renovation and expansion costs have been accrued properly as at March 31, 2013 based on OSC design consultant status reports.

Other expenses

- Travel and related expenses decreased \$62,000 (10.0%) to \$561,000 (2012 – \$623,000) and accounted for 0.6% (2012 – 0.7%) of OSC's total expenses.
- The cost decline is primarily from a decrease in the number of trips, especially for ongoing enforcement staff investigations of emerging markets issues.

CSA shared costs

The OSC is a member of the CSA, a forum of Canadian securities regulators. Professional services include costs to operate CSA offices (which are allocated by formula), plus OSC's portion of professional services costs for joint CSA projects.

The CSA's business relationships with third-party technology providers are managed through the CSA systems office. In prior years, costs for this office were included in CSA costs. Effective April 1, 2012, the Principal Administrators of the CSA agreed to fund the CSA systems office from CSA surplus funds held by the OSC, not from CSA member operations. This policy change explains the decrease in OSC contribution to CSA projects (noted below). Total fiscal 2013 CSA spending on shared projects was lower (\$1.9 million versus \$3.0 million in 2012) and the OSC contributed \$722,000 (versus \$1.1 million in 2012). OSC staff time is not included in these totals. All CSA projects, including developing harmonized securities policies and rules, are co-ordinated through a central secretariat. In fiscal 2013, the OSC contributed \$263,000 (2012 – \$250,000) to support the CSA Secretariat.



Liquidity and Financial Position

Financial instruments

Financial instruments used by the OSC consist of Cash, Funds held pursuant to designated settlements and orders, Funds held for CSA systems redevelopment, and Reserve fund assets; all are recorded at fair value. Trade and other receivables, trade and other payables and accrued liabilities are recorded at cost which approximates fair value given their short-term maturities. Cash, Funds held pursuant to designated settlements and orders, Funds held for CSA systems redevelopment and Reserve fund assets are held in Canadian deposit accounts with Schedule 1 banks, earning interest at 1.85% below prime. Before February 1, 2013, interest was earned at 1.75% below prime.

Management believes the OSC is not exposed to significant interest rate, currency or liquidity risks from its investments due to their short-term nature and because virtually all transactions are in Canadian dollars. The OSC's concentrations of credit risk from trade and other receivables are limited: they comprise a large number of debtors owing individually immaterial balances and amounts receivable from:

- Government of Canada for recovering Harmonized Sales Tax (HST) paid during the year;
- The Canadian Securities Transition Office (CSTO) for seconded staff;
- The Investor Education Fund (IEF) for seconded staff; and
- Funds held for CSA systems redevelopment, which the OSC oversees, to recover staff costs and other charges incurred by the CSA IT systems office.

During the year, the OSC revised its investment policy to set an amount limit of \$30 million in a Schedule 1 bank for each category of OSC Funds and to restrict investing funds not held in Schedule 1 banks to guaranteed obligations of the Province of Ontario. These changes maintain the OSC's prime objectives: capital preservation and risk minimization. They also better align the OSC's investment policy with *Financial Administration Act* requirements.

Liquidity

- At March 31, 2013, the OSC held \$11.2 million (2012 – \$23.1 million) in cash, had current assets of \$15.9 million (2012 – \$26.8 million) and current liabilities of \$17.1 million (2012 – \$15.2 million) for a current ratio of 0.9:1 (2012 – 1.8:1).
- The OSC holds enough cash, reserve fund assets and credit access to ensure liquidity for its forecast cash requirements.

In setting fees for the three years ending March 31, 2013, the OSC planned to operate at a deficiency in each year to eliminate its surplus by the end of the period. In 2013, the OSC had an operating deficiency of \$7.6 million; the year-end surplus was reduced to \$5.8 million. The OSC's planned deficiency, coupled with leasehold improvement spending and other capital items, caused its cash position to decrease by \$11.9 million (51.5%). Cash flows from operating activities produced an outflow of \$4.1 million (2012 – \$1.5 million). Property, plant and equipment consumed \$7.8 million (2012 – \$1.9 million).

For 2014, the OSC forecasts an operating deficiency of \$2.4 million. In March 2014, it projects its cash balance to decrease to about \$3.9 million; the general surplus, about \$3.4 million.

The OSC faces significant annual cash flow challenges from a timing mismatch between its revenues and expenditures. More than 75% of OSC revenues arrive in the last quarter of each fiscal year; expenses are incurred relatively evenly. This results in negative annual cash balances that peak in December. Historically, the OSC managed this issue through higher cash and accumulated surpluses. But a planned surplus reduction, resulting in part from the use of surplus funds to help offset fee increases, and declining cash balances in recent years required the OSC to fully use its \$20 million reserve in 2013 to help fund operations.

The OSC renewed its revolving line of credit for another two years (expiring June 30, 2014) for \$35 million; it contains no commitment or standby fees charged on undrawn amounts. The OSC used \$8.7 million of its line of credit between October and December 2012. When most registrant participation fees were received in January 2013, this amount was repaid and the \$20 million reserve was restored.

For 2014, the OSC expects that it will draw against its line of credit between August and December. The OSC will seek approval to increase its line of credit to \$60 million and to make it permanent. Subject to approval, it should succeed arrangements expiring in June 2014.

With a total operating surplus (including its reserve fund, and re-establishing its credit facility), the OSC expects to be able to properly finance its operations and pay for property, plant and equipment.

Revenues

Revenue generation remains a source of risk as OSC revenues reflect market activity. The degree to which OSC revenues mimic market fluctuations is greater than was anticipated when its fee structure was developed. (Additional discussion is shared in "Financial Risk.")

Reserves

Since 2001, the OSC has held a \$20.0 million general reserve to guard against revenue shortfalls or unexpected expenses, or to cover discrepancies between timing of revenue and expenses. Its prime investment consideration is protection of capital and liquidity. The OSC records income generated by the reserve in general operations.

Trade and other receivables

Trade and other receivables increased 32.0% to \$3.6 million (2012 – \$2.7 million). The net increase in trade and other receivables over the same period last year-end is from an increase in the amount owing by:

- The Funds held for CSA redevelopment for staff and other costs incurred by the OSC, which owe \$664,000 (2012 – \$0);
- IEF, which owes \$503,000 (2012 – \$236,000); and
- The Government of Canada, which owes \$869,000 (2012 – \$704,000) for HST recovery.

Funds held pursuant to designated settlements and orders

The OSC has a number of settlement agreements and orders arising from enforcement proceedings where monies are to be set aside (or "designated") and allocated as the OSC may determine. This includes allocations to harmed investors, where an allocation can be reasonably made. Before June 2012, these monies could only be allocated to or for the benefit of third parties. A June 2012 amendment to the *Securities Act* (Ontario) permits the OSC to use these funds to educate investors about how the securities and financial markets work. Funds that are not designated when settlements are approved or orders are made must be paid to the Consolidated Revenue Fund of the Government of Ontario.

The Commission may impose monetary sanctions for breaches of Ontario securities law and has exercised this authority since 2005. Sanction amounts depend on the circumstances of each proceeding. The Commission may consider a respondent's "ability to pay" in imposing financial sanctions, but typically levies sanctions appropriate to the circumstances, irrespective of a respondent's

	Assessed	Collected	% Collected
2005 – 2011			
Settlements	\$ 136,695,377	\$ 101,734,396	74.4%
Contested hearings	55,166,283	1,245,000	2.3%
Total	\$ 191,861,660	\$ 102,979,396	53.7%
2012			
Settlements	\$ 12,085,450	\$ 2,055,816	17.0%
Contested hearings	26,901,021	1,000,000	3.7%
Total	\$ 38,986,471	\$ 3,055,816	7.8%
2013			
Settlements	\$ 33,922,886	\$ 1,251,268	3.7%
Contested hearings	46,251,826	1,966,866	4.3%
Total	\$ 80,174,712	\$ 3,218,134	4.0%

ability to pay. This practice is intended to deter others from contravening the *Securities Act* (Ontario). The OSC continues to face challenges in collecting sanctions as respondents often have limited assets, poor credit or have left Ontario. Although the OSC actively pursues outstanding amounts, material differences remain between assessments and collections since 2005 (above table).

Staff continue to investigate how to improve OSC collections procedures. The experiences of other public and private sector organizations are being examined to identify effective methods the OSC could use.

Of the \$80.2 million in orders assessed during the year, the OSC recorded \$4.9 million in its Funds held pursuant to designated settlements and orders, as described in Note 6 to the financial statements. Of this amount, the OSC collected \$3.2 million and deemed \$1.7 million as being collectible.

The OSC paid \$28.6 million (including earned interest and fees incurred for the Administrator) to be distributed to eligible investors who bought third-party Asset-Backed Commercial Paper (ABCP). This disbursement is part of the ABCP settlement distribution plan announced in 2012. Ernst & Young Inc., the Administrator, was appointed to administer

the distribution of these funds to eligible investors.

As authorized by its Board, the OSC provided \$3.9 million to the Investor Education Fund (2012 – \$4.4 million) to enhance investor knowledge.

Funds held for CSA systems redevelopment

To March 31, 2013, the OSC has received \$95.9 million (2012 – \$79.2 million) from the operator of the System for Electronic Document Analysis and Retrieval (SEDAR), the National Registration Database (NRD) and the System for Electronic Disclosure by Insiders (SEDI), representing the accumulated surplus from the operations of SEDAR, NRD and SEDI from their inception. Interest earned on these funds to 2013 was \$4.8 million (2012 – \$3.8 million).

As described in Note 7 to the financial statements, these funds may be used to enhance the systems, reduce systems fees or offset shortfalls in revenue in SEDAR, SEDI and NRD. From April 1, 2012, these funds may also be used to fund the operations of the CSA IT Systems Office. In 2013, there were no SEDAR deficits. As at March 31, 2013, \$29.2 million (2012 – \$28.2 million) of the total funds held for CSA systems redevelopment is available for SEDAR, \$19.9 million (2012 – \$15.3 million) is available for SEDI and \$45.7 million (2012 – \$37.0 million) is

available for NRD. The OSC has committed to paying its share of annual shortfalls resulting from the operations of SEDAR (45.1%), SEDI (25%) and NRD (36.07%), if they happen and accumulated surpluses are unavailable.

The core CSA National Systems (SEDAR, SEDI and NRD) have been active for more than a decade. Contracts with their service provider will expire in October 2013, and a new organization will oversee their operations later this year. The new arrangement is expected to decrease the operating costs of the systems and provide opportunities to pass along savings to market participants. Plans are also underway to replace these systems to improve functionality and usability. The OSC will work with the CSA to convey the needs of its market participants to these initiatives.

The OSC, British Columbia Securities Commission (BCSC), Alberta Securities Commission (ASC) and L'Autorité des marchés financiers (AMF) finalized an agreement on April 2, 2013 on a governance framework for oversight and management of the new service provider that will operate the CSA National Systems when existing contracts expire. The Agreement identifies how certain functions of the CSA National Systems will be performed for the other parties; outlines how user fees will be established, collected and deployed; and addresses allocation and payment of liabilities arising from supplier agreements entered into by the CSA and the CSA National Systems.

The CSA has begun using these funds to pay for engaging the new systems service provider, the CSA IT Systems Office (which oversees the

CSA National Systems), and other activities for redeveloping the national systems. Spending on these latter initiatives will accelerate in coming years.

As at March 31, 2013, total accumulated costs related to the development or enhancement of the systems totalled \$5.9 million (2012 – \$2.5 million).

Property, plant and equipment

Property, plant and equipment costs increased to \$7.8 million (2012 – \$1.9 million) for expanding and refreshing OSC premises.

Liabilities

Trade and other payables increased 12.2% to \$17.1 million (2012 – \$15.2 million). The key contributor was an increase in accruals for work completed on refreshing the OSC's premises.

The OSC is committed to lease payments as outlined in Note 11 to the financial statements.

The accrued pension liability of \$2.2 million (2012 – \$2.0 million) represents future obligations for supplementary pension plans for present and past Chairs and Vice-Chairs. The unfunded supplementary pension plans' defined benefit obligation at March 31, 2013 was \$2.7 million (2012 – \$2.4 million). The recognized pension liability was \$2.2 million (2012 – \$2.0 million). The OSC's related expense for the year was \$281,000 (2012 – \$117,000) and is included in salaries and benefits.

(Thousands)	2013	2012
Furniture and equipment	\$ 369	\$ 55
PCs, laptops and other IT equipment	1,812	1,751
Leaseholds and other capital items	5,594	71
Total	\$ 7,775	\$ 1,877



Internal Control Over Financial Reporting (ICFR)

During fiscal 2013, the OSC's ICFR processes were reviewed and documentation was updated where needed. Operating effectiveness was tested using the framework and criteria established in the "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Staff performed an evaluation, under supervision by and with participation from management, of the effectiveness of the OSC's ICFR for preparing the March 31, 2013 financial statements.

No changes occurred during the year ending March 31, 2013 that have materially affected, or are reasonably likely to materially affect, the OSC's ICFR. The Chair and the Director, Corporate Services certify the design and effectiveness of ICFR in the Statement of Management's Responsibility and Certification.

The OSC identified a control improvement for verifying participation fees for market participants and reviewed selected participants to confirm that fees were calculated properly. While some discrepancies were found, the overall adjustment was not material. A program to perform a recurring review will be developed.

Critical Accounting Estimates

Preparing financial statements consistent with IFRS requires management judgments, estimates and assumptions that affect reported amounts of assets and liabilities for the date of the financial statements, as well as reported amounts of revenues and expenses for the period.

An accounting estimate is "critical" if:

- It requires assumptions about highly uncertain matters when it is made; or
- We could reasonably have used different estimates in the period; or
- Estimate changes are likely to occur between periods that would materially affect our financial condition, changes in our financial condition, or results of our operations.

Actual amounts can differ from these estimates if future outcomes differ significantly from management's forecast expectations. The OSC therefore uses various estimating techniques and assumptions to prepare its financial statements.

Estimates were used in the following accounts: collectability of trade and other receivables, valuation of pension liabilities, estimated useful life of property, plant and equipment, total trade and other payables and collectability of designated settlements and orders, and recovery of enforcement costs. Where appropriate, such as for pension matters, the OSC gets independent professional expertise to support calculating these estimates. It is management's opinion that, except for the collectability of designated settlements and orders and recovery of enforcement costs, none of the estimates in Note 2 to the financial statements requires the OSC to make assumptions about highly uncertain matters. A change in the collectability of designated settlements and orders and recovery of enforcement costs assumptions will change assets and liabilities related to designated settlements and orders and expenses will change related to the recoveries of enforcement costs.

Judgment was used to decide whether to consolidate the Investor Education Fund.

Risks and Uncertainties

The OSC must manage a growing range of risk from the pace of change and the continuing globalization of financial entities and their operations.

These developments include:

- *The overall investment marketplace:* these may be product-based, market structure-based, or relate to transactions by or activities of market intermediaries.
- *The domestic and international regulatory arena:* economies and markets have become more globally linked, affecting how many financial services regulations are viewed.
- *Stakeholder perceptions of regulatory effectiveness:* despite extensive efforts and spending by regulators, a gap remains between public expectations and perceptions of regulatory effectiveness.

The OSC has identified improving risk identification and management as a key goal. Understanding those we regulate is necessary to respond to emerging risks in a more timely and appropriate way. A strong focus on risk is needed to ensure we identify and mitigate risk effectively. With this in mind, the OSC approved a Risk Management Framework in November 2012 and is implementing it.

The Framework will:

- Promote a risk awareness culture within the OSC;
- Align the OSC risk appetite with its strategic direction;
- Identify and manage enterprise-wide risks (reputational, financial, operational and people);
- Provide an important contribution to setting the OSC's strategic direction and business planning;
- Allow proactive management of risk, performance measures, stakeholder disclosure, and prioritizing initiatives and allocation of resources.

A Risk Management Committee, staffed by management, has been established under the Framework to support the Board and Chair with risk management oversight. The Risk Committee also monitors and advises on *emerging* risks and reviews the OSC's regulatory responsibilities to determine if there are any risk-related gaps.

Operational Risk

Operational risk derives from direct or indirect loss from the organizational environment or external events, or from inadequate internal processes, staff resources, or supporting systems. Management is responsible for ongoing control and reduction of operational risk by ensuring appropriate procedures, internal controls and processes, other necessary actions and compliance measures are undertaken.

Specialist support groups, such as Human Resources, Corporate Services, Strategy & Operations and the Office of the General Counsel, assist operational management in mitigating risk. They do so by maintaining oversight in corporate data security, staff conduct requirements, technology stability and reliability, financial controls, corporate insurance and legal compliance, among others. The OSC has established policies and processes to identify, manage and control operational risk.

Key components include:

- Regular reviews of systems security measures to monitor controls and identify potential vulnerabilities to external parties accessing OSC data;
- Mitigating asset risks through insurance where practical and appropriate; and
- Separating duties across key functions.

Operational risk can include risk to the OSC's reputation. Reputational risk is addressed by the OSC's Code of Conduct and governance practices established by its Board of Directors (details available at www.osc.gov.on.ca), as well as other specific risk management programs, policies, procedures and training.

Legal Risk

Periodically, the OSC is involved in legal actions arising from the ordinary course of its business. Settlements from such actions will be accounted for when they occur. The outcome and ultimate disposition of such actions cannot be determined at this time; however, OSC management does not

expect the outcome of any proceeding, individually or in aggregate, will have material impact on its financial position.

Systems Risk

Disruption to any major systems applications (SEDAR, NRD and SEDI) operated by CDS INC. (CDS) for the CSA (including the OSC) is a potential source of risk. CDS recovers its costs to operate these systems by applying user fees to filers. In 2013, 94.2% (2012 – 92.9%) of total regulatory fee revenue at the OSC was collected through these national applications (SEDAR 40.6% and NRD 53.6%). No material change is expected in the volume of fees collected through these systems. The current operating agreement with CDS for these systems will expire on October 31, 2013; a new service provider will take over their operation after this date. In fiscal 2014, the CSA IT Systems Office will issue a competitive tender for redeveloping these systems.

The CSA requires CDS to provide an annual third-party audit report (CSAE 3416) that reviews the internal controls design for each system. CDS is also required to have an operating disaster recovery site for these systems that is tested annually.

Financial Risk

The OSC maintains strong internal controls, including management oversight to provide reasonable assurance of financial reporting reliability and preparation of financial statements for external purposes consistent with IFRS.

Most OSC revenue is generated through participation fees. The OSC fee model uses a tiered structure to moderate market fluctuation impact towards providing revenue stability. While the fee model has achieved this goal across multi-year periods, in any given year, predicting OSC revenues has been less certain because participation fees remained subject to variation.

In its new fee rules for fiscal years ending March 31, 2014, 2015 and 2016, the OSC introduced a *reference fiscal year* on which all participation fees will be calculated. As defined, the *reference fiscal year* is the participant's *last fiscal year ending before May 1, 2012*. This will significantly reduce the impact of market fluctuation on calculating participation fees. Nevertheless, market participants may exit or consolidate with another participant. This could result in revenues that are below forecast but which should not impair OSC operations.

Business Continuity

The OSC maintains a robust Business Continuity Plan to ensure critical regulatory services can continue despite external disruption. Detailed business continuity plans support each priority business function. Each plan includes documented recovery procedures, including manual workarounds and other mitigation strategies. Offsite recovery services and facilities have been secured, and remote access capabilities will enable OSC staff to access all key systems. An offsite facilities test is scheduled for June 2013. The OSC plan is continually reviewed and refined and includes strategies to recover data and functionality and to resume operations under various disruption scenarios. The OSC plan addresses its interfaces with self-regulatory organizations and other key market participants and includes strategies to effectively address various market disruption scenarios.

2014 OUTLOOK



The 2013 – 2014 OSC Statement of Priorities sets out organizational direction and proposed initiatives for the upcoming year.

The document is available at www.osc.gov.on.ca. The OSC has identified five broad priorities for 2014:

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- 1 Expanded outreach to investors
 - 2 Alternative capital-raising techniques for issuers
 - 3 Outreach to registrants as part of a preventative approach to compliance
 - 4 Intensified enforcement
 - 5 Oversight of rapidly changing market structures
-

Details on planned initiatives toward achievement of these priorities are set out earlier in the Annual Report.

For the coming year, the OSC will continue to focus on maximizing the use of its resources to obtain the highest level of efficiency possible. We will aim to consistently achieve the best possible outcome while incurring the least expenses wherever possible; this orientation to seek optimal value will define our activities in 2013 – 2014.

OSC Revenues and Surplus

The OSC is forecasting 2013 – 2014 revenues to increase by 15.9% from 2012 – 2013 revenues. The forecast reflects new fees and rates outlined in the OSC's fee rules (13-502 and 13-503), which took effect April 1, 2013.

These increases were necessary for two reasons:

- First, most of the rise in fees is needed to address the current operating deficit and return the OSC to cost recovery.
- Second, additional revenues are needed to meet evolving regulatory responsibilities, many of them driven by IOSCO and the Financial Stability Board (FSB) at the international level.

To maintain competitive capital markets in Canada, the OSC must align its regulatory framework to adhere to important global reforms and standards, including G20 commitments (OTC derivatives and systemic risk), increasingly complex international enforcement matters, and changing oversight responsibilities related to market infrastructure entities and complex new products. As planned, the OSC expects to continue to operate at a deficit in 2013 – 2014, and the OSC accumulated surplus is projected to decrease to \$3.4 million as at March 31, 2014.

2013 2014 BUDGET APPROACH



The OSC must continue to improve its capacity to keep up with market developments, innovation and investor concerns. It needs to continue to strengthen its institutional capabilities in key areas, including:

- Building its derivatives capacity;
- Expanding the new Office of the Investor;
- Growing expertise in complex products and infrastructure oversight; and
- Augmenting its research and data analysis capabilities to support a more data-based approach to issues and policy development.

The 2013 – 2014 OSC budget invests in key strategies identified in the three-year OSC Strategic Plan. Activities of strategic focus were allocated increases, while budgets for most programs were held to last year's levels or were decreased.

The 2013 – 2014 budget projects an increase of \$8.6 million (9.1%) over 2012 – 2013 and 3.6% above the 2012 – 2013 budget. Salaries and benefits, which comprise \$76.6 million or 74.0% of the budget, reflect an increase of \$4.0 million or 5.4% over 2012 – 2013 spending.

This increase mainly reflects costs for:

- Full-year expenses for staff hired during 2012 – 2013 to fill vacancies, including the Office of the Investor; and
- New approved positions to achieve the OSC's strategic plan, including:
 - Establishing an enforcement team to focus on criminal activity;
 - Addressing new market structure issues and oversight responsibilities; and
 - Undertaking analytical and research work, so the OSC can apply a more fact-based approach to its operational and policy work.

(Thousands)	2012 – 13 Budget	2012 – 13 Actual	2013 – 14 Budget	2013 – 14 Budget to 2012 – 13 Budget		2013 – 14 Budget to 2012 – 13 Actual	
				Change	% Change	Change	% Change
Revenues	\$ 93,524	\$ 87,278	\$ 101,160	\$ 7,636	8.2%	\$ 13,882	15.9%
Expenses	\$ 99,986	\$ 94,921	\$ 103,552	\$ 3,566	3.6%	\$ 8,631	9.1%
Deficiency of revenue compared with expenses	\$ (6,462)	\$ (7,643)	\$ (2,392)	\$ 4,070	–	–	–
Property, plant and equipment	\$ 8,057	\$ 7,775	\$ 5,660	\$ (2,397)	–	–	–

The significant decrease in the capital budget primarily reflects the build-out of recently acquired additional space in 2012 – 2013. The amount allocated to this initiative is lower because it is expected to be completed early in 2013 – 2014. The budget also includes support for upgrading and expanding our information technology, including replacing our network, to facilitate excellence in executing OSC operations.