



Canadian Foundation *for*
Advancement *of* Investor Rights

April 27, 2011

Robert Day
Manager, Business Planning
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

Sent via e-mail to: rday@osc.gov.on.ca

RE: Ontario Securities Commission Notice 11-765 – 2011-2012 Statement of Priorities (Draft for Comment)

FAIR Canada is pleased to offer comments on the draft Ontario Securities Commission (“OSC”) 2011-2012 Statement of Priorities (the “Draft Statement”), contained in OSC Notice 11-765 dated February 25, 2011.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

FAIR Canada Comments and Recommendations – Executive Summary

1. FAIR Canada is pleased that the OSC’s Draft Statement has identified the protection of investors as a foremost priority and that the OSC wishes to advance the key principles of enforcement, modernization and accountability.
2. FAIR Canada urges the OSC to revise the Draft Statement to make its specific priorities more concrete and measurable. FAIR Canada suggests the adoption of the following specific priorities in place of the general, aspirational statements in the Draft Statement:
 - 2.1. FAIR Canada recommends that the OSC publish a policy paper by the end of 2011 which will propose a requirement that all registrants be required to be backed by a compensation fund, either through mandatory SRO membership or the creation of a new fund, in order to protect investors in the event of insolvency of a registrant.

- 2.2. FAIR Canada recommends that, as part of its commitment to being proactive in pursuing regulatory standards and “reassessing current regulatory approaches to determine areas where change may be necessary to improve fairness and protection for investors”, the OSC commit to publishing a consultation paper by the end of 2011 that will consider reforms to encourage increased competition in the mutual fund industry in Canada, particularly with respect to fees.
- 2.3. FAIR Canada recommends that the OSC publish a consultation paper by the end of 2011 on implementing a requirement for all market intermediaries to act in the best interests of the investor/client.
- 2.4. The Ontario Legislative Committee has called for the appointment of one or more Commissioners with a strong retail investor perspective and FAIR Canada urges the OSC to make this one of its commitments for 2011. FAIR Canada recommends that the OSC include a commitment that in 2011 it will publish a comprehensive response addressing all recommendations made in the March 2010 Standing Committee on Government Agencies’ Report on the OSC (the “SCOGA Report”).
3. FAIR Canada encourages the OSC, as part of its commitment to insisting on the “spirit and letter” of regulatory requirements, to do more than simply increase the amount of information disclosed to consumers in order to protect investors. Retail investors should not be sold a product, particularly a complex product, unless the intermediary is satisfied, based on objective evidence, that the investors actually understand the product and its associated risks and costs.
4. In order to advance the priority of protecting investors, FAIR Canada strongly recommends that the OSC make specific commitments to further the ways in which it communicates with and is accountable to investors. For example, the OSC could consider holding town hall meetings for investors, or broadening the mandate and increasing the resources of the OSC’s Investor Advisory Panel (the “IAP”).
5. FAIR Canada recommends that the OSC consider providing an annual account of stewardship to a Committee of the Ontario Legislature in order to review its performance achieved as against the objectives and targets set out in its Statement of Priorities.

-
1. **FAIR Canada is pleased that the OSC’s Draft Statement has identified the protection of investors as a foremost priority and that the OSC wishes to advance the key principles of enforcement, modernization and accountability.**
 - 1.1. The OSC has correctly identified that “the interests of investors are at the core of everything the OSC does” and that it needs to have as a foremost priority “the protection of investors”. More needs to be done to protect investors given, among other things, the proliferation of complex products, greater reliance on the exempt market, and conflicts of interest in the distribution of products.

- 1.2. FAIR Canada will discuss each of the three key principles of enforcement, modernization and accountability in more detail in section 2 below.
2. **FAIR Canada urges the OSC to revise the Draft Statement to make its specific priorities more concrete and measurable.**
 - 2.1. The impetus for the introduction of a statutory provision requiring annual delivery of a statement of priorities by the OSC was to make the OSC open, responsive and accountable to various constituent groups. Pursuant to the OSC's Memorandum of Understanding with the Ontario Ministry of Finance, the Chair is responsible and accountable to the Minister for reviewing with the Minister the OSC's performance-based results included in the OSC's Statement of Priorities. **FAIR Canada does not believe that the 26 general statements in the Draft Statement are measurable nor does it believe that they allow for performance-based results.**
 - 2.2. FAIR Canada agrees with Kenmar Associates' submission that no specific metrics or milestones are provided and that definitive actions will speak louder than flowery words. The final Statement of Priorities should include concrete, measurable goals, which include delivery dates as priorities rather than general statements of intent. While we appreciate the difficulty of creating measurable goals in some cases, FAIR Canada is concerned that general statements of intention do not allow for the public (or the Minister) to assess how the OSC is addressing its stated priorities.
 - 2.3. Measurable goals would also give the OSC more realistically achievable targets and encourage the OSC to better fulfill its mandate to protect investors. FAIR Canada, like all stakeholders, wants the OSC to be successful and to encourage a culture of achievement within the Commission. **Measurable and concrete goals (rather than aspirational goals) will allow the OSC to improve morale and further strengthen the competence of its staff, and will foster a culture of achievement within the OSC.**
 - 2.4. FAIR Canada has suggested some concrete goals in this submission. However, we encourage the Commission to review **each of the Draft Statement's regulatory priorities** with a view to making its commitments more specific, concrete and measurable in order to provide the Commission with a blueprint for real action.

Enforcement

- 2.5. Enforcement is a fundamental function of the OSC. The OSC's statement that it will insist on "adherence to both the spirit and the letter of regulatory requirements" is a positive step towards fulfilling the OSC's mandate in the eyes of the public. The SCOGA Report stated that the OSC is "in the minds of most Ontarians... the public's guardian in the capital markets". The need to guard the public means, first and foremost, the threat and reality of strong and timely enforcement of laws and regulations for the protection of investors.

SRO Membership and Compensation Fund Protection

- 2.6. FAIR Canada recommends that the OSC publish a policy paper by the end of 2011 which will propose a requirement that all registrants be required to be backed by a compensation fund, either through mandatory SRO membership or the creation of a new fund, in order to protect investors in the event of insolvency of a registrant.
- 2.7. FAIR Canada and the MFDA have each issued reports ([A Decade of Financial Scandals](#) and [Regulatory Gap in Canada – Part II](#)) which identify a serious gap in coverage for investors in the event of the insolvency of a registrant. This is a serious defect in our system. In order to better demonstrate its commitment to investor protection (proposed priority 1 in the Draft Statement), the OSC should undertake its own analysis of the compensation fund gap and issue a policy paper by the end of 2011 which will propose a requirement that all registrants be backed by a compensation fund, either through mandatory SRO membership or the creation of a new fund.

Modernization

Price Competition in Mutual Fund Industry

- 2.8. **In March 2011 Morningstar released its Global Fund Investor Experience 2011 survey, which found that “Canada fails for Fees and Expenses” and awarded Canada an F- in the category of fees and expenses.** The high fees paid by Canadians are partly the result of the opaqueness of fees (particularly deferred sales charges and trailer fees) and the lack of an obligation that advisors provide advice that is in the best interests of the client. FAIR Canada recommends that as part of its commitment to being proactive in pursuing regulatory standards and determining areas “where change may be necessary to improve fairness and protection for investors” the OSC commit to publishing a consultation paper in 2011 that will consider reforms to encourage increased price competition in the mutual fund industry in Canada. Canadians should not have to continue to pay the highest mutual fund fees compared to other countries. FAIR Canada has observed significant efforts by regulators to encourage and foster competition in other areas of the financial markets. FAIR Canada would like to see the OSC adopt increased price competition in mutual funds as one of its measurable investor-focused priorities.

Clients’ Best Interest Standard

- 2.9. In order to demonstrate a real commitment to its first priority in the Draft Statement and to be proactive in pursuing regulatory standards that improve fairness and protection for investors, FAIR Canada recommends that the OSC undertake to propose a regulatory model for Ontario that requires all market intermediaries to put their clients’ interests first. **We recommend that the OSC add as a specific priority, the issuance of a consultation paper in 2011 on implementing a best interest of the client standard for all market intermediaries.**
- 2.10. FAIR Canada recognizes that this advocates a significant change to the framework of securities regulation in Ontario. However, we note that other leading jurisdictions, including the US, the UK, and Australia, have made significant movements towards this type of standard and are continuing to refine their approach in this direction. In the US, SEC staff issued a study

recommending the adoption of a uniform fiduciary standard for brokers-dealers and investment advisers when providing personalized investment advice about securities to retail customers. In the UK, the FSA has introduced new rules that will effectively ban financial advisers from receiving commission-based remuneration for selling investment policies starting in 2012. The Australian government has also introduced proposed reforms that would introduce a statutory best interests standard, requiring advisers to act in the best interests of their clients and to place the interests of their clients ahead of their own when providing personal advice to retail clients. We consider the “retail investors first” principle to be an evolving international standard.

Accountability

Retail Investor-Focused Commissioner Needed

- 2.11. The Ontario Legislative Committee has called for the appointment of one or more Commissioners with a strong retail investor perspective and FAIR Canada urges the OSC to make this one of its commitments for 2011.
- 2.12. In order to better demonstrate the OSC’s commitment to investor protection, FAIR Canada reiterates our recommendation (see our response to the 2010/11 draft Statement of Priorities (submitted February 11, 2010 and available at http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20100211_11-753_pascutto_singer.pdf)) that the OSC include as one of its specific priorities for 2011 that it appoint one or more Commissioners with a strong retail investor perspective.
- 2.13. FAIR Canada has great respect for all Members of the OSC and recognizes that Members currently take the retail investor perspective into consideration in the course of their duties. This recommendation is not intended as a criticism of any of the current Members. However, current Members of the OSC are persons with considerable experience representing and working with stakeholders other than retail investors. Based on our review of Member biographies, no Member of the OSC has extensive experience in primarily representing the interests of retail investors.
- 2.14. FAIR Canada recognizes that one of the criteria for selecting Commissioners is experience in investor-related issues. However, the selection process is not sufficiently transparent for the public to determine the extent to which that criterion has been satisfied. We urge the OSC to specifically communicate to the public how this criterion has been satisfied upon the appointment of a Commissioner.
- 2.15. The OSC should actively seek out individuals with a background in retail investor issues (provided they satisfy the other necessary criteria). FAIR Canada notes that despite the fact that the vast majority of market participants in Ontario are retail investors, there is no Member of the OSC whose body of work is known to reflect and foster their interests.
- 2.16. In the SCOGA Report, the Standing Committee on Government Agencies agreed that the appointment of a Commissioner with a greater understanding of retail investor issues was in the wider public interest, that it would not conflict with the OSC's Charter, and would not be

different from the practice of reserving a position for an individual from a listed company. The SCOGA Report stated “[w]e believe it is important...for retail investors to know that a member of the board is specifically responsible for representing their interests at the Commission.”

- 2.17. FAIR Canada notes that there are currently two available places on the OSC that are unfilled. In our view, the OSC would serve its own interests and those of retail investors well by appointing members to those positions with a strong background of protecting and advancing the rights and interests of retail investors.

Provide Response to Recommendations in the SCOGA Report

- 2.18. FAIR Canada recommends that the OSC include in its final Statement of Priorities a commitment that the OSC will publish a comprehensive response to the recommendations made in the unanimous [Ontario Legislature’s SCOGA Report](#). The SCOGA Report was published in March of 2010, and aside from a statement that it intends to “carefully study” the recommendations, the OSC has not yet issued a formal response to the twelve recommendations made by the Committee. In order to demonstrate accountability for its performance (the 5th identified priority in the Draft Statement) the OSC needs to provide a proper response to the recommendations made by the representatives of the people of Ontario in the unanimous SCOGA Report by the end of 2011.

3. **FAIR Canada encourages the OSC, as part of its commitment to insisting on the “spirit and letter” of regulatory requirements, to do more than simply increase the amount of information disclosed to consumers in order to protect investors. Retail investors should not be sold a product, particularly a complex product, unless the intermediary is satisfied, based on objective evidence, that the investors actually understand the product and its associated risks and costs.**

- 3.1. FAIR Canada recognizes the importance of the principle of full disclosure in securities regulation. **We consider overreliance on the provision of lengthy, complex and legalistic documents to be ineffective for investor protection.** This is particularly so for retail investors dealing with professional “advisors” intent on selling products, especially complex ones, to their clients rather than putting the clients’ interests first.

- 3.2. **Relying almost exclusively on the disclosure of long lists of material facts does not protect retail investors. FAIR Canada believes that regulators must take a more proactive role and use substantive measures to protect investors.** It is not enough to require complex legalistic disclosure which shifts responsibility onto unsophisticated retail investors. FAIR Canada advocates for the adoption of a new model of retail investor protection for complex financial products (including OTC derivatives but also structured products, SPACs, CFDs, leveraged, inverse and commodity ETFs and leveraged foreign exchange contracts).

- 3.3. This new model would place the burden on parties who sell complex financial products to investors (meaning dealers as well as originators) to ensure that their clients and investors actually understand the products being sold and their associated costs and that they understand

the implications of the disclosure documents provided. Where retail investors are not able to understand the nature of the product sold, the attendant risks, the costs, or the implications of purchase and sale, such products should not be sold to them. **In other words, FAIR Canada advocates the replacement of a standard of informational disclosure with a standard of active knowledge. The increase of multilayered risk in new complex products demands, in our view, a more demanding model. It is not enough to presume that investors will understand what they are buying. Some high risk complex financial products should simply not be permitted to be sold to all retail investors without regard to their level of financial sophistication.**

- 3.4. The new model means that originators and dealers of complex products will need to reach out to their investors and clients and build their knowledge and understanding of the products in question. Only this approach can actually protect the interests of the retail investor in a market of sophisticated financial instruments and ensure that clients' best interests are put first by dealers and advisors.
- 3.5. Finally, only this approach will answer the need for the OSC to modernize its fundamental regulatory approach, in keeping with the priorities identified in the Draft Statement. FAIR Canada considers that the need to re-assess regulatory approaches to improve fairness and protection, identified as a priority in section 3 of the Draft Statement, can only be met through a major change in the OSC's approach to regulating the sale of complex products.
- 4. In order to advance the priority of protecting investors, FAIR Canada strongly recommends that the OSC make specific commitments to further the ways in which it communicates with and is accountable to investors.**
- 4.1. FAIR Canada is encouraged that the OSC sees accountability as a third major principle guiding its priorities. A focus on communication, as identified in the Draft Statement, is well-placed and FAIR Canada recommends that the OSC identify as a specific priority means of listening to investors, particularly retail investors, in order to understand their concerns and be accountable to their needs and interests.
- 4.2. For example, the OSC may wish to consider holding town hall meetings for investors. The last OSC town hall meeting was held in 2005. Alternatively, the OSC could consider hosting an investor roundtable, whereby it could solicit input and feedback from investor advocates and consumer groups. FAIR Canada has facilitated similar roundtables with the Canadian Securities Transition Office and other organizations in the past and would be happy to assist the OSC in organizing an investor-focused roundtable. Another option may be to broaden the mandate of the IAP and increase its resources in order to allow the IAP to review all issues impacting retail investors, proactively identify relevant investor issues and take independent action. The IAP's ability to provide investor input to those at the OSC is hampered by its limited scope and limited resources.

- 5. FAIR Canada recommends that the OSC consider providing an annual account of stewardship to a Committee of the Ontario Legislature in order to review its performance achieved as against the objectives and targets set out in its Statement of Priorities.**
- 5.1. In order to increase transparency and accountability, FAIR Canada recommends that the OSC recommend to the Minister an annual review by a Committee of the Ontario Legislature of an OSC account of stewardship, which would describe the OSC's performance achieved as against the objectives and targets set out in its Statement of Priorities.
- 5.2. The Committee would be responsible for reviewing the OSC's account of stewardship and issuing its own report or opinion of whether the OSC met its objectives and targets. This account of stewardship and the subsequent review would increase the OSC's accountability to stakeholders and would encourage the OSC to ensure that its annual statements of priorities are concrete and measurable. It would also encourage the OSC to ensure that it meets all of its objectives and targets throughout the year. Such a review would add credibility to the OSC's claims of transparency and accountability.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-572-2282/ermanno.pascutto@faircanada.ca or Marian Passmore at 416-572-2728/marian.passmore@faircanada.ca.

Sincerely,



Canadian Foundation for Advancement of Investor Rights