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**RE: Ontario Securities Commission Notice 11-769 – Statement of Priorities**

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FAIR Canada is pleased to offer comments on Ontario Securities Commission (“OSC”) Notice 11-769 – Statement of Priorities for the year to end March 31, 2015 (the “2015 Draft Priorities”), published on April 3, 2014.

FAIR Canada is a national, charitable 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](http://www.faircanada.ca) for more information.

**1. Executive Summary**

- 1.1. Through this consultation, the OSC provides an important opportunity for stakeholder engagement. We acknowledge and appreciate the OSC’s transparency in this regard, and urge other securities regulators to similarly consult publically on their priorities.
- 1.2. FAIR Canada recognizes the OSC for its commitment to investor protection, seen in its selection of committed and knowledgeable members for its Investor Advisory Panel, its creation of the OSC Office of the Investor, its provision of funding to FAIR Canada and its leadership on numerous investor-focused regulatory initiatives.
- 1.3. However, FAIR Canada is concerned that the OSC’s 2015 Draft Priorities focus more on capital formation and regulatory burden than investor protection. FAIR Canada is concerned about what we perceive to be a shift in focus from investor protection to other concerns that are not at the core of the OSC’s mandate.
- 1.4. In our view, the 2015 Draft Priorities inadequately outline the challenges faced by Canadian investors in the current environment. Context regarding asymmetries in the market for “advice” and the influence of conflicts of interest is very important in

summarizing the environment in which the OSC operates. The importance of fostering Canadian investors' confidence in Canadian capital markets should also inform the OSC's priorities.

- 1.5. More than ever, Canadians bear a significant amount of responsibility for securing their financial well-being in retirement. High fees, poor investment recommendations, use of leverage, and risky securities have the potential to negatively, and significantly, affect outcomes for investors. Canadian investors have been demonstrated to have low levels of financial literacy, a lack of awareness of powerful conflicts of interest, and place a high level of trust in representatives (even if they are distrustful of financial firms). As a result, it is incumbent on regulators to prioritize initiatives that focus on protecting investors from the effect of these factors on their savings.
- 1.6. Education and disclosure are not sufficient regulatory responses to the foregoing issues, and a real commitment to implementing reform that will improve investor protection as well as outcomes is necessary. Investor outreach is laudable, but real action that actually improves fairness for investors is far more important.
- 1.7. In our view, the investor protection priorities included in the 2015 Draft Priorities are relatively weak. The priorities do not convey a commitment to action to improve outcomes for retail investors. Canadian investors require a real commitment to action, not just further research, consideration or review of these important priorities.
- 1.8. FAIR Canada is troubled by the lack of progress on the best interest standard project, which is a critical investor protection initiative. FAIR Canada urges the OSC to push this initiative forward, and to propose a framework for introducing a statutory best interest standard in 2014-2015.
- 1.9. We encourage the OSC to ensure that the mutual fund fees project is completed within the timeframe allotted and to react to the results in a timely manner with proposals to address the issues identified.
- 1.10. FAIR Canada is concerned about the lack of data and analysis to inform new prospectus exemptions, serious compliance issues with the existing exemptions, and a need for resources to ensure compliance and appropriate enforcement action in respect of exempt market securities. We caution the OSC from moving ahead too quickly in introducing new exemptions, and recommend policy be made on the basis of solid information and analysis.
- 1.11. We support the OSC's commitment to enforcement in cases involving fraudulent activity that harms investors. We encourage the OSC and other members of the CSA to prioritize the collection of better information about investors' experience with investment fraud in the interest of better informing policy and enforcement efforts.

- 1.12. There is a real need for a single, comprehensive tool that would allow investors to check the securities regulatory background of a potential advisor or investment firm. FAIR Canada calls for a user-friendly, one-stop tool where investors can access registration, disciplinary and background information (including proficiency and SRO membership) regarding advisers, dealers and their respective registered persons.
- 1.13. We note, however, that expansion of the exempt market does, and will continue to, detract from a clear message to investors to check registration to protect against fraud (among other things). We caution the OSC to be aware of these contradictory messages that are being sent to investors and stress the need for regulators to consider whether these messages can be reconciled.
- 1.14. FAIR Canada believes that Canadian securities regulators must address issues that have arisen as a result of weaknesses inherent in the “name-and-shame” system of dispute resolution for investment complaints. We recommend that regulators take immediate and strict enforcement action against dealers who deliberately subvert OBSI, sending an unmistakable message that such conduct breaches the good faith requirement of securities law and will not be tolerated.
- 1.15. FAIR Canada encourages the OSC to add investor compensation initiatives to its 2015 priorities. If section 128 applications are not a useful mechanism for investor compensation, we urge the OSC to examine why they are not and identify other means by which the OSC could assist investors in obtaining compensation.
- 1.16. FAIR Canada also makes other comments regarding the need for more updated information in draft priority documents, risk classification methodology, summary disclosure for ETFs, the priority entitled ‘Reduce Regulatory Burden’, and our prior years’ comments that have not been addressed.

## **2. Summary of Recommendations to the OSC**

- 2.1. Emphasize (and prioritize) investor challenges in setting out the context for priorities.
- 2.2. Commit to real action on important investor-protection priorities.
- 2.3. Include a proposed action to complete a framework for introducing a statutory best interest standard in 2014-2015.
- 2.4. Ensure that the research on mutual fund fees is completed in a timely manner and ensure that appropriate regulatory steps (i.e. propose a ban on embedded commissions) are taken as a result of the research findings.
- 2.5. Do not introduce new prospectus exemptions for retail investors absent a thorough analysis of the implications (both positive and negative) on capital-raising and investor protection.

- 2.6. Do not expand the prospectus exemptions available to retail investors until a minimum level of compliance can be assured.
- 2.7. Commit to ensuring adequate oversight of the exempt market and compliance and enforcement resources to deal with anticipated increased compliance deficiencies and other breaches of securities law expected to result from any additional prospectus exemptions.
- 2.8. Collect better data regarding investors' experience with investment fraud and publicize same, including publishing annual information regarding the number of investment fraud complaints the OSC receives including the number received from seniors.
- 2.9. Improve the registration check system for retail investors.
- 2.10. Prioritize the improvement of the investor dispute resolution system, to ensure that the system provides a meaningful service for retail investors.
- 2.11. Prioritize investor compensation in 2014-2015, whether through section 128 orders or through a review of other means by which the OSC could assist investors in obtaining compensation.
- 2.12. Consider providing status updates for initiatives carried-over from prior years to allow for more informed stakeholder comments on draft priorities.

### **3. General Comments**

- 3.1. Recognizing that it is legislatively required to consult on its statement of priorities, we note that, in doing so, the OSC provides an important opportunity for stakeholder engagement, while also opening itself up to potential criticism. We acknowledge and appreciate the OSC's transparency in this regard, and urge other securities regulators to similarly consult publicly on their priorities.
- 3.2. FAIR Canada views the OSC to be a progressive securities regulator. We recognize the OSC for its commitment to investor protection, seen in its selection of committed and knowledgeable members for its Investor Advisory Panel, its creation of the OSC Office of the Investor, its provision of funding to FAIR Canada and its leadership on numerous investor-focused regulatory initiatives.
- 3.3. However, FAIR Canada is concerned that the OSC's 2015 Draft Priorities focus more on capital formation and regulatory burden than investor protection. The tone of Notice 11-769 seems to stress the need for balance in supporting capital formation (not, we note, fair and efficient capital markets). FAIR Canada is concerned about what we perceive to be a shift in focus from investor protection to other concerns that are not at the core of the OSC's mandate. The OSC needs to put greater focus on protecting the investing public who provides the capital.

- 3.4. The context set out in Notice 11-769 suggests that the regulatory framework is highly influenced by economic concerns. Fair and efficient capital markets facilitate economic efficiency, and we do not dispute that the OSC should be attuned to these issues.
- 3.5. However, the single paragraph in the ‘risks and challenges’ section that deals with investors does not adequately outline the challenges faced by Canadian investors in the current environment. We believe that context regarding asymmetries in the market for “advice” and the influence of conflicts of interest are very important in summarizing the OSC’s environment. The importance of fostering Canadian investors’ confidence in Canadian capital markets should also inform the OSC’s priorities.
- 3.6. More than ever, Canadians bear a significant amount of responsibility for securing their financial well-being in retirement. High fees, poor investment recommendations, use of leverage, and risky securities have the potential to negatively, and significantly, affect outcomes for investors. Canadian investors have been demonstrated to have low levels of financial literacy, a lack of awareness (and understanding) of powerful conflicts of interest, and place a high level of trust in representatives (even if they are distrustful of financial firms). As a result, it is incumbent on regulators to prioritize initiatives that focus on protecting investors from the effect of these factors on their savings.

**Recommendation:** Emphasize (and prioritize) investor challenges in setting out the context for priorities.

- 3.7. Education and disclosure are not sufficient regulatory responses to the foregoing issues, and a real commitment to implementing reform that will improve investor protection as well as outcomes is necessary. Investor outreach is laudable, but real action that actually improves fairness for investors is far more important.
- 3.8. We believe that a 21st century securities regulator<sup>1</sup> should focus on strong investor protection priorities which are necessary for a properly designed regulatory framework. In our view, the 2015 Draft Priorities included in this category are relatively weak. The priorities do not convey a commitment to action to improve outcomes for retail investors. This may be, at least in part, due to challenges posed by the Canadian Securities Administrators’ (“CSA”) policy-making structure, but FAIR Canada believes that the OSC must play a leadership role in identifying and remedying investor protection issues for its citizens. Ontario investors require a real commitment to action, not just further research, consideration or review of these important priorities.
- 3.9. In general, FAIR Canada perceives the investor protection priorities to largely be a carry-over from prior years. In addition, we observe that there has not been a significant amount of progress made from the priorities of past years. Recognizing that policy development is often a lengthy process, we cannot help but note that exempt market

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<sup>1</sup> Ontario Securities Commission, “2012-2015 Strategic Plan - The OSC: A 21<sup>st</sup> Century Securities Regulator” (February 27, 2012).

initiatives are moving forward much more rapidly than (and seemingly without the rigorous research that has followed) the investor protection priorities.

**Recommendation:** Commit to real action on important investor-protection priorities.

#### 4. Statutory Best Interest Standard

- 4.1. FAIR Canada is troubled by the lack of progress on this critical investor protection initiative. We fail to understand how an industry that holds itself out as providing advice in investors' best interests (demonstrated in marketing and advertising material as well as investor surveys which clearly show that investors believe this to be the standard<sup>2</sup>) can oppose with great vigor a statutory standard that would align the regulatory framework with investor expectations. Regulators have allowed this expectations gap to persist by permitting salespeople and firms to hold themselves out to Canadian consumers as trusted advisors despite significant conflicts of interest that affect the advice provided.
- 4.2. The proposed OSC action to "complete research that will inform our decision regarding the application of a best interest duty and evaluate options to move forward" should have been completed by now. The OSC's 2013-2014 priorities committed to "[i]dentify options to move forward and complete a preliminary regulatory impact analysis of the application of a best interest duty for advisers and dealers by March 2014."<sup>3</sup> To our knowledge, this has not yet been completed. CSA Consultation Paper 33-403 was issued in October 2012 and comments were received in February 2013. It took the CSA ten months to simply summarize and publish the comments in CSA Staff Notice 33-316. CSA Staff Notice 33-316 did not provide any conclusions or next steps as a result of the thorough consultation (which involved both written consultations as well multiple roundtables), noting: "...CSA staff continue to consider and discuss the information gathered through our consultation process with a view to determining next steps."
- 4.3. In our view, this lack of progress is unacceptable. FAIR Canada urges the OSC to push this initiative forward, and to propose a framework for introducing a statutory best interest standard in 2014-2015. We hope that this is what the OSC means by "[r]esearch on best interest duty is completed and preliminary recommendations published".

**Recommendation:** Include a proposed action to complete a framework for introducing a statutory best interest standard in 2014-2015.

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<sup>2</sup> The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (prepared for the Investor Education Fund), online: <<http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf>>.

<sup>3</sup> (2013) 36 OSCB 6412.

4.4. FAIR Canada eagerly awaits the results of the OSC/IIROC/MFDA mystery shop research sweep of advisers. We commend the OSC and the self-regulatory organizations for engaging in this exercise and encourage regulators to continue to use this tool to gain unbiased insights into the experience of retail consumers. We encourage regulators to make public to all stakeholders, including the investing public, the findings of the results in a timely manner.

## 5. Mutual Fund Fees

5.1. FAIR Canada was pleased to see the OSC announce a request for proposals to conduct research on Canada's mutual fund fee structure in April 2014. We commend the OSC for leading this CSA initiative and moving forward with this necessary step. While FAIR Canada believes that existing evidence and research demonstrates the influence of trailing commissions and other compensation structures on mutual fund sales and investors' long-term outcomes, we are nevertheless pleased to see progress on this project.

5.2. Conflicts of interest are systemic and structural and have considerable consequences for the investing public. We applaud securities regulators for recognizing this issue in the context of mutual fund fees.

5.3. We encourage the OSC to ensure that the project is completed within the timeframe allotted and to react to the results in a timely manner with proposals to address the issues identified. We note that the project contemplates data requests to investment fund managers ("IFMs") and the timeline for the completion of the research is expected to be four months from the date that all requested data has been received from the IFMs. We recognize that some IFMs who do not support the mutual fund fees initiative will have an incentive to delay in providing the data (as it will delay the completion of the report) and urge the OSC to ensure that data is provided in a timely manner.

**Recommendation:** Ensure that the research is completed in a timely manner and ensure that appropriate regulatory steps (i.e. propose a ban on embedded commissions) are taken as a result of the research findings.

## 6. Exempt Market

### Lack of Data and Analysis

6.1. In its 2012-2015 Strategic Plan<sup>4</sup>, the OSC committed to expanded research and analytical capability "to be able to respond to and keep pace with market developments and investor concerns and to support policy-making"<sup>5</sup>. However, we do not see this

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<sup>4</sup> *Supra* note 1.

<sup>5</sup> *Ibid.* at page 11.



commitment to research reflected in the fifth proposed priority ‘Improve Capital Formation’.

- 6.2. FAIR Canada has noted its concerns in its previous comments on OSC priorities and in response to other consultations that there is little information available in respect of the exempt market upon which important policies are being determined. As a result, policy is being formed without a thorough analysis of the implications - both economic and on investors. Many assumptions have been made but have not been tested. We are concerned about the potential investor harm posed by new prospectus exemptions, and are concerned that these initiatives are being pushed through in the absence of key information inputs needed in order to make an informed decision let alone thorough research and analysis.
- 6.3. Where exemptions that are currently in use in other jurisdictions (particularly in other Canadian provinces) are contemplated, we would expect regulators to provide fulsome information about investor experience with such exemptions in consultation materials. FAIR Canada has not seen information about what type(s) of investor purchases in reliance upon each of the exemptions (and the proportions thereof), what investors’ outcomes are, the incidence and prevalence of investor harm from unsuitable and fraudulent exempt market investments, etc.

**Recommendation:** Do not introduce new prospectus exemptions for retail investors absent a thorough analysis of the implications (both positive and negative) on capital-raising and investor protection.

#### Serious Compliance Issues

- 6.4. It is essential that in evaluating the appropriateness of introducing additional prospectus exemptions (particularly new exemptions that will significantly widen the pool of potential unsophisticated investors), the level of compliance with the existing rules – and expected compliance with any new exemptions - be considered.
- 6.5. We note that the evidence available (primarily as a result of regulatory sweeps and reviews) suggests a multitude of problems with such exemptions, particularly compliance with the requirements of prospectus exemptions. FAIR Canada is concerned that, despite this terrible compliance track record, regulators are focused on increasing the pool of retail investors to whom prospectus-exempt securities may be sold.
- 6.6. When designing any new exemptions, there must be adequate assurance that the rules will be adhered to and regulators must have the resources to supervise and police compliance. Otherwise, regulatory requirements simply provide the illusion of investor protection.



**Recommendation:** Do not expand the prospectus exemptions available to retail investors until a minimum level of compliance can be assured.

*Need for Compliance and Enforcement Resources*

- 6.7. FAIR Canada recommends that, in light of the OSC's priorities aimed at expanding available prospectus exemptions, it also commit to ensuring adequate oversight of the exempt market and that compliance and enforcement resources are available to deal with the anticipated increase in compliance deficiencies and to address issues with enforcement action where warranted.
- 6.8. FAIR Canada recommends that the risk-based approach to compliance include a commitment to conduct a compliance audit of all registrant firms within a given time period.

**Recommendation:** Commit to ensuring adequate oversight of the exempt market and compliance and enforcement resources to deal with anticipated increased compliance deficiencies and other breaches of securities law.

## 7. Fraud

- 7.1. FAIR Canada strongly supports the OSC's commitment to bring forward more cases involving fraudulent activity that harms investors.
- 7.2. FAIR Canada encourages the OSC and other members of the CSA to prioritize the collection of better information about investors' experience with investment fraud. We note that there is a lack of meaningful statistics regarding investment fraud in Canada. Better empirical information would assist regulators in many ways, including proactively helping investors to identify and avoid fraudulent offerings, detecting and stopping fraudsters before they harm investors, and prioritizing enforcement efforts to send clear, strong signals to deter potential fraudsters.

**Recommendation:** Collect better data regarding investors' experience with investment fraud and publicize same, including publishing annual information regarding the number of investment fraud complaints the OSC receives including the number received from seniors.

- 7.3. We suggest that the OSC work with its CSA colleagues to develop a better registration check system. FAIR Canada questions the utility of the current website for retail investors.
- 7.4. There is a real need for a single, comprehensive tool that would allow investors to check the securities regulatory background of a potential advisor or investment firm. FAIR Canada calls for a user-friendly, one-stop tool where investors can access registration, disciplinary and background information (including proficiency and SRO membership)

regarding advisers, dealers and their respective registered persons. Investor testing should be conducted to ensure the system is user-friendly and generates meaningful, helpful results. The current system is simply not helpful to the investing public, but regulators continue to expend efforts to direct people to it.

**Recommendation:** Improve the registration check system for retail investors.

- 7.5. We note, parenthetically, that expansion of the exempt market does, and will continue to, detract from a clear message to investors to check registration to protect against fraud (among other things). We caution the OSC to be aware of these contradictory messages that are being sent to investors and stress the need for regulators to consider whether these messages can be reconciled.

## 8. Investor Complaints and Compensation

- 8.1. FAIR Canada believes that Canadian securities regulators must address issues that have arisen as a result of weaknesses inherent in the “name-and-shame” system of dispute resolution for investment complaints. Over the past few years, this system has deteriorated rapidly. Most recently, firms have announced their refusal to compensate in certain cases in advance of the Ombudsman for Banking Services and Investments’ (“OBSI”) investigation (that is, they inform OBSI up front that the firm will not compensate its customers no matter what OBSI’s final conclusions are).
- 8.2. Securities acts, regulations and rules across the country require investment firms to deal with their clients “fairly, honestly and in good faith” — an obligation that extends to dealing with customer complaints. Dealers who refuse to participate meaningfully in a regulator-mandated dispute-resolution process, or, worse, dealers who thumb their noses at that process in advance, are fundamentally not acting in good faith. They are deliberately subverting the process. Securities regulators must address such behaviour.
- 8.3. FAIR Canada suggests that the OSC add improvement of the investor dispute resolution system as a priority for 2014-2015. We recommend that regulators take immediate and strict enforcement action against dealers who deliberately subvert OBSI, sending an unmistakable message that such conduct breaches the good faith requirement of securities law and will not be tolerated.

**Recommendation:** Prioritize the improvement of the investor dispute resolution system, to ensure that the system provides a meaningful service for retail investors.

- 8.4. Compensation is the top priority for investors who suffer losses because of violations of the securities acts. The OSC identified applications under section 128 of the *Securities Act* (Ontario) to compensate investors as one of its priorities in its 2012-2013 Statement of Priorities. Its report on those priorities notes that “[t]he OSC did not make an application

with respect to section 128 during 2012-2013”<sup>6</sup> and concluded that none of the pending cases have been suitable for this sort of application. FAIR Canada encourages the OSC to add investor compensation initiatives to its 2015 priorities. If section 128 applications are not a useful mechanism for investor compensation, we urge the OSC to examine why they are not and identify other means by which the OSC could assist investors in obtaining compensation.

**Recommendation:** Prioritize investor compensation in 2014-2015, whether through section 128 orders or through a review of other means by which the OSC could assist investors in obtaining compensation.

## 9. Additional Items

- 9.1. Report Card Would Assist Stakeholders - FAIR Canada notes that in commenting on proposed draft priorities, it would be of assistance to stakeholders to have access to the previous year’s report card. While we recognize that logistically this could be challenging for the OSC, it is difficult for FAIR Canada and other stakeholders to comment on proposed priorities when we do not know the status of the previous year’s proposed actions. Often, many of the priorities are only slightly amended from the prior year, but it is unclear why.

**Recommendation:** Consider providing status updates for initiatives carried-over from prior years to allow for more informed stakeholder comments on draft priorities.

- 9.2. Risk Classification Methodology - We support the proposed action to work with the CSA to consider mandating risk classification methodology. This is important information that investors require, and we fully support the introduction of mandated methodology that conveys risk to investors.
- 9.3. Summary Disclosure for ETFs - FAIR Canada supports the introduction of summary disclosure document for exchange traded funds.
- 9.4. ‘Reduce Regulatory Burden’ – FAIR Canada does not agree that ‘Reduce Regulatory Burden’ should be a priority for the OSC. While regulators should be mindful of the costs and avoid imposing unnecessary regulation, we do not believe the OSC should buy into the notion that regulation is a burden generally that must be reduced and minimized. Regulation usually improves quality and supports the fairness and efficiency of capital markets and confidence in those markets. For that reason it is inappropriate to make the imposition (or continued application) of regulations conditional on meeting some sort of regulatory impact study.

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<sup>6</sup> Ontario Securities Commission, “Report Card on Statement of Priorities For fiscal 2012-2013” (June 25, 2013).

- 9.5. FAIR Canada's Prior Comments on Priorities - FAIR Canada notes that we have made important comments in prior years' submissions in response to the OSC's draft statement of priorities that have not been addressed. We believe these suggestions are important and still very relevant, and urge the OSC to consider unaddressed recommendations.

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 Neil Gross at 416-214-3408 ([neil.gross@faircanada.ca](mailto:neil.gross@faircanada.ca)) or Lindsay Speed at 416-214-3442 ([lindsay.speed@faircanada.ca](mailto:lindsay.speed@faircanada.ca)).

Sincerely,

A handwritten signature in blue ink, appearing to read "Neil Gross".

Canadian Foundation for Advancement of Investor Rights