

February 23, 2009

Standing Committee on Government Agencies Review of the Ontario Securities Commission

A Matter of Investor Confidence

1) Summary of Recommendations

The following are the Recommendations made in this submission:

OSC Oversight and Accountability

- (1) The Legislature should improve its oversight of the OSC. Its oversight should include a requirement that the annual reports of the OSC be automatically referred to a Committee of the Legislature which should have appropriate resources and powers including the ability to compel witnesses.
- (2) The Committee should commission (or recommend to the Legislature the commissioning of) a regulatory audit of the OSC by securities regulation experts retained by the Legislature and reconvening the Committee once the experts have reported to the Committee.

Lack of Retail Investor Involvement in Securities Regulation

- (3) Retail investors and shareholders should be adequately represented on the Commission. Of the current 3 commissioner vacancies, one should be expressly allocated for a retail investor representative.

Investor Advisory Committee

- (4) The OSC should be asked to implement an independent investor committee as part of its consultative committee structure along the lines of the UK Investor Panel including adequate financial resources and support and compensation for the members of the committee.

Retail Investors – Restitution and Redress

- (5) The Ontario Government and OSC give serious consideration to implementing the recommendations of the Expert Panel Report with respect to complaint handling and redress by:
 - granting the OSC the power to order compensation in the case of a violation of securities law so that the investor would not be required to resort to the courts;

- establishing of an investor compensation fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law and;
 - mandatory participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.
- (6) Pending implementation of legislative changes which often takes many years, the Committee should ask the OSC to follow up on the recommendation that IIROC review its arbitration procedure with a view to making it more helpful and less costly to investors and more transparent. The maximum claim should be raised to \$350,000 or higher.

Shareholder Rights and the TSX

- (7) The OSC should be asked to review the regulatory role of the TSX in light of the conflict of interest between its regulatory function and the profit mandate of the TSX and international best practice for exchanges that have demutualized and became “for profit” public companies. The OSC should be asked to report back to the Legislative Committee.
- (8) The OSC should be asked to direct the TSX to bring its rules up to international best practice particularly as it relates to shareholder approval for major transactions.

Financial Literacy

- (9) The Ontario government should take leadership in financial literacy and develop and implement a provincial financial literacy strategy. It should work with other governments to develop a national financial literacy strategy.
- (10) Ontario should make financial literacy mandatory in all high schools so that the next generation enters the work force and financial system with a basic level of financial literacy.
- (11) Government (including the OSC and educators) should test the effectiveness of existing adult financial literacy initiatives and not simply assume their effectiveness.
- (12) The OSC should be asked to revisit the “accredited” or “sophisticated” investor exemption and require objective evidence of financial literacy. The OSC needs to shift responsibility back to financially sophisticated market participants who manufacture and sell financial products. Market participants should be required to establish that the consumer truly understands the products before buying them.

2) FAIR Canada

We thank the Committee for the opportunity to make this submission in connection with the Committee’s review of the Ontario Securities Commission.

The **Canadian Foundation for Advancement of Investor Rights/Fondation canadienne pour l'avancement des droits des investisseurs ("FAIR Canada" or "FAIR")** is an independent, non-profit organization dedicated to representing the interests of investors in securities regulation. FAIR Canada was founded in 2008.

FAIR's mission is to be a national voice for investors on securities regulation and to serve as a catalyst for the enhancement of the rights of Canadian shareholders and retail investors.

RS and IDA, which merged in June 2008 to form the Investment Industry Regulatory Organization of Canada ("IIROC"), agreed to provide \$3.75 million funding from their restricted or discretionary funds. This funding is expected to be sufficient for the establishment of the Foundation and its operation for a three year period. The IDA and RS (now IIROC) are the founding financial sponsors of the Foundation.

The Foundation is completely independent of IIROC and IIROC has no role in the governance of the Foundation or determining the positions of the Foundation on any issues.

Further information is available on our website: www.faircanada.ca.

[Ermanno Pascutto](#) is the initial Executive Director of FAIR. From 1984-89 he was the Executive Director of the Ontario Securities Commission and then served as Vice Chairman and a founding director of the Hong Kong Securities & Futures Commission.

3) The OSC Mandate

The Ontario Securities Commission has a statutory mandate to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets.

The objective of FAIR Canada in making this submission is to direct attention to issues that in our view diminish investor confidence in our financial markets and the OSC's fulfillment of its investor protection mandate and point the way towards potential solutions. Our objective in making this submission is to improve the OSC's accountability, to improve the protection provided to retail investors and shareholders and to enhance investor confidence in the OSC and in the markets.

4) OSC Oversight and Accountability

In August 2004, the **Standing Committee on Finance and Economic Affairs (SCFEA)** conducted its five year review of the Securities Act as required by an amendment in 1994. As part of this process, an independent **Securities Review Advisory Committee (SRAC)**, headed by Purdy Crawford, had previously been established in 2000 to review legislation, regulations, and rules concerning matters of which the OSC has oversight and to make recommendations. Following the publication of a draft report and public comment, the final report of the SRAC was released in May 2003 by the Ontario Ministry of Finance. In August 2004, the all-party Standing Committee on Finance and Economic Affairs held public hearings and published its report with recommendations in October 2004. Our present comments will refer to this latter report, posted at the following link, which incorporates

reference to the SRAC recommendations and also takes into account the testimony presented to the SCFEA in August 2004.

<http://www.ontla.on.ca/library/repository/mon/9000/247247.pdf>

Recommendation 4 of the SCFEA report (pp. 8-10) considers oversight and accountability issues relating to the Ontario Securities Commission. The SRAC ("Crawford") report compared the Ontario legislature's oversight of the OSC with the oversight of the Securities and Exchange Commission (SEC) in the U.S. and noted a relative deficiency of oversight in the Canadian context.

The SEC has the oversight of two congressional committees, one in the House of Representatives and the other in the Senate, which receive substantial support from the Government Accountability Office (GAO). In addition, the SEC has a dedicated Office of the Inspector General (OIG), which makes semi-annual reports to Congress on SEC operations and programs (mentioned neither in the Crawford or SCFEA report).

According to its recent report to congress, the Office of the Inspector General performs a number of functions aimed at promoting "*the integrity, efficiency, and effectiveness of the critical programs and operations of the Securities and Exchange Commission.*" These functions include conducting independent and objective audits, evaluations, investigations, and other reviews of Commission programs and operations; the prevention and detection of fraud, waste, abuse, and mismanagement in Commission programs and operations; the identification of vulnerabilities in Commission systems and operations and the recommendation of constructive solutions; the provision of expert assistance to the Commission in improving its programs and operations; and keeping the Commission and Congress fully and currently informed of significant issues and developments.

In contrast, the Ontario Securities Commission has no internal oversight by a body equivalent to the OIG and also lacks adequate oversight by the Ontario Legislature.

This was noted over four years ago by the SCFEA, which endorsed the view of Glorianne Stromberg in her testimony to the Committee. Ms. Stromberg recommended that as a first step towards providing better oversight of the Commission, and the other financial regulators for which the OSC is responsible, the Legislature should "*establish a standing committee with a mandate to consider not only the five-year review reports, but also the effectiveness of securities laws, the operations of the Commission, and financial services generally*" and that "*the Ontario government consider establishing an independent government accountability agency,*" i.e. similar to the GAO (2004 SCFEA report, p. 9).

In its formal recommendation, the Standing Committee on Finance and Economic Affairs acknowledged that "*the status quo is unacceptable*" and recommended that "*the government initiate a review of the Legislature's oversight of the Ontario Securities Commission.*" As an initial step towards strengthening oversight, it recommended that

Any new oversight mechanism should include a requirement that the annual reports of the Commission be automatically referred to a Committee of the Legislature, and should ensure that the Committee has the ability to compel witnesses to appear before it, including the responsible minister, to answer questions regarding progress in implementing recommendations approved by the Legislature.

It does not appear that this recommendation has been implemented. In December 2005, there was an amendment to section 3.10 of the Securities Act, mandating the empowerment of a standing or select committee of the Legislature to review the OSC's annual report *"and report the committee's opinions and recommendations"* to the Legislature. **Nevertheless, even this amendment, which falls short of the above recommendation, has not been implemented to date.**

This long-standing neglect of the strengthening of the Ontario Legislature's oversight of the Commission, which was recognized as being inadequate several years ago, is problematic. Not only does the OSC lack the oversight mechanisms that exist with the SEC, there also has been a failure to remedy this acknowledged deficiency. Moreover, it is notable that even the existing oversight mechanisms in the U.S. were insufficient to deter the alleged Madoff ponzi scheme, which was not caught by the SEC despite repeated, detailed tips brought forward by an expert financial analyst, Harry Markopolis. Ontario has had its own share of financial scandals including ABCP, Norshield, Portus, etc. The people of Ontario are suffering through the worst financial and economic crisis of our lifetime and many have lost a substantial portion of their life savings including retirement savings. This is a time when effective regulation is more important than ever and when oversight and accountability of regulators is vital.

Recommendations

(1) The Legislature should improve its oversight of the OSC. Its oversight should include a requirement that the annual reports of the OSC be automatically referred to a Committee of the Legislature which should have appropriate resources and powers including the ability to compel witnesses.

(2) The Committee should commission (or recommend to the Legislature the commissioning of) a regulatory audit of the OSC by securities regulation experts retained by the Legislature and should reconvene the Committee once the experts have reported to the Committee.

5) Lack of Retail Investor Involvement in Securities Regulation

In his testimony to a congressional committee on 4 February 2009, Harry Markopolis claimed that the SEC (as well as FINRA, the self-regulatory body) was not only incompetent, but also 'captured'. While incompetence can be remedied by the requisite training, 'capture' is a different kind of problem. The common understanding of regulatory capture is where a government agency, which is created to act in the public interest, instead favours the commercial or special interests of the regulated industry. The existence of this problem has long been recognized in economic and regulatory theory. Many of the causes of 'capture' are understood and there are mechanisms that help to mitigate it. Capture may be subtle and may come about as the result of an overweighting of personnel drawn from the industry sector together with the absence of stakeholder input from the consumer—in this case, retail investors.

It should be kept in mind that in raising this issue, we are not making an allegation of misconduct by any person. It is the view of FAIR Canada that the senior management of the OSC are sincere people who are acting in a bona fide manner to discharge the mandate given to them under the *Securities Act*. There is certainly no criticism of any individual intended. The problem is the lack of balance in terms of influence on OSC decision making and policy development. The senior management, the commissioners and the external advisory committees are all composed of professionals from the financial industry and their advisors (i.e. lawyers and accountants). It is trite to say that senior management and commissioners of the OSC are also “investors”.

The failure of Canadian securities regulators (including the OSC) to intervene to assist ABCP retail investor victims may be consistent with the dominant financial industry influence and the lack of retail investor representation.

The response of the OSC and other provincial securities commissions in the ABCP crisis is very much in contrast to the intervention of U.S. state attorney generals in the auction rate securities scandal, who forced investment banks participating in the distribution and marketing of these instruments to repurchase about \$50 billion of securities from investors. In Canada, the OSC took a hands off approach: “After the [Pan-Canadian Committee] restructuring plan was launched, the OSC purposefully kept its distance because it did not want to interfere with something that might help noteholders get some of their money back” (National Post, 16 May 2008). Canadian retail investors were left to struggle with a drawn out 18-month legal process and market-based solution. Unlike the U.S., no regulator intervened on behalf of retail investors to offer assistance with ensuring that they were properly represented in the negotiations (let alone to order firms to provide restitution).

Clearly government agencies such as the OSC need to engage people from the corporate securities side for the regulatory task, given their possession of a level of experience and expertise not found in regular staff of the agency, i.e. individuals who are able to develop regulatory policies while considering the commercial context. At the same time, given the public interest and investor protection mandate of the OSC, it is also important to ensure that the interests of key stakeholders, namely retail investors, are represented within the structure of the organization.

FAIR is concerned that retail investor representation is lacking in the makeup of the Commission (or board of directors of the OSC) as it is presently constituted. Moreover, the OSC is now proposing to replace three of its part-time Commissioners with yet more individuals with industry background. The OSC recently published an ad in which applications are invited from individuals with professional background with a corporate issuer, investment dealer, or law firm.

<http://www.pas.gov.on.ca/scripts/en/AdvPosDetails.asp?num=1>

<p>Recommendation: Retail investors and shareholders should be adequately represented on the Commission. Of the current 3 commissioner vacancies, one should be expressly allocated for a retail investor representative.</p>
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6) Investor Advisory Committee

FAIR Canada acknowledges the need for financial industry representation on the Commission and its many external consultative committees. However, it is vital that relevant stakeholder interests have balanced representation. This balance is decisively lacking in the present instance.

Following the OSC's Investor Town Hall in May 2005, the Commission decided to redress this imbalance by adding a retail investor advisory committee to its consultative committee structure. **The UK's Financial Services Consumer Panel was studied as a possible model, however, the OSC decided to implement a weak version of this model.**

The membership of the IAC was announced in November 2005. As OSC Chair, David Wilson, commented: ***"We believe that direct investor input is critical to the health of Ontario's capital markets and we are looking to the IAC to play a key role in our efforts to address issues of importance to retail investors."*** The following January, just before the initial meeting, Mr. Wilson emphasized, regarding the Committee: ***"We're making it a priority to bring retail investors inside the circle of policy development."***

In principle, this was exactly the right perspective. Nevertheless, the Committee was not given the resources or structure it needed to be effective. Unlike the Consumer Panel in the UK, the IAC was provided with no financial resources, received no research budget, no support staff, and had no means to communicate with the public. Despite an assurance by Mr. Wilson in November 2006 that the IAC would publish a report on its activities in the new year, no report was ever published.

In June 2006, London School of Economics professor, Julia Black, completed her study for the IDA Task Force, *"Involving Consumers in Securities Regulation."* Her study compared the IAC, which was still in its early days at the time, with the UK Consumer Panel and a similar body in Australia. Although she made recommendations that would have helped to strengthen the effectiveness of the IAC, these were not implemented.

The OSC disbanded the Investor Advisory Committee in December 2007 without explanation and without making a public announcement. The only public comment occurred in an [Investment Executive](#) article in April 2008 where OSC management remarked that the IAC had been abandoned, having *"run its course."* It was never replaced and retail investors again find themselves marginalized and faced with the struggle of representing their interests over a powerful, well-resourced, industry, amply represented on the commission and its consultative committees.

An illustration of the current marginalization of investor interests relative to industry in this sector may be seen in the list of those contributing submissions on the CSA's Request for Comments on the Point of Sale document posted at the following link

http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part8/Comments/81-318/com_81-318_index.jsp

These were forty-five written submissions from a well-resourced financial industry and related industry lobby groups, which have ample funds and legal expertise to ensure that industry interests are effectively represented in the development of regulatory policy. What about retail investors? Apart from the submission by FAIR, only one organization, the Small Investor Protection Association, made a submission on behalf of retail investors. Retail investors have been left to struggle to organize and represent their interests with a few hard-pressed volunteers, some retired or semi-retired, others with full-time jobs—with no funding and no staff to support their

initiatives.

This situation is most unfair and unhealthy and must be remedied as soon as possible.

The **Expert Panel Report** commented on the lack of engagement of retail investors and in the lack of involvement of retail investors in the regulatory process on page 31 of the Report:

“Our consultation process revealed that investors are not always adequately engaged and consulted in the development of securities regulatory policy. Securities commissions in Canada provide fewer opportunities for investor advocacy and engagement than other key capital markets jurisdictions. This is to the detriment of securities regulation in Canada and diminishes public confidence in regulatory accountability, integrity, and efficiency.”

After pointing out that the lack of retail investor engagement diminishes public confidence in Canadian securities regulators several recommendations were made. The Expert Panel recommended the establishment of an independent investor panel and that the securities regulator establish a dedicated investor issues group within the agency.

Although the Expert Panel on Securities Regulation has recommended the implementation of an independent investor advisory panel as part of single securities regulator, this project could take 3-5 years to become operational. Further a national securities commission may never be implemented in response to the Expert Panel’s Report and even if it is implemented the form is still uncertain. Ontario investors should not be asked to wait for several years for something that may never come into existence. **If retail investor input was “critical to the health of Ontario’s capital markets” in 2005, it is even more critical today when the financial security of the people of this province is at stake.** We recommend the immediate creation of an adequately resourced body to represent retail investor interests at the OSC as one part of an initiative to rectify the present imbalance.

Recommendation: The OSC should be asked to implement an independent investor committee as part of its consultative committee structure along the lines of the UK Investor Panel including adequate financial resources and support and compensation for the members of the committee.

7) Retail Investors – Restitution and Redress

Retail investors, who are of course key stakeholders in the financial services industry, have long expressed frustrations about the difficulty in obtaining restitution and redress and the reluctance of the regulators to intervene on their behalf when wrong-doing is found on the part of financial firms and their staff.

The Expert Panel Report had the following assessment of the current system for redress and complaint handling:

Investors whose money has been compromised by error or wrongdoing on the part of market participants expect the system of complaint-handling and redress to be accessible

and responsive. The current system, however, requires significant knowledge, resources, and persistence to navigate properly. It all too often leaves investors frustrated and angry.

In 2001-02, the **OSC's Regulatory Burden Task Force** heard complaints about the IDA's arbitration program and in their December 2003 report, pointed out that "Arbitration between parties of widely different means is not a satisfactory mechanism for resolving investors disputes." They suggested that

the Commission recommend to the IDA that it review its arbitration procedure with a view to correcting its perceived flaws and making it more helpful and less costly to investors. In particular, we recommend that the maximum claim be raised to at least \$350,000 and that arbitration decisions be published without naming the clients involved in the proceedings.

The recommended changes were never made.

The Ontario Legislature's **Standing Committee on Finance and Economic Affairs** heard further complaints about retail investor issues, including access to restitution, during the hearings held in August 2004 as part of the five-year review of the Securities Act (mentioned above in relation to oversight and accountability issues involving the OSC).

SCFEA recommended that

the government work with the Ontario Securities Commission to establish a workable mechanism that would allow investors to pursue restitution in a timely and affordable manner and that the government report on its progress in this regard within 12 months.

There is a note of urgency in this recommendation, given the incorporation of a reporting mechanism. **Almost five years later, the necessary changes still have not been implemented by the Commission.**

The Expert Panel made the following recommendation with respect to redress and complaint handling:

We recommend the following to improve investor complaint-handling and redress mechanisms:

- *A securities regulator with the power to order compensation in the case of a violation of securities law so that the investor would not be required to resort to courts;*
- *Establishment of an investor compensation fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law; and*
- *Mandatory participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.*

Recommendations:

(1) The Ontario Government and OSC give serious consideration to implementing the recommendations of the Expert Panel Report with respect to complaint handling and redress by:

■ granting the OSC the power to order compensation in the case of a violation of securities law so that the investor would not be required to resort to the courts;

■ establishing of an investor compensation fund funded by industry to allow the securities regulator to directly compensate investors for a violation of securities law and;

■ mandatory participation of registrants in the dispute resolution process of a legislatively designated dispute resolution body.

(2) Pending implementation of legislative changes which often takes many years, the Committee should ask the OSC to follow up on the recommendation that IIROC review its arbitration procedure with a view to making it more helpful and less costly to investors and more transparent. The maximum claim should be raised to \$350,000 or higher.

8) Shareholder Rights and the TSX

Canada falls below international best practice in maintaining shareholder rights particularly in the matters that are under the jurisdiction of the TSX. Examples of the TSX requirements that fall below acceptable standards include:

(1) Abusive private placements that violate the spirit of the TSX listing rules for private placements to insiders;

(2) Shareholder approval is not required where listed companies issue shares resulting in massive dilution and loss of value for public shareholders in major transactions undertaken by management without shareholder approval.

The TSX consulted the markets on introducing shareholder approval requirements in 2007 following the Goldcorp/Glamis controversy in 2006 but to date it has failed to act and the OSC has not required the TSX to bring its rules in line with international standards. FAIR Canada wrote a letter dated January 21, 2009 to the CEO of the TSX (see http://www.faircanada.ca/wp-content/uploads/2008/12/tr-to-tom-kloet_tmx-group-inc.pdf) urging the TSX to amend its rules to require shareholder approval for major transactions to bring them in line with international standards. This change has broad support among investors including the Canadian Coalition for Good Governance and the Ontario Teachers' Pension Plan.

The OSC leaves broad areas of shareholder rights to the TSX. But, the TSX is both a regulator and a "for profit" listed company. The TSX (now part of TMX Group Inc. symbol X-TSX) was allowed to continue to regulate listed companies even after it demutualized and became a listed "for profit" company. There is an inherent conflict between the "for profit" status of the TSX and it acting as a regulator of listed companies. The TSX views listed companies as its "clients" while considering that shareholders of listed companies are lacking in status in dealing with the TSX.

The TSX/TSX-V listed company regulatory function should either operate as a separate entity within the TSX with its own board of directors (or at the very least independently of the business side of the TSX) or responsibility

for regulation of listed companies should be transferred to an independent SRO or the securities commissions.

In the UK, administration of the listing requirements was transferred from the London Stock Exchange ("LSE") to the Financial Services Authority ("FSA") after the LSE became a "for profit" listed company. In Hong Kong, the listed company regulatory function of the stock exchange is independent of the business side of HKEx and is overseen by the Listing Committee, a committee of market practitioners (including investor representatives) jointly selected by the Securities & Futures Commission and the Exchange. This separation of the business and regulatory arms of the HKEX was implemented when HKEX demutualized and went public in 2000.

Recommendations:

- (1) The OSC should be asked to review the regulatory role of the TSX in light of the conflict of interest between its regulatory function and the profit mandate of the TSX and international best practice for exchanges that have demutualized and became "for profit" public companies. The OSC should be asked to report back to the Legislative Committee.**
- (2) The OSC should be asked to direct the TSX to bring its rules up to international best practice particularly as it relates to shareholder approval for major transactions.**

9) Financial Literacy

Attached is a FAIR Canada op-ed piece on financial literacy which calls for a national Strategy for Financial Literacy. If the Province of Ontario and OSC were to show leadership in financial literacy our recommendations would be as follows:

Recommendations:

- (1) The Ontario government should take leadership in financial literacy and develop and implement a provincial financial literacy strategy. It should work with other Canadian governments to develop a national financial literacy strategy.**
- (2) Ontario should make financial literacy mandatory in all Canadian high schools so that the next generation enters the work force and financial system with a basic level of financial literacy.**
- (3) Government (including the OSC and educators) should test the effectiveness of existing adult financial literacy initiatives and not simply assume their effectiveness.**
- (4) The OSC should be asked to revisit the "accredited" or "sophisticated" investor exemption and require objective evidence of financial literacy. The OSC needs to shift responsibility back to financially sophisticated market participants who manufacture and sell financial products. Market participants should be required to establish that the consumer truly understands the products before buying them.**

ATTACHMENT

FAIR CANADA

**A NATIONAL STRATEGY FOR
FINANCIAL LITERACY**

**Attachment to FAIR Canada Submission of February 23, 2009 to the
Standing Committee on Government Agencies**

Review of the OSC

A NATIONAL STRATEGY FOR FINANCIAL LITERACY

Why we should care about Financial Literacy?

1. Canadians are participating in the financial markets in greater numbers and are increasingly reliant on financial markets for financial security. With the shift to defined contribution pension plans, individuals will rely even more on the performance of the equity markets for financial security in retirement.
2. The financial markets are complex and, on the whole, Canadians are financially illiterate. This is the fault of the educational system as financial literacy is not a priority of the school system. Canadians have relied on the financial industry to advise them and on securities regulators to protect them when things go wrong. They have been disappointed.
3. There have been numerous financial scandals in recent years where investors have lost untold \$ millions. The most recent major financial scandal is the ABCP crisis. Hundred of Canadian investors had \$ millions of their life savings frozen and faced massive losses. The securities industry and the securities commissions failed to come to their rescue. Only through hard work on the part of the ABCP investors (and some luck) were they able to come through ABCP crisis with a reasonable result for the majority (but not all) retail investors.

Regulators Shift Responsibility to Investors

4. Instead of intervening to protect investors, the response of Canadian regulators to highly publicized cases of investor abuse is to dedicate resources to investor education and financial literacy programs for adults. Each of our financial sector regulators has identified this as a priority objective. This is consistent with the notion that individuals should take more responsibility for their own financial security, even as markets and products become more complex.
5. **Investor education programs tend to shift responsibility (and blame) from financially sophisticated market participants who manufacture and sell financial products (and those who regulate such market participants) to a financially illiterate consumer.** The problem is that Canada has not prepared its people to take on this responsibility. Making investor education "available" to busy adults who do not have a basic understanding of financial matters is like trying to build a house without a foundation, in your spare time.

Legally "Sophisticated" Investors may be Financially Illiterate

6. This problem has been compounded in Canada because of the expanded concept of a "sophisticated investor" which includes anyone who has a certain level of income or

financial assets. **There is no requirement that the person be financially literate. This effectively treats ordinary Canadians as being as financially sophisticated as institutional investors for purposes of purchasing financial products subject to limited (or no) regulation.** The doctor who earns \$200,000 per year, middle class “boomers” who have inherited money from their parents’ estate, retired persons with \$1M in financial assets, etc. The reality is that most Canadians do not have a basic level of financial literacy, let alone the financial sophistication needed to protect themselves in the “exempt market”.

Is Adult Investor Education a Failed Strategy?

7. While considerable resources are dedicated to adult investor education, little work has been done to evaluate the impact of such initiatives. Recent reports conclude that adult financial education is unlikely to have major lasting effects on knowledge or behaviour. **Perhaps it is time for regulators to study whether the money spent on investor education for Canadian adults is well spent?**

Canada Graduating another Generation of Financial Illiterates

8. When I graduated from high school in the late 1960s, I was financially illiterate. (Fortunately for me, I studied commerce and finance and law in university and worked in the financial markets and securities regulation.) When my children graduated from high school a few years ago, the situation had not changed – financial literacy was still not part of the curriculum.
9. **Young Canadians graduate from high school and university without a basic knowledge of financial matters (such as shares, bonds, mutual funds, pension plans and RRSPs, mortgages and credit). Financial literacy is not part of the school curriculum let alone mandatory. Without have provided young Canadians with basic financial literacy skills we then expect them to fend for themselves in increasingly complex financial world.**

Canadian Strategy for Financial Literacy

10. A focus on investor education at this early stage of life will build a stronger foundation for adult financial literacy. A basic level of financial literacy should be mandatory for anyone graduating from high school in Canada so that the next generation of Canadians is literate.
11. The U.S. and U.K. have national strategies to improve financial literacy. The United States has a "National Strategy for Financial Literacy" lead by the U.S. Department of the Treasury. For youth, the strategy stresses the importance of integrating financial concepts into the school curriculum. The British Government has a strategy for improving the financial literacy skills of its people by 2011.
12. It is time that Canada develops a national strategy for financial literacy with a focus on our youth so that the next generation of Canadians is financially literate.

Small First Steps in BC

13. An important step has been taken by the B.C. Securities Commission in developing the "Planning 10: Finances" program for Grade 10 students which has now become mandatory in B.C. high schools. The BCSC and the Financial Consumer Agency of Canada

also recently launched “The City” a new financial education resource designed to help young Canadians improve their knowledge of today’s complex financial system.

14. These are small steps in the right direction. We should be expanding on such initiatives by expanding the content and making such programs a mandatory part of the high school curriculum across Canada.

Preparing Canadians to take Responsibility for their Finances

15. In a perfect world, investors would be financially literate and able to make good choices. In a perfect world, all advisors would be working for their client and regulators would protect investors. **In the real world, complex financial products are sold to (rather than chosen by) consumers who are not financially sophisticated. In the real world, advisors are not always trustworthy and the system fails to adequately protect investors when things go wrong.**
16. It is time for the Canadian governments (federal, provincial and territorial) to develop and implement a Strategy for Financial Literacy so that the next generation of Canadians is not financially illiterate. It is time for securities regulators to rethink their strategy.

Recommendations for Action

Here are FAIR Canada’s recommendations for action:

- (a) Canadian governments should work together to develop and implement a national financial literacy strategy.
- (b) Financial literacy should be mandatory in all Canadian high schools so that the next generation of Canadians enters the work force and financial system with a basic level of financial literacy.
- (c) Government (including regulators and educators) should test the effectiveness of existing adult financial literacy initiatives and not simply assume their effectiveness.
- (d) Securities regulators need to shift responsibility back to financially sophisticated market participants who manufacture and sell financial products. They should be required to establish that the consumer truly understands the products before buying them. Regulators should also revisit the “accredited” or “sophisticated” investor exemption and require objective evidence of financial literacy.

This submission was written by Ermanno Pascutto, Executive Director of FAIR Canada and Pamela Reeve. Pamela J. Reeve is an Associate Professor of Philosophy at St. Augustine's Seminary, a member college of the Toronto School of Theology. She has made numerous submissions on retail investor issues to government and regulatory bodies over the past several years and was a member of the OSC's Investor Advisory Committee (2005-07).