19 August 2004

Standing Committee on Finance and Economic Affairs
Main Legislative Building, Room 151
Queens Park, Ontario

Dear Committee Members,

This is my response to your invitation to make comment and recommendations to the Standing Committee on Finance and Economic Affairs concerning the Five Year Review of the *Ontario Securities Act*.

My evidence focuses on what the public sees, hears, and believes based on the actions and statements of our regulators and questions the legitimacy of the SRO system, as it pertains to the securities industry, and the actions of our statutory regulators in Ontario.

I trust you will find it both informative and compelling.

Please contact me if I can assist you further on these matters.

Please note. This document contains hyperlinks to supporting documentation on the world wide web. Should these individual links become 'broken', there is a hyperlink address at the end of the document that will take you to a web page on which the links will be kept updated.

FROM THE BOTTOM UP

INTRODUCTION

The primary purpose of government regulation in any industry should be the public interest, i.e. to protect the public. As the federal government does not have regulatory jurisdiction over the securities industry, provincial policy dictates what the public is permitted to know and the protections, or lack thereof, which exist.

When the general public or individual investor has a grievance against their broker, they are directed by the statutory regulator - the Ontario Securities Commission ("OSC"), to engage a non-statutory association.

The Investment Dealers Association of Canada ("IDA") or the Mutual Fund Dealers Association of Canada ("MFDA") is, for the investor, their first contact beyond the OSC and the actual dealer when seeking remedy, financial or otherwise, to their grievance(s). A valid grievance normally is based on a violation of the *Ontario Securities Act* ("*OSA*") or the *Commodity Futures Act* ("*CFA*").

The IDA being a registered lobbyist for its members and the industry representative will then decide what action to take, if any, against one of its members. Neither the IDA or MFDA has legislated authority in Ontario to administer any *Act*.

IMPROPER DELEGATION OF AUTHORITY

The Ontario government delegated responsibility for administration of the *OSA* and the *CFA* to the OSC. The OSC in turn 'recognized' several self regulatory organizations ('SROs') creating 'recognized SROs' and then proceeded to "push down (the) direct regulation of registrants to self-regulatory organizations"[1] that would otherwise be performed by the commissions themselves.

Two such SROs are the MFDA and the IDA. It is mandatory under OSC Rules 31-507 [2] and 31-506 [3] that all investment and mutual fund dealers in Ontario be members of the IDA, or the MFDA, or both.

The MFDA is a new SRO and is still in its development stage. The OSC 'recognized' the IDA by way of a Recognition Order in 1995 under the *OSA* and in 1984 under the *CFA*.

[1] http://www.osc.gov.on.ca/About/Speeches/sp_19981103_toniferrari.jsp
[2] http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/rule_20001013_31-506_osc.jsp
[3] http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/rule_20000818_31-507_fr.jsp

(1995) IDA RECOGNITION ORDER

The IDA's only authority to act in the public interest, if any, is derived from the OSC's Order of Recognition [4] ("Order").

When a government empowers or delegates authority to a private association, they do so conditionally. These conditions or undertakings are necessary to prevent improper or excessive use of their authority.

Failure to adhere to the principles and undertakings of an Order constitutes a breach of that Order and are thereby sufficient grounds for revocation of recognition under that Order.

(1995) IDA RECOGNITION ORDER BREACH

The Recognition Order clearly states:

> "The Guidelines for Investigations of Supervisory Practices ("Guidelines") are to be followed and updated…." (Schedule B.3)[5]

A copy of the Guidelines was requested from the IDA in 1998. The written response to this request on 01 December 1998 stated the following:

> …the *document is not current, nor has it been applied* to our knowledge by staff of the Division (IDA Enforcement) *in any investigation*… [6] (*emphasis added*)

In October 2000 a request[7] for these Guidelines was made through the Ontario Information Privacy Commission ("OIPC"). In their successful effort to maintain the Guidelines in secrecy, the OSC and IDA made the following representations to the OIPC:

> Factual Background to Records at Issue
>
> …the Guidelines advise as to *when and how the IDA will conduct investigations* of member firm supervisory functions. This includes investigative techniques and procedures of the IDA. (pg. 3, para. 6) (*emphasis added*)

The OSC, with express oversight authority and responsibility for the IDA, avoided

[4] http://regulators.itgo.com/Recognition/(1995)18OSCB5293.htm
[5] http://regulators.itgo.com/Recognition/(1995)18OSCB5293.htm#3
[6] http://regulators.itgo.com/ACCESS/Guidelines/AWAD.html
[7] http://regulators.itgo.com/ACCESS/Guidelines/Guidelines.htm

accountability to the public and its registrants under s. 153 of the *OSA*.[8]

The IDA has breached the Order of Recognition and the OSC and IDA, in complicity, have both misrepresented information to the OIPC.

The OSC has taken no immediate action to rectify this situation. This is a breakdown in the oversight function that the OSC has been mandated to exercise over the IDA since the Recognition Order dated 27 October 1995.

> Nor is there effective oversight from other quarters. Politicians know little about securities regulation and care less. The Ministry of Finance struggles valiantly, but has neither the personnel nor the expertise to function as an effective cop. And the courts have given the regulators near carte blanche to make decisions that are perceived to be within their area of expertise.
>
> *The Air Canada 'fine' is 'manifestly illicit'*, Jeff MacIntosh, Law Professor, Director of Capital Markets Institute, University of Toronto, National Post, 31 July 2001

(1997) IMPROPER TRANSFER OF STATUTORY AUTHORITY

The Toronto Stock Exchange ("TSE"), a statutory body under the *Toronto Stock Exchange Act*, and an SRO, regulated its members subject to the *TSE Act* and the *Toronto Futures Exchange Act*. In order for a dealer to operate under its government issued license, the dealer had to be registered with the OSC. The dealer also had to be a member of the TSE for purposes of the Ontario Contingency Fund.

In February of 1997, there was a transfer of regulatory authority from the TSE, a statutory body, to the IDA, a non-statutory body. The IDA was a 'recognized SRO', however OSC states that there was no statutory delegation of authority within the recognition process.

The OSC approved this transfer of a government function from a government agency to a private association. It was not approved by the Lieutenant Governor in Council or the Minister of Finance.

According to Ms. Helen Graham, Director, Finance and Industrial Policy Branch, Ontario Ministry of Finance, this transfer from the TSE, upon whom the legislative conferred authority pursuant to its enabling statute, to the IDA, a private organization with no enabling statute, required ministerial approval.[9]

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[8] http://www.ipc.on.ca/scripts/index_.asp?action=31&N_ID=1&P_ID=3591
[9] http://regulators.itgo.com/ACCESS/MRA/MRA_OSC_Request_17April01.html

Nevertheless, the Executive Director of the OSC, Mr. Charlie Macfarlane, has advised that "ministerial approval was not required for the transfer of the Member Regulation authority…" [10]

This highly questionable transfer was effected by the" Member Regulation Agreement".[11]

POLITICAL ACCOUNTABILITY

Such transfers are often characterized in terms of trade-offs between improved performance and efficiency, and reductions in political control and accountability and raises questions regarding the political, legislative, administrative and fiscal accountability of the IDA.

Although the IDA states that it is accountable to the OSC for its performance, the degree to which the OSC can effectively oversee the IDA's activities, and if necessary control and direct them, is open to question.

The same can also be said about the degree to which the responsible ministry can effectively oversee the OSC's activities. The ministry, by statute, can only appoint a minority of board members to the OSC. Perhaps more seriously, not withstanding the ministry's capacity to amend the IDA Recognition Orders unilaterally, the degree to which the ministry retain the capacity to effectively oversee the OSC's responsibility to oversee [12] the IDA's activities, or retains the expertise to challenge it on technical and policy matters, is diminished.

Diminished capacity necessarily weakens such authority. Along with these weakened links between the Minister of Finance, the OSC, and the IDA, comes the diminished capacity of the legislature and the public to obtain answers or elicit effective action from the minister presumed to be accountable. These current weakened links are on the brink of total disconnect.

THE FOX GUARDING THE HEN HOUSE

The quality of protection of the public in the securities industry is often compared to the quality of protection afforded those who perished in the Walkerton tragedy and the ensuing Walkerton Inquiry. Although directly affected investors may not directly perish their financial well-being is seriously impacted. The Walkerton Inquiry Part II stated the following in their conclusions:

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[10] http://regulators.itgo.com/ACCESS/MRA/MacfarlaneResponse.pdf
[11] http://regulators.itgo.com/ACCESS/MRA/TORONTO%20STOCK.htm
[12] http://regulators.itgo.com/Oversight/OVERSIGHT.html

> The options of a special purpose agency and delegated administrative authority were found to have limited capacity to deal with the interagency coordination functions needed to secure drinking and source water protection, and to carry significant risks associated with the de-coupling of policy and operational functions.

> Finally, there is a well-documented propensity for specialized bodies such as agencies or regulatory commissions to develop very close relations with regulated entities. Specific mechanisms to assist public interest and community based interveners in policy-making and regulatory processes are needed to counteract this tendency.

Drinking Water Protection in Ontario: A Comparison of Direct and Alternative Delivery Models, Issue Paper Prepared for Part II of the Walkerton Inquiry, page 50 at para 3.

NO INVESTOR REPRESENTATION

The following is pre-publication excerpt from *The Naked Investor - How Almost Everybody But You Gets Rich From Your RRSP* [13], by John Lawrence Reynolds:

> "Currently, I (Susan Wolburgh-Jenah) think the IDA have a third of their directors representing public interest groups," she suggests. "The IDA's position historically has been, 'We are an industry group, we need to have a lot of representation on our board from industry people.' But you would want to have… a majority or fifty percent of people on the board, perhaps an academic, who has never worked with the industry, who has no ties to the industry…"
>
> So in mid-2004, the Vice-Chair of the OSC believed that one-third of the IDA board consisted of "public interest directors," and that the proportion should be perhaps half. Below is the actual composition of the IDA board of directors for 2004-2005. Can you spot the "public interest people" who have "no ties to the industry"? [13]

Only one of twenty-three Board Members appeared to qualify.

> The OSC vice-chair's claim that one-third of the IDA's board consist of public-interest representatives suggests that the very top echelon of the commission has little idea about what is really going on in the industry where investor representation is concerned.

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[13] *The Naked Investor - How Almost Everybody But You Gets Rich From Your RRSP*, John Lawrence Reynolds, to be published in January 2005 by Penguin Canada; page 3

This fact is evidence that the IDA-MFDA-OSC partnership functions more like Cerebrus, the three-headed dog guarding the gates of hell, than like a system designed to protect the interests of small investors.[13] (page 9)

(2000) OSC AUDIT OF IDA

In August 2000, in response to public outrage of the inefficiency and lax enforcement of the IDA, the OSC prepared a 25-page Audit of the IDA[14]. It was a critical performance appraisal and focused largely on the IDA's enforcement procedures. According to the commission's report, the IDA's Mr. Clarke, Senior Vice-President of Member Regulation, altered penalty recommendations put forward by staff in the IDA's enforcement branch "on a very frequent basis" without documenting reasons for his changes.

Immediately following the completion of the "Chambers Report", the IDA dismissed two senior officials;

1. Greg Clarke, Senior V.P. Member Regulation
   (now employed by Richardson Partners Financial Limited)
2. Fred Maefs, Director of Enforcement
   (now employed by Ministry Of Environment - Legal Services Branch)

IDA official attacked in OSC report: Undermined policing, National Post, 04 April 2001

When this Audit was requested by an investor, through an Access to Information request to the OIPC, the OSC made the following representations to maintain the document in secrecy.

> The OSC and the IDA take the position that if the record is disclosed, it could reasonably be expected that similar information will no longer be supplied to the OSC. More specifically, the OSC submits:
>
> ... [I]t is reasonable to expect that the consequence of disclosing information in the report would be for the IDA to no longer provide similar information to the OSC in the course of its oversight reviews. Information provided by the IDA that goes into the report goes beyond a simple presentation of facts and statistics to candidly address possible problems and concerns. The IDA has previously indicated to OSC Staff in the context of possible disclosure of its self-assessment reports that the IDA would be unlikely to provide useful critical commentary on its own performance should that commentary be publicly available. In that event, the IDA has previously indicated that it would provide the OSC with little more than a statistical review as an annual self-assessment.,

[14] http://regulators.itgo.com/ACCESS/ChambersReport/Chambers.html

> ... [I]t is equally unlikely that the IDA will continue to provide useful critical commentary of its own organization in the context of an oversight examination should that commentary be publicly available. In the event that OSC Staff can expect nothing more from the IDA in an oversight examination than a statistical review, ... the quality of future disclosure made by the IDA to OSC Staff would be significantly diminished.,
>
> ... [I]t is reasonable to expect that disclosure of the record would result in similar information no longer being provided to the OSC by other self-regulatory organizations that the OSC oversees, in addition to the IDA. The OSC presently oversees other recognized self-regulatory organizations such as Market Regulation Services Inc. ("RS Inc.") and the Mutual Fund Dealers Association ("MFDA") and recognized stock exchanges such as The Toronto Stock Exchange Inc. ("TSX"). OSC Staff conducts oversight examinations of these other self-regulatory organizations in much the same way they do the IDA. In the course of these examinations, these other self-regulatory organizations also provide the OSC with information similar to that provided by the IDA and contained in the record at appeal. If disclosed…other self-regulatory organizations would be unlikely to provide the OSC with this kind of information in the future as well….
>
> *Order PO-2206*, [2003] O.I.P.C. No. 34

The Ontario Information Privacy Commission ordered the document to be released to the public, and stated the following:

> In essence, the position of the OSC and the IDA is that if the record is disclosed, the IDA will be reluctant to cooperate with the OSC in its reviews.
>
> This submission lacks credibility.
>
> *Order PO-2206*, [2003] O.I.P.C. No. 34

The OSC has applied for a judicial review of this OIPC order to the Divisional Court. The IDA has applied for intervener status.

> The Premier's strong endorsement of the importance of our Freedom of Information and Protection of Privacy legislation is welcome news," says Commissioner Cavoukian: "We have been calling for a culture shift, and Premier McGuinty has answered the call. He has positioned freedom of information under the umbrella of democratic renewal, and made it clear to senior officials that disclosure of records will now be the norm.
>
> Commissioner reassured by Premier's commitment to freedom of information, Commissioner Cavoukian, 16 June 2004

The public and most IDA members remain in the dark.

(2001) THE CHAMBERS REPORT

As a result of the OSC Audit, the IDA retained Robert Chambers of AssetRisk Advisory Group to perform an independent review.

Mr. Chambers called for a more streamlined enforcement division but he also noted that the IDA needs to do a better job of managing its position as a self-regulatory organization and a trade association.

> In order to manage the conflicts that could arise between the two functions, there is a senior vice-president in charge of member regulation and trade association," wrote Mr. Chambers, adding "there is a perception that the senior management in member regulation is too close to members and that this introduces a bias in the enforcement process.
>
> The enforcement division was chastised for "lack of trained and experienced investigators, counsel and complaints officers."
>
> *IDA regulation under fire*, National Post, 03 April 2001

This “Chambers Report” was also requested through the OIPC and access was denied.

ABOVE THE LAW

The IDA, as a private organization, appears to be able to escape the normal application of the statutes that allow the legislature and the general public the ability to oversee the activities of the delegates of the provincial government. The current structure also mitigates against our collective ability to ensure proper use of the powers granted to the OSC, including those powers which have been sub-delegated to private associations such as the IDA, and how they have been sub-delegated.

Each of the *Audit Act, Ombudsman Act, Freedom of Information and Protection of Privacy Act*, and even the *Lobbyist Registration Act* has an appointed associated legislative officer, such as the Provincial Auditor, Ombudsman, Information and Privacy Commissioner, and the Integrity Commissioner, who are provided with security of tenure and statutory guarantees of independence to enable them to deliver objective assessments and advice without fear of political interference.

These laws are intended to shape the behaviour of the provincial government and its agencies and to ensure fairness, competence and consistency in the administration of public services. However these statutes do not appear to apply directly to private bodies to which the provincial governments or its’ agencies have delegated, properly or

improperly, legislative authority.

The public's legitimate question is - Who is, or should be, in control and therefore responsible and accountable for the public interest and why has the current system been allowed to drift to the point where no such control or accountability exists?

> On December 1, 2001, in the United Kingdom, the FSA became the single regulator of financial services, banking and insurance. It assumed responsibility for supervising firms formerly regulated by SROs. There is no reliance upon SROs under the new U.K. Act. We understand that one of the reasons for abandoning self-regulation is that SROs were viewed as associations that represented their members' interests over those of the investing public.
>
> 5 Year Review of the Ontario Securities Act Draft Report pg. 69

Other jurisdictions, which have transferred regulatory responsibility to private bodies, have retained stronger formal accountability structures. "Executive Agencies" in the United Kingdom and Crown entities in New Zealand remain explicitly subject to direct parliamentary oversight. "Restructured Agencies" in New Zealand also remained under the jurisdiction of the Auditor General, the Ombudsman, and are subject to Freedom of Information and Protection of Privacy legislation. The federal government has applied similar requirements to the Canadian Food Inspection Agency. In the case of Alberta, delegated administrative organizations remain subject to freedom of information legislation and oversight by the Provincial Auditor.

In contrast, the IDA appears to be accountable only to the OSC as a result of the express oversight authority vested in the OSC by the relevant legislation and its contractual obligations set out in the Recognition Order.

This inward focus is in contrast to the emphasis on independent external assessment, review and public reporting on agency behaviour and performance through legislative officers, the legislature itself and the work of non-governmental organizations, the media and the public, which have been central to the accountability framework for conventional government agencies elsewhere.

The public can only try to rely on the information provided by government. What are Ontarians to believe? The President of the IDA, Mr. Joe Oliver, stated the following to a parliamentary committee:

> The IDA is Canada's only national entity with delegated responsibility for securities regulation and investor protection. As a result, it is in a unique position to assist the Government of Canada and the provincial authorities in coordinating and meeting consumer protection goals and policies in the securities field. [15]

The IDA was recently challenged in the Superior Court of Justice by an investor seeking to add the IDA as a defendant to a lawsuit against one of its members. The IDA stated in its defence against alleged regulatory negligence in failing to act, the following:

> The IDA is merely "an unincorporated voluntary Association of Securities Dealers governed by a constitution, bylaws and regulations which deal with the conduct, management and control of the Association's affairs."
>
> Although the IDA is not a statutory body, it does operate within a statutory regime.
>
> *IDA Factum*, Ontario Superior Court of Justice, page 5, paras. 12 and 13

The Court of Appeal of Ontario ruled on June 25, 2003 in *Morgis v. Thomson Kernaghan & Co* [2002] O.J. No. 4057, that the IDA has no duty of care to the individual investor.

LEGAL ACCOUNTABILITY

In addition to the differences in the political and administrative accountability framework for the IDA relative to traditional provincial agencies, the establishment of the IDA gives rise to an important set of questions around the legal accountability of non-governmental organizations to which government functions are "delegated". Over time, a body of judicially enforceable constitutional, statutory and common law has emerged, designed to ensure fairness and justice in the administration of laws, policies and programs by governments. These rules provide important limitations on the exercise of power by the state in a democratic society. However, the status of these principles may not be immediately clear when government functions are transferred to private organizations, to which they are not normally understood to apply.

[15] Senate Standing Committee on Banking, Trade and Commerce, Issue 36 – Evidence – Afternoon Sitting, 02 November 1998

Mr. Kyle. Thank you. One of the themes that I explore with my students is the very question that you raise – the extent to which public interest or public law principles must continue to have relevance in situations where governments have privatized and downloaded on the private sector roles traditionally performed by government or, in creating new regulatory regimes, have utilized the private sector as the vehicle of regulation. These are issues that have attracted very little attention in the case law (in Canada) to this point in rather sharp contrast to the situation in both the United Kingdom and New Zealand, just to cite two examples.

Prof. David Mullan, Faculty of Law, Queen's University, E-mail to Robert Kyle dated 04 October 2000

The Supreme Court of Canada has dealt with a number of cases involving the delegation of government functions to private organizations such as the IDA. In general, the courts have taken the view that governments cannot escape their responsibilities under the *Charter of Rights and Freedom* ("*Charter*") by delegating functions to private organizations. This has been most clearly expressed by the Supreme Court of Canada in its 1997 decision of *Eldridge v. British Columbia (Attorney General) ("Eldridge").*

In its decision in *Eldridge*, the court held that governments cannot evade their Charter responsibilities by delegating the delivery of policies and programs to private entities. In particular, the court stated the following:

> Even though a legislature may give authority to a body that is not subject to the *Charter*, the *Charter* applies to all the activities of government whether or not they may be otherwise characterized as "private" and it may apply to non-governmental entities in respect of certain inherently governmental actions. Governments, just as they are not permitted to escape *Charter* scrutiny by entering into commercial contracts or other "private" arrangements, should not be allowed to evade their constitutional responsibilities by delegating the implementation of their policies and programs to private entities.
>
> *Eldridge v. British Columbia (Attorney General)*, (1997) 151 D.L.R. (4th) 577 (S.C.C.)

This is significant in that rather than determining whether the functions are carried out by entities that are in the public or private sector, it is the nature of the activity being carried out that has become the central issue in determining whether the *Charter* applies.

This would appear to be an example of the Court recognizing the need to respond to the growing practice of the delegation of governmental functions and powers to private entities that are not subject to direct government control.

The nature of the IDA in Canada is currently unclear. To the extent that the OSC has delegated its authority under its enabling statutes, then the procedural and evidentiary rules applicable to other agencies, to whom statutory authority has been conferred, ought to apply to proceedings before the IDA. The IDA states that neither the *Evidence Act* nor

the *Statutory Powers and Procedures Act* applies to their quasi-judicial tribunals.

PROSECUTIONS

The delegation of full responsibility for the conduct of prosecutions for alleged violations of securities laws to the IDA raises a range of important questions. While the IDA's vice-presidents decide whether to pursue prosecutions, his or her decisions are not within the purview of the Attorney General or the Minister of Finance. For instance, the Directives of the Ministry of the Attorney General regarding how the OSC ought to conduct its prosecutions do not to apply to the IDA.

The October 1995 Ontario Recognition Order required the establishment of a protocol to be followed in the investigation of incidents under the "delegated" acts by the OSC. The undertakings exact the standards and guidelines to be followed in the event of an investigation and ensure the avoidance of conflict of interest, or the appearance of conflict of interest, regarding the conduct of an investigation. The undertakings as part of the Order are there to protect the public from the improper exercise of authority. As mentioned previously, the Order has been breached without consequence.

The government's duty to protect the public interest and investors' rights has somehow become lost in the "delegation" from the Ministers of Finance to the Commissions, to the 'recognized SROs'. The public has every reason to lose confidence in the integrity of our capital markets and those who purportedly guard the public interest.

EFFICIENCY

The principle strength of the SRO model is that the IDA is not constrained by jurisdictional fiscal policy. In other words, it is able to generate revenues to support its operations, regardless of the government's fiscal situation. However, this again raises the question of democratic control over the use of state power, in this case the ability to require the payment of fees.

Individuals or firms engaged in activities regulated by the IDA are compelled, through legislative requirements for approvals from the IDA, to pay the fees established by it, fees which in turn are associated with these approvals.

A secure source of revenue to protect the public interest could have been established through the placing of existing licensing and inspection fees into a dedicated fund. The Government of Ontario in a number of other instances has done this in the past few years. The creation of the IDA was not necessary to achieve this outcome, nor has it. The revenues realized by the IDA through licensing charges and fees have risen significantly. This has not, however, translated into increases in front-line service delivery staff. Rather, the only changes in staffing levels in relation to the IDA have been the addition

of managerial and professional staff for administrative and legal purposes. These outcomes must raise questions about the efficiency of the IDA SRO model, which requires the reproduction of administrative functions previously carried out by the OSC.

Given the lack of technical and policy capacity within the OSC in areas delegated to the IDA, the content of these regulations will inevitably rely on input from IDA. This would effectively delegate policy and standard setting to the IDA. Such an outcome would be contrary to separation of administration and policy-making that was supposed to lie at the heart of the IDA's institutional design.

CONFLICTS OF INTEREST/COMMITMENT

> Trade associations that self-regulate are vulnerable to potential conflicts of interest…
>
> Investor advocate Robert Kyle says the separation of the IDA's regulatory and lobbying functions is "most pressing."
>
> "The role of separating administrative and policy-making functions — rowing and steering — within the model has not been achieved in the case of the IDA," Kyle writes in his response to the Crawford report. "Furthermore, the structure has resulted in a significant loss of accountability relative to a conventional government agency."
>
> Kyle says the Ontario government should undertake a detailed, independent evaluation of current securities administrative organizations, including the IDA.
>
> *Self-Regulatory Model Open to Conflict Of Interest Charges, IFBC Says*, Advisor.ca, 20 August 2002

> It's almost like having one lawyer represent both the bandit and the victim, while promising to act in the best interests of both at the same time.
>
> *New Complaint System on the Way*, The London Free Press, 23 July 2001

The issue is further exacerbated by the fact that the IDA regulates its' members by contract – but has no contractual obligation to the public. The Five Year Review Committee made the following recommendation within the Draft Report[16]:

> The Committee recognizes that there is considerable potential for conflict between an SRO's role as a trade association and its responsibilities as an SRO. Ideally, we believe that trade association and SRO functions should be carried out by two separate bodies, each with distinct governance structures.

[16] Five Year Review Committee Draft Report ~ Reviewing the Securities Act (Ontario), page 69

This recommendation was subsequently dropped in the Final Report following discussions with the IDA and the Nova Scotia Securities Commission ("NSSC"). The NSSC stated "…the NSSC would urge the committee to consider whether this is the appropriate time, on a cost-benefit analysis, for the securities industry to undergo such a radical change." [17]

Inherent conflicts of interest need to be remedied. The securities industry does require a radical change. In doing nothing, the "cost" is borne by the public and the inevitable erosion of public confidence is far greater than the costs that would be incurred if the IDA were required to separate their functions.

LIMITING COMPETITION

> "The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public.
>
> To widen the market and to narrow the competition is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can serve only to enable the dealers, by raising their profits above what they would naturally be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens.
>
> The proposal of any new law or regulation of commerce which comes from this order ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention.
>
> It comes from an order of men whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have upon many occasions, both deceived and oppressed it."
>
> Adam Smith, *The Wealth of Nations (1776)*, Book One, Ch. XI, at p. 358, para. 262 (Penguin Books Ltd., Markham, 1977)

> This is a ploy by an incompetent and inept bureaucracy trying to justify its meaningless existence by appeasing and going to bat for the very people they are supposed to regulate under the pretext of protecting us dumb Canadian investors.
>
> *OSC expects 'happy' resolution of trading dispute*, Investor, National Post, 04 November 2000

[17] http://www.gov.on.ca/FIN/english/publications/2003/5yrsecuritiesreview6.htm#t63

The inherent limitations in allowing an industry to regulate itself are well known; the natural enthusiasm for regulation on the part of the group to be regulated, the temptation to use a facade of industry regulation as a shield to ward off more meaningful regulation, the tendency for businessmen to use collective action to advance their interests through the imposition of purely anti-competitive restraints as opposed to those justified by regulatory needs, and a resistance to changes in the regulatory pattern because of vested economic interests in its preservation.

Professor Dale Oesterle of the University of Colorado, Senate Subcommittee on Securities (1973), as quoted in Ontario Securities Commission Bulletin 4824, 1995

The IDA has the ability to set policy and rules within their "club" and have them approved by their board. Those "members" who may be in a position to set the rules may be the same "members" who benefit most from determining how many players there ought to be and how they get to "play", without any apparent accountability to the public whatsoever. The OSC blindly or collusively appears to "rubber stamps" these by-laws.

As the securities industry continues to hemorrhage, it would not have been surprising if squabbling over such things such as the IDA's mandate faded into the background. But far from being relegated to a secondary issue, the tough times for some firms, particularly the smaller ones, have made the IDA's dual mandate a critical factor in their battle for survival.

Canaccord goes to bat against bank-owned brokers, Investment Executive, 26 October 2001

> ... [T]he theoretical justification for regulation is to protect the public interest on the one hand, but on the other hand private interests are equated with the public interest. Thus, private interests can seek the sponsorship of the state to support their own interests. ...
>
> In the context of the investment dealer industry... the demand for public support of the industry, in the form of entry barriers and [fixed] commission regulations, can be seen to be argued from the perspective of destructive competition, concentration of power, efficient capital markets, [and] absence of foreign intervention -- all of which were categorized as being in the public interest. In reality, however, it will be shown that these demands had little to do with the public interest and more to [do] with the industry's private rent-seeking objectives. (p.37)[18]

[18] Stephen L. Harris, March, 1995 Doctoral Thesis, *The Political Economy of the Liberalization of Entry and Ownership in the Canadian Investment Dealer Industry* as quoted in OSC Bulletin 4824, 1995, pg. 12. para. 13

> I criticize ... the industry of which I am a member, as I am of the opinion that we have used the regulation of the securities industry to our advantage, rather than to that of the consumer and user of our services, by building protective measures around the Canadian securities industry to the virtual exclusion of competition. ...
>
> Stephen L. Harris quotes from a speech by Austin Taylor, past chairman of McLeod Young Weir Limited (at p.300) OSC Bulletin 4824, 1995. pg. 12. para. 13

BIAS (REAL OR PERCEIVED)

Perception is critical. A perception of bias is noted with respect to the OSC's and IDA's role as policymaker, investigator, prosecutor, adjudicator and sanctioner.

> When one's professional life is at stake, the perception of having ones' fate determined by an independent and impartial decision-maker is critical. Indeed, such perceptions may be everything.
>
> *A Perception of Bias*, Jeffrey S. Leon, Partner, Fasken Martineau DuMoulin, National Post, 24 June 2003

There are those who argue that the IDA has no legal authority to revoke or suspend a members government issued license. Albeit, should this mandatory "club" revoke a membership, the result is the same, regardless whether any infraction of the prevailing *Securities Act* or *Commodity Futures Act* has occurred.

The IDA has the same conflicts of interest that Mr. Purdy Crawford, Chair of the Five-Year Review Committee of the *Ontario Securities Act*, refers to in the press:

> And rightly or wrongly, some of the participants in those hearings have a perception that the various roles of the commission are not separated appropriately.
>
> *OSC Open to hiving off tribunal*, Purdy Crawford, Chair of 5 Year Review of the Ontario Securities Act, National Post, 25 June 2003

One of the first principles learned in administrative law is that "justice should not only be done, but should manifestly and undoubtedly be seen to be done." That principle, first introduced to the case law nearly 80 years ago, is still important today.

It is now beyond doubt that a growing number of fully informed, fair-minded participants in proceedings before the OSC are concerned about the appearance of unfairness associated with the mix of regulatory, investigatory and adjudicative functions at the commission. As Jeffrey Leon so compellingly argued in his article on this page (A Perception of Bias, June 24), "no amount of public relations or public education will cure the problem." The taint is there, and words cannot wash it out.

The taint is there, Edward L. Greenspan, Q.C., Greenspan, Whit; David Stratas, Heenan, Blaikie, National Post, 02 July 2003.

LACK OF ACCOUNTABILITY

One possible criticism of relying on transparency is that SROs are responsible for commissioning external performance reviews of themselves, this would raise the same conflict issues associated with audits of public companies or solicited credit ratings. But under the current regulatory oversight regime, investors receive no information at all on how well self-regulatory functions are being performed. The securities commissions prefer to keep the results of their examinations confidential. Disclosure of an external performance review would unquestionably be superior to the status quo, which is keeping investors in the dark.

Big OSC costs. Benefits? Neil Mohindra, Senior Economist, Financial Sector Regulation at the Fraser Institute, National Post, 31 May 2002

A clear example was a request for a highly critical external assessment of the IDA's enforcement activities known as the "Chambers Report".

LACK OF TRANSPARENCY

There are many members of the public who have been denied access to information from the IDA. The Small Investor Protection Association issued a letter to the OIPC that included the following statement:

> What on the surface at first appears to be polar extremes between brokers interests and client interests, is revealed upon closer examination to be areas of genuine overlapping concern having to do with enforcement standards and methodology, transparency, due diligence and accountability – more predominantly on the part of the regulators.
>
> Letter from S.I.P.A. to Ontario Information Privacy Commission dated 31 May 2001

The U.S. National Association of Securities Dealers ("NASD") Dispute Resolution speaks to IDA dispute resolution:

> "We operate in the sunshine," said Linda Fienberg, president NASD dispute resolution, adding she can't imagine why a self-regulatory organization would not make that information available to the public. "We want investors to review that kind of information before they deal with brokers so they can ensure themselves the person is reputable."
>
> *Investor group calls for less secrecy*, Linda Fienberg, President, NASD Dispute Resolution, National Post, 06 October 2001

PUBLIC INTEREST

The content of the expression of "public interest" is nebulous:

> The expression "public interest" appears 33 times in the Ontario Securities Act, but is never defined. In most cases it appears in whimsical statements, such as, "If the Commission considers that it would be in the public interest" (s.21)," as the Commission determines to be necessary or appropriate in the public interest" (s.17), "if it is satisfied that to do so would be in the public interest" (s.21), "if in its opinion it is in the public interest" (s.127), and so forth. What is this "public interest" of which the OSC is the guardian?
>
> Who's served by 'the public interest'? Pierre Lemieux, Co-Director, Economics and Liberty Research Group, Université du Québec à Hull, National Post, 20 February 2002

As a result, some commentators have suggested that its meaning appears to "change with the winds" making it difficult for the regulated to comply with an apparently subjective standard:

When enforcement staff asks the commission to exercise its public interest jurisdiction in relation to specific violations of securities laws, there is a reasonable degree of certainty and predictability in the proceedings. The same cannot be said of staff proceedings in cases where there are no specific alleged violations of securities laws, on the basis that staff has the view that conduct is contrary to the public interest. Subjects of investigations can end up in the invidious position of having engaged in a common practice or a previously accepted course of conduct, only to find that with the development of new or altered standards, staff now view such conduct as being contrary to the public interest.

This is the heart of the problem: the unspecified or undefined aspect of the jurisdiction. Most cases will never get to a hearing, at least in part because the registrant cannot win. Even if the registrant can anticipate ultimate success at a hearing, the risk is too great, given the potential reputational damage caused by the negative publicity associated with the proceedings. Thus staff, and not the commission, become the real arbiters of the public interest.

Fair Process Needed, Jeffrey Leon, Fasken Martineau DuMoulin, National Post, 16 April 2002

You have to have the definition of public interest before you decide.

- Former Prime Minister Jean Chretien

Manley puts brakes on bank mergers, Canadian Press, 29 October 2002

Canada's former Prime Minister Jean Chretien made the preceding statement when commenting on possible bank mergers, which is equally applicable to the OSC when adjudicating. Does the IDA have the authority to make findings substantiated by their determination of what constitutes public interest? If not, why are they permitted to do so? If they do, who gave this private "club" this public authority?

VOLUNTARY V. NON-VOLUNTARY MEMBERSHIP IN AN SRO

Contrary to the position continually advanced by both the IDA in the courts, the IDA is not a voluntary organization. OSC Rule 31-507 states that membership is required as a condition of registration to practice under a government issued securities licence.

The IDA was originally formed as a "club" by and for the benefit of its members; its nature has changed in recent years, as either government through regulation or the OSC by practice have required market players to join the "club" in order to be licensed under the statutes that govern their conduct. Whereas prior to 'recognition', the association board, representing its members, would approve or disapprove of any changes to policies or bylaws, it is now the OSC who either approves, disapproves or provides for "non-disapproval". The IDA is no longer a merely voluntary association but rather an "arm" of the government.

The IDA purports to govern on behalf of the public interest without any apparent obligation to comply with "public law".

The IDA states that their powers over its members are entirely contractual. The terms of the contract are the by-laws of the IDA. However, contract law does not permit for the imposition of penalties, rendering any penalties unenforceable. This results in the inability to properly enforce by-laws that have been approved by the OSC. This also seriously detracts from the definition of a "regulator".

IDA FINES UNENFORCEABLE

The IDA in recent years has levied enormous financial penalties as a form of "window dressing" to appease the public – the fact is the IDA has no authority, nor should they under their current structure, to enforce payment of such fines. The courts have not been approached by the IDA to enforce the penalties since the underlying contract between the association and its members is unenforceable.

> Once again the IDA announces a large fine against a defunct securities firm.
>
> These blatant attempts at showing the public that the securities industry is regulated would be humorous if one was not aware that so many small investors have been fleeced when brokers breach the rules with relative impunity.
>
> …so the fine of $3 million seems a bit meaningless if it will not be collected.
>
> The Self Regulatory Organizations make a show of discipline, but too often issue letters of reprimand to avoid disciplinary actions going on record.
>
> *IDA fines Rampart – Another Chapter in The Fleecing of the Lambs*, Small Investor Protection Association, 26 January 2001

IDA ARBITRATION FOR ABUSED INVESTORS

Extracts from the *Regulatory Burden Task Force Report*[19] prepared for the Ontario Securities Commission.

Comments Received From Market Participants:

A great many market participants told us that the IDA's arbitration procedure is flawed and unhelpful to retail investors. The arbitration process is adversarial and is often

[19] *Regulatory Burden Task Force Report*, Task Force established by the OSC in October 2001, and reported December 2003. pages 18-24

conducted by a retired judge whose role is to adjudicate on an impartial basis rather than to assist the investor making the claim. Consequently, only sophisticated investors are able to use the process without the assistance of counsel and expert witnesses and have a reasonable chance of success. The average investor does not have the financial resources to deal effectively with defensive actions mounted by a securities dealer that can afford high-priced legal counsel and expert witnesses.

The IDA advertises that the administrative costs (filing fee, arbitrator's fee, room rental, other disbursements) are $3,000-4,000 for the typical dispute, which costs are generally borne equally by the securities dealer and the investor. However, the IDA does not advertise the fact that where the investor chooses to be represented by counsel and / or to retain expert witnesses, the total costs will be closer to $15,000 and that the investor is responsible for his /her own legal fees. In addition, investors are only entitled to claim a maximum amount of $100,000 with the result that investors are required to claim greater losses through expensive judicial proceedings that are beyond the means of the average retail investor. We were also told that the IDA should publish the decisions and reasons for decisions resulting from its arbitration proceedings because this would assist investors, and their advisors, in their understanding of how the IDA's arbitration system actually works in practice. This could be accomplished without identifying the clients of the financial institutions involved in the arbitration proceedings.

We were advised that the ombudsman model embodied in the Financial Services OmbudsNetwork has been a much more equitable and effective dispute resolution process, available for claims up to $350,000, and investors do not have to bear any administrative costs.

We note that the Enforcement section on the IDA website informs investors about the dispute resolution services of the Ombudsman for Banking Services and Investments as well as the IDA'S arbitration procedure.

Recommendation:

Arbitration between parties of widely differing means is not a satisfactory mechanism for resolving investor disputes. The process can degenerate into a mini-trial where dealers are able to use the greater resources at their disposal to defend themselves. Consequently, we suggest 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.

3.2 Resolving Investor Complaints

Comments Received From Market Participants:

Representatives of individual retail investors who act as investment dispute consultants

advised that the investor complaint process is not understood by such investors and is not as effective as it should be. This problem is exacerbated by the existence of multiple regulators having different degrees of authority over the activities of financial services providers.

3.3 Restitution and Disgorgement

Comments Received From Market Participants:

A major complaint from investors is that the OSC and the SROs (IDA, MFDA and RS Inc.) lack the power to determine the liability of a securities dealer to an investor and issue a restitution and / or disgorgement order. To seek redress investors must resort to the courts for claims in excess of the monetary limits applicable to the ombudsman and IDA arbitration remedies. Some suggested that the OSC should apply to the courts under s. 128 of the *OSA* for restitution orders on behalf of investors. This procedure has seldom been used.

Regulatory Burden Task Force Report, Task Force established by the OSC in October 2001, and reported December 2003. pages 18-24

THE OSC REFUSES TO APPLY TO COURTS FOR INVESTOR RESTITUTION

The Ontario *Securities Act* states the following:

> *Securities Act*, R.S.O. 1990, c. S.5, as am. S.O. 1992, c. 18, s. 56; S.O. 1993, c. 27, Sched.; S.O. 1994, c. 11, ss. 349-381; S.O. 1994, c. 33, ss. 1-9; S.O. 1997, c. 19, s. 23; S.O. 1997, c. 10, ss. 36-40; S.O. 1997, c. 43, Sched. F, s. 13; S.O. 1997, c. 31, s. 179; S.O. 1999, c. 9, ss. 193-221; S.O. 1999, c. 6, s. 60; S.O. 2001, c. 23, ss. 209-217; S.O. 2002, c. 18, Sched. H, ss. 6-14; S.O. 2002, c. 22, ss. 177-181, 183, 184, 186-188.
>
> 128. The Commission may apply to the Ontario Court (General Division) for a declaration that a person or company has not complied with or is not complying with Ontario securities law. 1994, c. 11, s. 375
>
> (3) If the court makes a declaration under subsection (1), the court may, despite the imposition of any penalty under section 122 and despite any order made by the Commission under section 127, make any order that the court considers appropriate against the person or company, including, without limiting the generality of the foregoing, one or more of the following orders:
>
> 13. An order requiring the person or company to compensate or make restitution to an aggrieved person or company.
>
> http://www.e-laws.gov.on.ca/DBLaws/Statutes/English/90s05_e.htm#BK172

The OSC states the following on its web site:

> Regulators do not unwind transactions or order compensation or order restitution. Orders for such must be obtained through arbitration or a civil proceeding through the court system.
>
> http://www.osc.gov.on.ca/Investor/Complaints/cpt_index.jsp para 4.

So why doesn't the OSC apply to the courts on behalf of those it is mandated to protect?

(FRAUD) IDA PRE-CASE DECISION

Broker: JAMES DONALD BRUCE
Employer: Nesbitt Burns Inc. (now BMO Nesbitt Burns)

IDA Notice to Public: Disciplinary Hearing (17 December 2002):

- misappropriating funds from various clients, forging client signatures

Notice of Hearing Withdrawn (13 February 2003)

The IDA considered the matter resolved because Mr. Bruce undertook never to re-apply for approval to a member firm in any capacity.

Fraud is contrary to the Criminal Code which the IDA hasn't either the authority to administer or enforce. However, Part 3 of the Trading Rules created by the Canadian Securities Administrators (CSA), of which the OSC is a member, contains a provision that prohibits market manipulation and fraudulent activity. The OSC has neither acted itself nor forwarded this information to the proper law enforcement agencies.

The Toronto Police Services Fraud Investigation Unit and the RCMP Commercial Crime Unit have never heard of this case. It is posted on the IDA web site, along with 29 others involving fraud. Both law enforcement organizations have stated that there is no onus upon the IDA to refer cases to them – so the IDA didn't.

The IDA has requested that they be given the ability to "file decisions of disciplinary panels as decisions of the court". The IDA's clear lack of enforcement and capricious manner negates the need, or any justification, for such authority.

The Five Year Review Committee Draft Report contained a recommendation that a provision be introduced into the *Securities Act* to combat fraud and market manipulation. The Minister of Finance tabled the 2002 Amendments, section 182 to amend the Act by adding the following section:

> 126.1 A person or company shall not, directly or indirectly, engage or participate in any act, practice or course of conduct relating to securities or derivatives of securities that the person or company knows or reasonably ought to know,
>
> (a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, a security or derivative of a security; or
> (b) perpetrates a fraud on any person or company.

Heavy lobbying by securities industry associations and participants scuttled proclamation.

(2004) IDA AND OSC IN COLLUSION

On May 14, 2004 the Ontario Securities Commission published an IDA summarized version of the public comments received by the IDA questioning the validity of the proposed IDA By-law 20 and Regulation 1300.1. The OSC approved the changes to IDA by-law 20 and Regulation 1300.1 on that same date.

Members of the IDA, during the public comment period, questioned the IDA's authority.

> We also question generally whether the Association has the power to regulate former Members or employees [*Chalmers v. T.S.E.* (1989) 70 O.R. (2d) 532 at p. 543 (C.A.)].
>
> IDA Letter to Scotia Capital Inc., RBC Dominion Securities, HSBC Securities (Canada) Inc. and TD Waterhouse to IDA dated 27 January 2004, Comment 4, page 3.

The IDA responded with the following:

> The Court in *Derivative Services Inc.*[2] affirmed the IDA's authority to investigate former members for business while a member, thus (current) By-law 20.21, which is carried through in the proposed amendments to By-law 20, would likely not be found to be ultra-vires as was the case in *Chalmers*.
>
> Therefore, the IDA has the necessary authority to extend its regulatory reach ….
>
> [2]Investment Dealers Association of Canada and Derivative Services Inc. and Malcolm Robert Bruce Kyle [1999] I.D.A.C.D. No. 29
>
> IDA Letter to Scotia Capital Inc., RBC Dominion Securities, HSBC Securities (Canada) Inc. and TD Waterhouse to IDA dated 27 January 2004, Comment 4, page 5.

Firstly, the court referred to above by the IDA, was the IDA itself.

Secondly, an Order dated December 23, 1999 of the Honourable Mr. Justice Lederman regarding Derivative Services Inc. stated the following:

> The Supreme Court of Canada decisions in *Harelkin*, [1979] 2 S.C.R. 561, *Matsqui Indian Band*, [1995] 1 S.C.R. 3, and *Consolidated Maybrun Mines Ltd.*, [1998] 1 S.C.R. 706, lead one to conclude that where the factual record is not complete, and a remedy is potentially available within the ongoing or further appeal within the administrative tribunal system, the court generally will decline to intervene, absent special circumstances. This is so even in the face of alleged jurisdictional error. One of the bases of this principle is to avoid the fragmentation of proceedings before tribunals. Another is to accord due deference to the intention of the Legislature to give jurisdiction to specialized tribunals -- in this instance, the OSC has been designated by the Legislature as the appropriate forum.[2]
>
> [2] *Derivative Services Inc. v. Investment Dealers Assn. of Canada* [1999] O.J. No. 5307, at para. 3

There is no affirmation from the Honourable Mr. Justice Lederman to support the IDA's claim to legal jurisdiction.

Finally, the IDA and OSC both appeared before Mr. Justice Lederman when he rendered his decision. Not only has the IDA misrepresented to the public and the IDA members, the OSC – with full knowledge, has condoned this activity by approving the by-law and failing to act when it was brought to their attention.

POWER OF A COURT

The IDA has requested from various commissions and government directly "the ability to file decisions of disciplinary panels as decisions of the court". [20]

The IDA has also requested statutory immunity. Again, regulating by contract, the absence of enabling legislation, not constituted as an administrative tribunal (under the SPPA), not subject to the *Evidence Act*, and the claim that the IDA is not "government" within the meaning of subsection 32(1) of the *Charter* are hurdles that must be addressed prior to any proper consideration.

[20] http://regulators.itgo.com/Reports/PDFs/BCSCFinalModel_IDA.pdf, Letter from Joe Oliver , President of IDA, to B.C. Securities Commission dated 01 August 2003, page 2, part I, SRO Powers and Jurisdiction

IMPROPER RULE MAKING PROCEDURE

The OSC has, in s. 21.1(4) of the *OSA*, very substantial powers with respect to the rules and related instruments of a recognized SRO. The Commission can "make any decision with respect to" any such rule or instrument. This power combined with the power to compel membership in a recognized SRO, has in effect allowed the OSC to increase regulatory requirements without being subject to the protections imposed by the rule-making process, including the involvement of the Minister of Finance or the Lieutenant Governor in Council. In essence this permits the OSC to create new regulatory requirements by merely approving or providing non-disapproval of new IDA by-laws. These by-laws may be well outside of the *OSA* or based, as above, on improper premise.

SETTLEMENT AGREEMENTS FOR INVESTORS

The IDA issued to its members with the intent to ban "prohibitive language" in settlement agreements with their clients.

> The Association's position in respect of the above types of releases is that releases shall not contain language which would prevent the client from disclosing to securities regulatory authorities, self regulatory organizations (including, but not limited to the Association) or other enforcement authorities the facts or terms of the settlement. In addition, the release shall not contain any language which prevents a client from initiating a complaint.
>
> *IDA Member Regulation Notice*, MR-076, 22 May 2001

This raises several concerns for the public.

- How will the IDA know when a member and the member's client have entered into a settlement agreement containing the prohibited language?
- Will the investor notify the IDA and risk retribution for breach of contract (confidentiality agreement) by the IDA member?
- Will the IDA member voluntarily provide the IDA with a settlement agreement that contains the prohibited language?
- Is there relevant information to investigations concerning Bre-X, YBM, Livent, Nortel, Yorkton Securities, and other securities industry disasters in Canada?

For the record - there are settlement agreements that contain such language.

Investors remain without regulatory remedy. The IDA considers the issue to be at a satisfactory end and refuses to address this issue or the proffered settlement agreements. IDA members, incorporating such "prohibitive language", are protected under this veil.

IN CONCLUSION

The IDA has been one of the most significant private organizations to which important governmental functions have been transferred, given the scope of IDA's mandate and its importance as a "front-line" securities regulator. The SRO model is clearly under consideration by the provincial government in terms of other regulatory functions related to the protection of public good, including the environment. However, the advisability of further expansion of the delegated administrative authority model must be questioned.

The goal of separating administrative and policy-making functions has not been achieved in the case of the IDA. Furthermore, the structure has resulted in a significant loss of accountability relative to a conventional government agency.

Concern, responsibility and accountability for the public interest has fallen by the wayside at the level of the individual investor or groups of investors. At the same time, there are no clearly evident gains in efficiency or effectiveness within the SRO model within the securities industry in Canada/Ontario.

It is also important to consider that the performance of similar agencies in other jurisdictions where, from the outset, much more extensive accountability frameworks have been put in place than those provided in Ontario.

The delegated administrative authority model also raises a number of deeper questions that must be considered before it is expanded. The transfer of governmental functions and authority to a private entity that is not under the effective control of government is of particular concern, as it removes the exercise of governmental power from democratic control. Under the IDA model, this control is exercised by staff, and through the IDA's board of directors, by the regulated industries, rather than by a Minister who is accountable to the Legislature and electorate.

Potential for greater discretion in the exercise of governmental power, as well as the lack of openness and transparency in its use is significant. The establishment of limits, controls and accountability requirements on the use of power by the executive has been a central feature of democratic systems of government over the past three centuries. The potential for the reversal of this direction accounts, in large measure, for the response of the courts in drawing private entities to which governmental powers and functions have been delegated, back under the rules regarding the use of that power that apply to the state. The lack of attention paid to these questions by governments, on the other hand, particularly in Ontario, has been troubling.

Furthermore, the granting of powers to the IDA by the OSC for the purpose of carrying out its mandate indicates that the IDA and similar agencies are, in effect, agents of the Crown, regardless of their protestations that they are merely contractual bodies. The private sector management model tends to regard the public as "customers" or "clients" to be serviced, rather than citizens with interests and rights to be protected. The transfer of public functions to the private sphere also diminishes the important avenues for the public to express policy preferences to government. This has significant implications for the future health of our democracy, which need to be considered carefully before further steps are taken down this road.

> "When General Motors makes a car that's a real lemon, it eventually stops producing that model. If only the investment business had the same standards."
>
> *Fund watchdog bound to fail*, Derek DeCloet, Financial Post, 06 April 2001

As per comments of the Consumers Council of Canada regarding the regulation of financial services in Canada:

> The regulation of financial services in Canada, according to Dr. Yudelman, "remains a consumer's nightmare, a tangled, confused structure divided by type of government, type of financial service, government regulation versus self-regulation, and by prudential and market regulation."
>
> *The Scorpion and the Frog*: A Consumer View of Canadian Financial Services and Ways to Transform Them; Consumers Council of Canada, Executive Summary, June 2001, page iii

Recent revelations in the United States precipitated by the New York State Attorney General Eliot Spitzer suggests that any regulatory system that relies upon the industry it regulates for resources is unlikely to be able to provide unbiased investor protection:

> (t)he major failure has been at the SRO (self-regulatory organization) level.
>
> Whether you are talking about research or mutual funds or specialists, there has been a failure to properly question behavior that they know about before anyone else. Every one of those issues was understood by the industry and not responded to.
>
> *On the Warpath*, Eliot Spitzer, New York State Attorney General, , New York Post, 25 January 2004
>
> SROs have scant incentives to monitor quality and expose fraud because fraud exposure is often interpreted by consumers as a bad signal of SRO quality.
>
> Self-regulation has been an abysmal failure — an absolute, abject, complete zero. It has not done anything to protect investors. – Eliot Spitzer, New York State Attorney General
>
> *Self-regulating groups under pressure to change*, Investment Executive, June 2003

Mr. Arthur Levitt, Chairman of the U.S. Securities Exchange Commission during the Clinton administration made the following assessment:

> "All self-regulatory organizations claim to place the public interest above all else… but all S.R.O.s, when push comes to shove, favour their listed companies or the brokers that bring them the business. That may be all right in a marketing sense. But the conflict is too great to be allowed to stand."
>
> *Growing S.E.C. Role in Big Board Reform*; The New York Times, 25 September 2003

Self-regulation is not working. Commission oversight is not working. Provincial Government oversight is not working. The public desperately needs a federal securities regulator that is not only responsible but also accountable. But, as equally important, we need to establish an independent agency, empowered through legislation, with an investor protection mandate and with the necessary authority to order financial restitution.

Mr. Spitzer lambasted the U.S. Securities and Exchange Commission for not detecting fund-industry wrongdoing.

> "This has been an outrageous betrayal of the public trust by that agency."
>
> "The regulators who were supposed to have been watching this industry were asleep at the switch. And I'm going to pull that switch. - Eliot Spitzer, New York Attorney General
>
> *Mutual Funds Face Overhaul As Spitzer and SEC Fight for Turf*, Wall Street Journal, 31 October 2003

The OSC sent out a survey to the mutual fund dealers in Canada, in a response to a growing concern that mutual fund dealers in Canada may acting improperly as well. This survey is not public – but is shared with the SROs – the members. There is no disclosure to the public. The reason for this lack of transparency, I surmise, is the following:

> Somebody said to me – 'Boy if we have a scandal in Canada, we are going to have to be as transparent as the United States.' And I said 'Well, if we are, we could just destroy our markets.' – David Brown, OSC Chairman
>
> *Scandal would kill market, OSC head says*, Globe and Mail, 20 September 2002

The Ontario securities industry has been, and still is, fraught with regulatory scandals such as Bre-X, YBM, Livent, Nortel (repeatedly) and even Canadian participation in Enron. Maintaining public and investor confidence in the integrity of the capital markets by failing to disclose the true state of regulatory transgressions is not in the interest of the public.

These factors coupled with seemingly ineffective enforcement and a regulatory regime that fails to provide effective consumer/investor protection has led to a loss of legal and

regulatory credibility in and outside of Canada.

As a citizen of Ontario, I am encouraged to read about the Premier and his Ministers emphasizing the Government's commitment to transparency and integrity. I hope the OSC and the IDA will not be held to a lower standard than Premier McGuinty and his Cabinet.

> "We're not going to shrink from our responsibility to stand up for the public interest," he said. "We're going to protect the Ontario public."
>
> - Ontario Premier Dalton McGuinty
>
> *Ontario won't give in on 407*,Canadian Press, 12 August 2004

The consequences of inaction may well force a greater dependency on the social safety nets provided by government.

We look to this Standing Committee of Finance and Economic Affairs to remedy this situation. All political parties have publicly stated a commitment to transparency, disclosure and protection of the public.

Here is your opportunity to demonstrate that commitment. Investors need your help.

Please find my recommendations below and give them thoughtful consideration and should the committee find it useful, I would be happy to answer any questions.

Recommendations

1. The creation of a federal independent judicial body charged with an investor protection mandate, empowered by legislation to decide issues of law, and the ability to order financial redress for investors.

2. The *Ontario Securities Act* ("*OSA*") and *Commodity Futures Act* ("*CFA*") should be amended to name the Provincial Auditor/Attorney General as the corporate auditor for the delegated administrative authorities created under it, including the IDA/MFDA. In the Interim, the Minister of Finance should request that the Provincial Auditor undertake an audit of the IDA/MFDA as a "special assignment" under section 17 of the *Audit Act*.

3. The Provincial Auditor should undertake an audit of the OSC's oversight and monitoring of the operations of the IDA/MFDA and other delegated administrative authorities.

4. The *OSA* and *CFA* should be amended to bring the delegated administrative authorities created through it under the jurisdiction of the *Ombudsman Act*.

5. The Lieutenant Governor in Council should adopt a regulation under the *Freedom of Information and Protection of Privacy Act* designating the IDA and other delegated administrative authorities as "institutions" for the purposes of the *Act* and strike section 153 of the *OSA* that provides for an exemption for disclosure to self-regulatory bodies or organizations.

6. The *OSA* and *CFA* should be amended to require that any persons lobbying the IDA/MFDA and other delegated administrative authorities register their activities on the lobbyist register under the *Lobbyist Registration Act*.

7. Any future delegations of functions of provincial agencies currently subject to the *OSA* or *CFA* should be accompanied by a delegation of the agency's functions to the delegated agency under the *OSA* or *CFA*.

8. The Lieutenant Governor-in-Council should adopt a regulation under the *OSA* and *CFA* requiring the review by independent legislative officers of the undertakings of the IDA/MFDA and other delegated administrative authorities.

9. The *OSA* and *CFA* should be amended to state that the *Evidence Act*, the *Statutory Powers Procedure Act* and the *Judicial Review Procedure Act* apply to the proceedings before the IDA/MFDA and other delegated administrative authorities under the delegated legislation.

10. The status of prosecutions conducted by the IDA/MFDA and other delegated administrative authorities should be clarified. The IDA should conduct prosecutions only once their jurisdiction has been clearly established. This means that a formal arrangement for the delegation of the conduct of prosecutions to delegated administrative authorities, similar to the provisions of Part X of the Provincial Offences Act regarding the delegation of the conduct of prosecutions to municipalities, should be established. In the interim, the IDA/MFDA should enter into a memorandum of understanding with the Ministry of the Attorney General with respect to the application of the Ministry's policies, contained in the Crown Policy Manual, regarding the conduct of prosecutions.

11. The Recognition Agreement should be amended to require that the IDA/MFDA carry insurance for regulatory negligence, including coverage for the Crown for liability for the IDA/MFDA's actions, sufficient to deal with the known worst-case outcomes in the areas under the IDA/MFDA's jurisdiction.

12. The Government of Canada should undertake a detailed, independent evaluation of the performance of the existing delegated administrative organizations, including the IDA/MFDA, before further use is made of the model.

13. The *OSA* should be amended to state that all public hearings and or decisions involving the OSC or any administrative authority recognized by the OSC should

be disclosed to the public by the OSC within a defined time frame.

14. The Minister of Finance should request that the Attorney General undertake to review the OSC and IDA/MFDA definition and application of public interest as it applies to enforcement file closures, determination of case priorities and type of adjudication.

15. The *OSA* and *CFA* should be amended to have any new by-laws, rules, or policies created by the delegated administrative authorities, the IDA/MFDA or the OSC, require the approval by either the Minister of Finance or the Lieutenant Governor in Council.

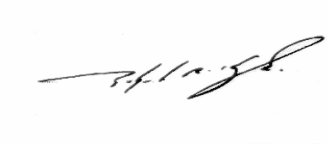
16. All reprimands issued by the IDA/MFDA to a member should be made public.

17. The *OSA* and the *CFA* should be amended to include the payment of defendant costs and punitive damages should the respondent be successful in its/her/his defence against either the IDA/MFDA or any other delegated administrative authorities.

18. IDA arbitration decisions should be made public.

I look forward to seeing the final report in October 2004.

Respectfully yours,



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