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STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS

REPORT ON THE FIVE YEAR REVIEW OF THE SECURITIES ACT

1st Session, 38th Parliament

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The Honourable Alvin Curling, MPP,
Speaker of the Legislative Assembly

Sir,

Your Standing Committee on Finance and Economic Affairs has the honour to present its Report on the Five Year Review of the *Securities Act* and commends it to the House.

Pat Hoy, MPP,
Chair

Queen's Park
October 2004

MEMBERSHIP OF THE

STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS*

1st Session, 38th Parliament

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CONTENTS

INTRODUCTION

The Review Process

Amendments to the *Securities Act* in 1994 (effective in 1995) require the Minister of Finance to appoint a committee to review the legislation every five years. Section 143.12 of the Act provides:

> 143.12(1) Within five years after this section comes into force and within each five year period after that, the Minister shall appoint an advisory committee to review the legislation, regulations and rules relating to matters dealt with by the Commission and the legislative needs of the Commission.
>
> (2) The committee shall review the legislation, regulations and rules relating to matters dealt with by the Commission and the legislative needs of the Commission and solicit the views of the public in respect of these matters by means of a notice and comment process.
>
> (3) The committee shall prepare for the Minister a report of its review and its recommendations.
>
> (4) The Minister shall table the report in the Legislature.
>
> (5) Upon the report being tabled, a select or standing committee of the Legislative Assembly shall be appointed to review the report, hear the opinions of interested persons or companies and make recommendations to the Legislative Assembly regarding amendments to this Act.

In accordance with s. 143.12(1), a review committee, chaired by Purdy Crawford, Q.C., was appointed in 2000. The review committee (the Five-Year Review Committee) released a Draft Report for comment in May 2002, and a Final Report on March 21, 2003 (the Crawford Report).

The Crawford Report[1] was tabled in the Legislative Assembly on May 29, 2003. At that time, the government announced that a select committee of the Assembly would be struck to review the Report, and report back to the Assembly in the fall. The provincial election in October 2003 delayed the fulfillment of the statutory review requirements.

[1] Ontario, Five-Year Review Committee (Purdy Crawford, Q.C., Chair), *Five Year Review Committee Final Report: Reviewing the Securities Act* (Toronto: Queen's Printer, 2003).

On June 29, 2004, an Order of the House directed the Standing Committee on Finance and Economic Affairs

> to fulfill the review, consultation and reporting obligations as set out in Section 143.12(5) of the *Securities Act* and specifically the priority recommendations as set out in the *Five-Year Review Committee Final Report: Reviewing the Securities Act (Ontario)* including:
>
> Securities regulation in Canada and a single regulator system; and
>
> The appropriate structure for the adjudicative tribunal role of the Ontario Securities Commission (OSC); and
>
> That the Committee submit its Final Report to the Assembly on or before Monday, October 18, 2004.[2]

The Standing Committee held public hearings at Queen's Park on August 18 and 19, 2004. Notice of the hearings was posted on the Ontario Parliamentary Channel, the Committee's website, and in the *National Post* and the *Globe and Mail* newspapers on August 3, 2004.

Invitations to appear before the Standing Committee were sent to the Chair of the Five-Year Review Committee; Gerry Phillips, Chair of Management Board of Cabinet (and minister responsible for the *Securities Act*); and David Brown, Chair of the Ontario Securities Commission. In addition to these witnesses, the Standing Committee received oral and written submissions from industry organizations, major investors, academics, lawyers, investor advocates, and individuals with personal experience in the securities market.

The Standing Committee would like to stress that all groups and individuals who contacted the Committee Clerk by 5:00 p.m. on Wednesday, August 11, 2004, were scheduled as witnesses at the public hearings.

This Report

The Crawford Report contains 95 recommendations dealing with many aspects of securities regulation in Ontario. Twenty of those recommendations have either been implemented or require no further action.

In this report, we have focused on "priority recommendations" that require further action, as set out in the Standing Committee's terms of reference, and as identified in the Crawford Report and in submissions made to the Standing Committee.

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[2] Ontario, Legislative Assembly, *Votes and Proceedings*, 29 June 2004.

Future Reviews

Under the existing legislation, the Minister will appoint the next Five-Year Review Committee at the end of 2004. The Crawford Report suggested that the *Securities Act* be amended to require that future committees be appointed five years after the date of delivery of the final report of the previous committee, instead of appointing committees every five years.

The Standing Committee's Recommendation

Recommendation 1

The next review committee should be struck in May 2007. The committee should deliver an interim report by May 2008 and a final report by early 2009. Thereafter, a review committee should be appointed four years after the date of the establishment of the previous committee. This recommendation is in no way intended to discourage or preclude the Minister of Finance from initiating reviews of individual issues, as necessary.

A SINGLE SECURITIES REGULATOR

The Crawford Report Recommendation

Recommendation 1 in the Crawford report reads:

> 1. We recommend that the provinces, territories and federal government work towards the creation of a single securities regulator with responsibility for the capital markets across Canada. To this end, we strongly encourage the Government of Ontario to actively support the Wise Persons' Committee recently established by the Federal Finance Minister.

Discussion

The Issue

In his presentation to the Standing Committee, Purdy Crawford stated that the members of the Five-Year Review Committee still regard the creation of a single securities regulator as "the most pressing securities regulation issue in Ontario and across Canada." In their view, a single regulator "would be the most efficient and effective regulatory structure for the Canadian securities market."

This view was shared by the Chair of Management Board of Cabinet, the Chair of the Ontario Securities Commission, and by many organizations and individuals who made submissions to the Standing Committee.

The main arguments in favour of a single regulator can be summarized as follows:

- Under the current regulatory structure, public companies that wish to issue securities or gain access to markets across Canada must understand, monitor and comply with 13 sets of securities laws and deal with 13 different regulators. This increases the costs of doing business in Canada.
- Enforcement and investor protection is inconsistent under the existing multi-regulatory system.
- Canada is the only G-7 country without a single securities regulator. In a global market place, where capital flows across borders with few restrictions, foreign investors may choose to invest in countries with lower regulatory costs.
- In the absence of a single regulator, Canada lacks a body that can address securities regulation and policy from a national perspective, and a body that can represent Canada's interests on the international stage.

In stating its case for a single regulator, the Crawford Report acknowledged that there are certain advantages to a multi-regulatory system. Most importantly, it can be argued that in a country where economic activity varies from region to

region, provincial control over securities laws allows each jurisdiction to more effectively address regional needs.

Moving to a Single Securities Regulator

While those who addressed the issue before the Standing Committee were unanimous in their support for a single securities regulator, there was less agreement on how this could be achieved.

The submissions we received identified three major reform proposals that are currently being discussed, two of which involve the creation of a single regulator:

- *The Passport Model:*[3] Under this inter-provincial initiative, individuals and firms could do securities business in all provinces by registering with a primary regulator and complying with its laws. In addition, companies could obtain approval to issue shares in all jurisdictions by complying with the primary regulator's disclosure laws.
- *The Federal Wise Persons' Committee (WPC):*[4] The WPC recommended that in the absence of provincial cooperation, the federal government should exercise its constitutional authority to enact a new *Canada Securities Act*, based on the Uniform Securities Law Project.[5] The Act would be administered by a single Canadian Securities Commission, consisting of regional representatives.
- *The Ontario Proposal:*[6] The Ontario proposal calls for a new provincial-territorial securities regulator. The main features of the proposal are a single regulator, a common body of laws, and a single fee structure.

Both Mr. Crawford and Minister Phillips expressed the view that the passport model is not a sufficient response to the need for a single securities regulator. Specifically, the passport model would continue a system in which 13 regulators issue interpretations of 13 securities statutes; would not result in consistent securities law enforcement across the country; would not establish an identifiable body that could represent Canada in international discussions; and would not allow for effective and timely formulation of policy. Moreover, the pursuit of a passport model could divert attention from what many believe to be the real solution - moving to a single regulator.

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[3] Provincial-Territorial Ministers Responsible for Securities, *Securities Regulation in Canada: An Inter-Provincial Securities Framework* (Discussion Paper), June 2003.

[4] The Committee to Review the Structure of Securities Regulation in Canada (the Wise Persons' Committee), *It's Time*, 17 December 2003. The report may be viewed at http://www.wise-averties.ca/reports/WPC%20Final.pdf.

[5] See the Canadian Securities Administrators' Uniform Securities Legislation Project, *Blueprint for Uniform Securities law for Canada* (2003). The consultation draft may be viewed at http://www.osc.gov.on.ca/Regulation/USL/usl_20031216_harmonization.pdf.

[6] Ontario, Management Board Secretariat, *Modernizing Securities Regulation in Canada* (Discussion Draft), 7 June 2004. The paper may be viewed at http://www.gov.on.ca/MBS/english/mbs/releases/general/june2404-report.html.

Minister Phillips also commented on the Canadian Securities Administrators' Uniform Securities Law Project (USL), which has the objective of developing more uniform securities laws across Canada. He suggested that while the USL is an important step toward improving the existing system, it does not go far enough. The project would not result in uniform securities legislation; rather, it would only result in 13 sets of more uniform laws, but with important differences.

Minister Phillips argued that the Ontario proposal addresses "head on" the fundamental problem of multiple regulators and multiple sets of securities laws. In his view, the advantages of the Ontario proposal are:

- stronger, easier to understand protection for investors;
- one set of clear, consistent requirements that would be easier for companies and investors to understand;
- lower compliance costs for companies;
- easier for companies to raise capital across the country and for securities firms to operate in other provinces;
- faster response to regulatory policy issues;
- better enforcement of securities laws, resulting in greater confidence in our markets; and
- a consistent voice for Canada internationally.

In pursuing this proposal, Minister Phillips indicated that Ontario is willing to consider a flexible structure that would accommodate those provinces with concerns about retaining a strong local and regional presence.

Other witnesses expressed a clear preference for the federal government to take control of this issue. The Ontario Teachers' Pension Plan, for example, argued that securities regulation should be exclusively a federal matter. In this way, Parliament could enact a consistent, and more stringent, set of securities laws, enforceable by one level of government. The Toronto Stock Exchange (TSX) supports a national securities commission, as proposed by the Wise Persons' Committee. The TSX believes this would send the clearest message to international markets that Canada is committed to establishing a modern regulatory system.

Some witnesses, while supportive of a single regulator, cautioned that the concept faces significant opposition. It was noted, for example, that British Columbia has a distinct philosophical approach to securities regulation, and that Quebec has its civil law tradition. Other provinces have concerns about small business financing, and some depend on the revenues from regulatory fees. In the words of one witness, there is also the "palpable scepticism about Ontario's dominating role."

In light of these practical difficulties, it was suggested that a possible compromise for Ontario might be to agree to the passport model, provided the other provinces commit to a single regulator within a short time.

The Standing Committee's Recommendation

The Standing Committee heard overwhelming support for the principle of a single securities regulator, and strongly supports the concept. At the same time, we recognize there are obstacles to achieving this goal. Most significantly, other provinces do not want to lose the ability to address regional needs. However, we believe that these obstacles can, and should, be overcome.

Recommendation 2

The Standing Committee recognizes the critical need for a single securities regulator, and strongly recommends that the Ontario government continue to work with all stakeholders, including Ministers in other provinces, toward the development of a single securities regulator. The key elements of the new regulatory system should be one new regulator, one common body of securities law and one set of fees.

UNIFORM SECURITIES TRANSFER LEGISLATION

The Crawford Report Recommendation

Recommendation 5 of the Crawford Report states:

> 5. We strongly encourage the Commission and the CSA [Canadian Securities Administrators] to continue developing securities transfer legislation modelled on revised Article 8 of the Uniform Commercial Code in the U.S. and we urge governments across Canada to ensure that such legislation is adopted on a uniform basis as soon as possible.

Discussion

Several witnesses appearing before the Standing Committee, including Purdy Crawford and the Canadian Depository for Securities, emphasized the need for a nationally harmonized law to oversee the holding, transferring and pledging of securities and interests in securities. Although technically speaking a matter of commercial law, the Crawford Report identified it as an issue of "fundamental importance [to] efficient and safe capital markets."

The Standing Committee heard that technological change has led to an increasing reliance on intermediaries to hold and deal with securities. Yet, the laws in Ontario governing the holding and transfer of securities still reflect the paper-based system of certificate holdings.

It was also pointed out that many foreign jurisdictions have already amended their commercial laws to address this issue. In the United States, this was done in 1994, through the revision of Article 8 of the Uniform Commercial Code. Commercial laws in Ontario and other provinces, however, have not been similarly modernized.

This situation, we were told, creates legal uncertainty, particularly for Canadian market participants who routinely engage in cross-border securities trading and pledging transactions, and makes them less competitive with market participants in the U.S.

We also heard that the Uniform Law Conference of Canada has proposed the adoption of a uniform provincial securities transfer act (USTA), based on Article 8 in the U.S. The Standing Committee was strongly urged to recommend the enactment of the USTA.

The Standing Committee's Recommendation

Those witnesses who addressed this issue were unanimous in their support for the Crawford Report recommendation. They made a compelling case that Ontario law in this area has fallen behind the U.S. and European jurisdictions and needs to be modernized.

The Standing Committee sees this as an opportunity for Ontario, not only to improve the investment environment for Ontario investors, but also to play a leading role in establishing uniform legislation across Canada.

Recommendation 3

The government should introduce securities transfer legislation modelled on revised Article 8 of the Uniform Commercial Code in the United States.

THE ONTARIO SECURITIES COMMISSION

Oversight and Accountability

The Crawford Report Recommendation

Recommendation 8 of the Crawford Report reads:

> 8. We recommend that the Minister of Finance and the Commission consider whether studies of specific aspects of the Commission's operations, similar to those conducted of the SEC [Securities and Exchange Commission] by the General Accounting Office in the U.S., should be undertaken.

Discussion

Over the last decade, the Ontario Securities Commission (the Commission) has acquired greater independence from government. Amendments to the *Securities Act* in 1994 transformed the Commission from a government agency to a Crown corporation, and in 1997 it became a self-funding body.

In light of these changes, the Crawford Report considered whether the province has retained sufficient oversight of the Commission. It noted, for example, that prior to becoming a Crown corporation, the Commission's internal controls were established and monitored by the government. Now, the Commission establishes its own controls.

It was also mentioned that in the United States, oversight of the SEC is the responsibility of two congressional committees, one in the House of Representatives and one in the Senate. These committees receive substantial support from the General Accounting Office (GAO), an independent government agency that reviews government programs and spending. The GAO released nine reports in 2001 on SEC operations.

The Standing Committee received a submission on this issue from Glorianne Stromberg, a securities lawyer and former commissioner of the Ontario Securities Commission.[7] In her view, there is currently no effective oversight of the Commission. She noted that the Ontario Legislature last reviewed the Commission in 1988, when the Standing Committee on Government Agencies issued a report expressing concerns about the Commission's oversight of Self-Regulating Organizations (SROs), the effectiveness of these organizations, and the overall efficiency of the Commission. Yet, since that time, the Legislature has delegated a significant amount of responsibility to the Commission, including the power to make rules that have the force of law.

In Ms Stromberg's opinion, existing oversight mechanisms (the requirement that rules receive ministerial approval, the tabling of Statements of Priorities and Annual Reports in the Legislature, and the five-year review process) are inadequate. As a first step towards providing better oversight of the Commission (and its other financial regulators), she recommended that the Legislature 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 matters generally. In addition, it was recommended that the Ontario government consider establishing an independent government accountability agency, similar to the General Accounting Office in the U.S.

[7] See the written submission of Glorianne Stromberg, 20 August 2004.

The Standing Committee's Recommendation

Recommendation 4

The Standing Committee believes that the status quo is unacceptable, and recommends that the government initiate a review of the Legislature's oversight of the Ontario Securities Commission. 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.

Structure of the Ontario Securities Commission

The Crawford Report Recommendation

Recommendation 9 of the Crawford Report reads:

> 9. We recommend that the current structure of the Commission as a multi-functional agency be given further thought and study by the Commission and the Minister on a priority basis.

Discussion

Perhaps one of the most contentious issues addressed in the Crawford Report was the subject of the appropriate structure of the Commission.

Under the *Securities Act*, the Commission performs multiple functions: policy development; conducting investigations into possible breaches of securities laws; prosecuting cases; and adjudicating cases. However, it is the dual role of prosecutor/adjudicator that has for years been the source of complaints from corporate lawyers and companies that have been subject to the Commission's rulings. They say this dual role creates a perception of bias (if not actual bias).

Indeed, critics of the existing structure have become more vocal since the Commission acquired new powers to assess administrative penalties of up to $1 million and to order people to disgorge profits.[8] With these additional powers, it is argued, the Commission has moved away from its regulatory role and into the realm of a criminal court. Given this significant change in mandate, the structure of the Commission needs to be reassessed.

As stated by Purdy Crawford in his presentation to the Standing Committee, combining regulatory and adjudicative functions in one administrative agency is a model that has often been used in other regulatory settings. Furthermore, the model has received the approval of the Supreme Court of Canada, which has ruled

[8] These powers were given to the Commission under the *Keeping the Promise for a Strong Economy Act (Budget Measures) 2002*, formerly Bill 198, in response to recommendations contained in the Five-Year Review Committee's Draft Report.

that it is not contrary to the legal doctrine of reasonable apprehension of bias. The question to be asked, therefore, is not whether the current structure is legal, but whether it is one that gives rise to perceptions of potential for conflict or abuse.

Minister Phillips told the Standing Committee, "We approach this issue [restructuring the Commission] with an open mind and the government is prepared to study it as recommended by the Five Year Review Committee." He also suggested that the issue of separating the adjudicative function from the regulator's other roles would be especially relevant when considering the structure of a single regulator. In this regard, he indicated that both the Ontario proposal and that of the federal Wise Persons' Committee are open to the possibility of a single regulator with a separate adjudicative tribunal.

The Evidence in Favour of Retaining the Current Structure

David Brown, Chair of the Commission, acknowledged that one of the main disadvantages of the "integrated" model (the current structure) is the risk of a perception of bias. To address this, the Commission has established a system of internal separation of investigative and adjudicative functions. Commissioners who participate in any aspect of an investigation do not sit on a hearing of the same matter.

Mr. Brown then set out what he believes to be significant advantages to the integrated model:

- By hearing and deciding real cases, the commissioners gain hands-on experience that informs their development of policy. This is important, since the Act requires that commissioners not only adjudicate cases, but also exercise sanctioning powers in the public interest. The policy development process gives commissioners insight into the public interest – insight that is invaluable in the adjudication process.
- The integrated model reflects the roles and responsibilities of an administrative agency/regulator, as distinct from a court. Administrative agencies were developed to fulfill roles different from (and not appropriate to) the courts, often resolving issues in accordance with a statutory mandate to protect the public interest. In fulfilling this mandate, they have power to formulate policy or make rules that have the force of law.

In Mr. Brown's view, the main disadvantage of moving to the "bifurcated" model of regulation, where adjudication is performed by a separate body, would be the loss of expertise the Commission acquires when performing multiple functions. In addition, it might be difficult to find a sufficient number of individuals with the expertise to serve as members of a part-time adjudicative tribunal.

Phil Anisman, a securities lawyer and strong proponent of retaining the Commission's integrated structure, described the interplay between the adjudicative and policy-making roles as a "cross-fertilization process." He said this process has been observed at other regulatory agencies, and suggested that the experience in the United States with separate adjudicators has not been positive.

Citing a leading American administrative law treatise, he argued that creating "a decision-making structure with strict agency-based separation of functions is one of the most powerful ways of reducing the effectiveness of a regulatory system."

The Standing Committee also received a written submission from the Chair of the Alberta Securities Commission, describing that province's experience with bifurcation. To address perceptions of institutional bias, the Alberta Securities Commission was reorganized in 1988 into two separate entities: the Board (adjudication) and the Agency (investigation/enforcement). Alberta found that, in practice, bifurcation did not produce the anticipated benefits. Rather, it proved to be "unwieldy" and "deprived personnel in one entity of the experience and expertise of those in the other." In 1996, legislation was passed that restored the multifunctional structure.[9]

The Evidence in Favour of Restructuring

In response to the Crawford Report, the Ontario Securities Commission asked the province's Integrity Commissioner, Coulter Osborne, to head a review committee to examine the Commission's structure. The Fairness Committee was appointed in February 2003 and issued its report in March 2004. Mr. Brown tabled the report with the Standing Committee on August 18, 2004.[10]

The Fairness Committee acknowledged the Commission's attempts to eliminate the potential for bias through the internal separation of adjudicative and investigative functions. Moreover, it found no evidence that Commission hearings have been biased or unfair.

Nonetheless, it was satisfied that nothing short of separating the Commission's adjudicative function from its other functions could overcome the problem of perceived bias. The Committee summed up the arguments in favour of restructuring as follows:

> . . . the nature of the apprehension of bias has become sufficiently acute as to not only undermine the Commission's adjudicative process, but also the integrity of the Commission as a whole among the many constituencies that we interviewed. Matters of institutional loyalty, the involvement of the Chair in the major cases, the increased penalties, the sense that 'the cards are stacked against them', the home court advantage, the lengthy criminal law-like trials, and the Commission's aggressive enforcement stance, which will likely only increase over time, all combine to make a

[9] See the written submission of Stephen P. Sibold, Q.C., Chair of the Alberta Securities Commission, 20 August 2004.

[10] See the *Report of the Fairness Committee to the Ontario Securities Commission* (Coulter A. Osborne, Q.C., Professor David J. Mullan, Bryan Finlay, Q.C.), 5 March 2004.

> compelling case for a separate adjudicative body.[11]

The Fairness Committee recommended that a new tribunal be created that would have jurisdiction over all matters in which sanctions against a person are sought. It should not, however, have general jurisdiction over matters such as takeover bids, exemption orders and other ongoing matters that relate to specific transactions. Except in rare cases, these matters should continue to be handled by the Commission. The adjudicative tribunal envisioned by the Fairness Committee would be composed of panels of part-time experts who would receive per diems and occupy offices separate from the Commission.

Other witnesses expressed similar concerns about the perception of bias at the Commission. One lawyer drew on his experience with the complaints system at the Real Estate Council of Ontario, where complaints against realtors were handled by a tribunal of realtors and by the provincial Licence Appeal Tribunal, composed of independent lawyers. He believes the instances of actual bias at either body were probably low; however, due to perception, cases before the panel composed of realtors generated far more complaints of bias. He recommended the creation of a separate securities adjudicative tribunal.[12]

The Standing Committee's Recommendation

The Standing Committee was presented with persuasive arguments on both sides of this issue. On the one hand, witnesses such as the current Chair of the Commission, a noted securities law expert, and the Alberta Securities Commission made a strong case for retaining the current structure of the Commission.

On the other hand, many were of the opinion that even if there is no evidence of actual bias at the Commission, the perception of bias has damaged the agency's credibility. This was the conclusion of an independent panel of experts (the Fairness Committee), which found the evidence in support of separating the adjudicative functions of the Commission from its other roles to be "overwhelming."

In our view, the issue of perception has become paramount.

Any new single securities regulator should include a separate adjudicative function. Failing substantial progress toward the establishment of such a regulator over the next 12 months, we believe the Ontario government should take the necessary steps to separate the adjudicative role of the Commission from its other roles. This should not preclude the government from immediately beginning the serious examination of the necessary steps needed to undertake such a transition.

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[11] Ibid., p. 32.
[12] See the submission of William Weissglas, 18 August 2004.

Recommendation 5

The adjudicative function of the Ontario Securities Commission should be separated from its other functions, based on the recommendations of the Fairness Committee.

RULEMAKING

"Basket" Rulemaking

The Crawford Report Recommendation

Recommendation 13 of the Crawford Report reads:

> 13. We recommend that the Act be amended to give the Commission 'basket' rulemaking authority that is substantially identical to that conferred on the Lieutenant Governor in Council pursuant to clause 143(2)(b) of the Act. The Commission should be given the authority to make rules respecting any matter that is 'necessary or advisable for carrying out the purposes of the Act.'

Discussion

As outlined in the Crawford report, the Commission prior to 1994 regularly issued policy statements. Although these policy statements did not receive legislative or ministerial approval, they were treated as having the force of law. In 1993, a court found that one of the Commission's policy statements was invalid on the basis that the Commission had exceeded its legislative jurisdiction. With the validity of policy statements in doubt, the government established the Daniels Committee in 1993 to study securities regulation. In 1994, legislation was passed to give the Commission rulemaking authority.

The purpose of the 1994 amendments was to give the Commission authority to make rules dealing with issues that were previously the subject of Commission policies. The amendments set out a list of matters that could be the subject of rules, but did not include a "basket provision" that would allow the Commission to make rules on matters generally within its statutory mandate. Without a basket provision, the Commission must request a legislative amendment to deal with new issues that are within its legislative mandate, but which are not specifically listed in the Act's rulemaking provisions. For example, in 1999, the Act had to be amended to allow the Commission to make rules dealing with certain prospectus disclosure and distribution requirements.

The Standing Committee received submissions from two securities lawyers who strongly opposed the Crawford Report's recommendation. They warned that granting the Commission basket rulemaking authority would, in effect, give un-elected officials "unfettered" power to make binding law. Moreover, if this power

were given to the Commission, the Legislature would, in practice, rarely be involved in securities regulation. (It was also noted that a limited basket rulemaking power was recommended by the Daniels Committee in 1993, but rejected by the Legislature.)[13]

The Crawford Report acknowledged these concerns, but concluded that they must be balanced against "the need for regulatory responsiveness and flexibility. Piecemeal legislative amendments to broaden the heads of rulemaking authority unnecessarily slow down the rulemaking process."[14] It was also mentioned that the securities commissions in Alberta, British Columbia and the United States each have a basket rulemaking power.

The Standing Committee's Recommendation

Although the proposed rulemaking authority would be subject to certain constraints (rules would have to relate to the purposes of the Act and would be subject to notice and comment requirements), the Standing Committee has reservations about granting the Commission broader authority to make binding law.

We agree with the approach originally taken by the Daniels Committee that if the Commission believes that it requires rulemaking power to deal with a matter that is not addressed in the Act, it is reasonable that it should be required to ask the Legislature for this additional authority. Indeed, that is one of the purposes of the five-year review process.

We also have concerns about giving the Commission greater lawmaking powers in light of our earlier conclusion that legislative oversight of the Commission needs to be enhanced.

Therefore, we cannot support the Crawford Report's recommendation to give the Commission a basket rulemaking power.

Recommendation 6

The Ontario Securities Commission should not be given basket rulemaking authority.

Blanket Rulings and Orders

The Crawford Report Recommendation

Recommendation 21 of the Crawford Report reads:

> 21. We recommend that the Act be amended to allow the Commission to issue blanket rulings and orders that provide exemptive relief only.

[13] See the submission of Phil Anisman, 19 August 2004, and the written submission of Richard J. Balfour, 24 August 2004.
[14] Crawford Report, p. 75.

Discussion

Blanket orders and rulings exempt certain market participants from complying with specific sections of the Act. These are considered to be particularly useful where the Commission has determined that a group of participants may be exempted from certain obligations, such as prospectus requirements.

The Crawford Report argued that blanket orders and rulings would give the Commission another tool with which to address both changes in the marketplace and emerging issues in a timely manner.

David Brown, Chair of the Commission, described how market participants frequently want to do something that rule-makers never intended to prevent. Currently, it takes up to 18 months to change a rule. In the meantime, individual market participants must bear the cost of applying for an exemption.

Again, the Standing Committee heard from securities lawyers who raised concerns about unduly broadening the powers of the Commission. They pointed out that because blanket exemptions are not subject to notice and comment period requirements, the opportunity for comment is effectively eliminated. In the words of Phil Anisman,

> This is especially significant in view of the fact that exemptions from the Act's requirements frequently exempt parties from obligations designed to protect investors. In these circumstances the time and the opportunity for reflection and comment on proposed rules are desirable. The relatively short delay necessary to permit such public participation outweighs the 'efficiency' that the recommendation is intended to achieve.[15]

The Standing Committee's Recommendation

In light of the concerns raised by individual investors, the Standing Committee is reluctant to support a proposal that would broaden the Commission's power to exempt market participants from provisions that were intended to enhance investor protection. On balance, we are not persuaded that the potential gains in efficiency flowing from a power to issue blanket rulings and orders are significant enough to warrant our support for this recommendation.

Recommendation 7

The Ontario Securities Commission should not be given power to issue blanket rulings and orders; however, the Standing Committee recognizes that the Commission needs to be able to act in a timely manner and asks the government to study alternative mechanisms that would enhance efficiency, without sacrificing investor protection.

[15] Ibid., p. 14.

REGULATION OF MARKET PARTICIPANTS

Registration

The Crawford Report Recommendation

Recommendation 28 of the Crawford Report reads:

> 28. We believe that the Act should continue to distinguish between the requirement to be registered to advise concerning securities and the requirement to be registered to trade in securities (or, as we propose in our earlier recommendation, to be in the business of trading in securities). However, we recommend that the Commission and CSA carefully review the proficiency, experience and suitability requirements applicable to dealers and employees to ensure that they are sufficiently flexible to permit various models for delivering advice while at the same time ensuring that they are sufficiently rigorous to match the increasingly important role of 'incidental advice' provided by dealers and salespersons.

Discussion

In considering the issue of who should be registered as a market participant, the Crawford Report described a "convergence between trading and advising activity." It found that dealers and employees who have been registered to trade in securities are increasingly providing financial advice to their clients before executing a trade. Despite this trend, dealers and their employees are registered mainly on the basis of their ability to provide trading services, rather than on their expertise in giving financial advice.

The focus of the Crawford Report was on the increasing number of dealers and their employees who are now providing "incidental advising." The Report did not say they should be restricted from providing such services; rather it was concerned that the "proficiency, experience, suitability and other regulatory requirements" keep pace with these developments.

We heard from numerous investors and investor advocates who were critical of the overall quality of investment advice that is currently being provided to small investors. One witness put the issue in the following terms:

> When the average Canadian decides to deal with a high-quality firm in response to its advertising, do they think they are dealing with an advisor who will act in their best interests and be held to professional standards, or do they think they are dealing with a salesperson in a buyer beware

> context, in whom they would place no more trust than they would when buying a used car?[16]

Following the release of the Five-Year Review Committee's Draft Report, the Ontario Securities Commission issued a discussion paper entitled *The Fair Dealing Model*.[17] The paper proposes three different "relationship models" by which registrants (e.g., dealers) would deal with their clients. Whenever an investor opens an account, he/she would be required to choose from one of the following:

- the "managed for you relationship," in which the investor relies completely on the firm;
- the "advisory relationship," in which the investor makes decisions in reliance on the objective, expert advice of the representative; and
- the "self-managed relationship," in which the firm provides trade execution services only.

The goal of this initiative is to "ensure that consumer expectations match the services provided."

The Five-Year Review Committee said it would support the *Fair Dealing Model*, provided the levels of proficiency required of the registrant reflect the degree of dependency in the relationship. One investor advocate appearing before the Standing Committee also expressed support for the Commission's initiative.[18] On the other hand, the Financial Advisors Association of Canada was critical of *The Fair Dealing Model*, arguing it would make "self-interested companies" responsible for regulatory oversight. The Association called for the creation of an independent professional body to regulate the provision of financial advice.

The Standing Committee's Recommendation

While the Standing Committee is sympathetic to those who believe there is a need to raise the overall level of financial advice that is being provided to the small investor, the Standing Committee is not in a position to assess whether dramatic steps, such as the creation of a new professional body for financial advisors, is appropriate.

We believe the Crawford Report's recommendation represents a reasonable approach to dealing with this emerging issue.

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[16] See the submission of Larry Elford, 19 August 2004.
[17] *The Fair Dealing Model* may be viewed at http://www.osc.gov.on.ca/Regulation/Rulemaking/Current/Part3/cp_33-901_20040129_fdm.pdf.
[18] *Supra*, Larry Elford.

Recommendation 8

The government should closely monitor the implementation of Recommendation 28 of the Crawford Report, and should ask the Ontario Securities Commission to report on the progress in implementation in its annual report to the Legislature.

Self-Regulation

SROs Enforcing their Own Rules

The Crawford Report Recommendation

Recommendation 36 reads:

> 36. We recommend that the Commission study whether the Act should be amended to give SROs [Self-Regulatory Organizations] the following statutory powers:
>
> - jurisdiction over current and former members or 'regulated persons' and their current and former directors, officers, partners and employees;
> - the ability to compel witnesses to attend and to produce documents at disciplinary hearings;
> - the ability to file decisions of disciplinary panels as decisions of the court;
> - statutory immunity for SROs and their staff from civil liability arising from acts done in good faith in the conduct of their regulatory responsibilities; and
> - the power to seek a court-ordered 'monitor' for firms that are in chronic and systemic non-compliance, close to insolvency or for other appropriate public interest criteria.
>
> In considering these issues, the Commission should consider what checks and balances, if any, are necessary to ensure procedural fairness and protections are available to those who will be subject to the new statutory powers.

Discussion

Due to a perception that SROs are not able to impose meaningful sanctions on their members, the Five-Year Review Committee considered whether recognized

SROs and stock exchanges should have statutory authority to enforce their own rules. In considering this issue, the Committee observed that securities legislation in the United States now gives SROs authority to revoke a member's registration, to censure or impose limitations on a member, and to remove from office or censure officers and directors of a member.

The Investment Dealers Association of Canada (IDA) addressed this specific issue in its presentation to the Standing Committee. The IDA maintains that Canadian SROs do not have effective enforcement powers, and argued that these bodies need the ability to compel clients and financial institutions to testify and produce documents at investigations and disciplinary hearings. Without this power, good cases must be abandoned. In addition, SROs need the ability to enforce penalties imposed by discipline committees against individuals who are no longer in the business, as if they were court orders. Otherwise, the disciplinary process loses credibility.

The IDA expressed its support for the Crawford Report's recommendation that the issue needs to be studied, but told the Standing Committee that the CSA is opposed to this initiative.

Separation of Self-Interest and Self-Regulation

The Crawford Report Recommendation

Recommendation 38 reads:

> 38. We recommend that the IDA consider whether improvements can be made to certain of its structures, such as the composition of its disciplinary panels and the membership of its board of directors, to lessen perceptions of conflict of interest in self-regulation.

Discussion

In its Draft Report, the Five-Year Review Committee identified as a "pressing issue" the potential for conflict of interest between the regulatory/public interest role of the SRO and its commercial objectives. It described how the IDA, for example, is both an SRO and a trade association for investment dealers. As a trade association, the IDA represents the interests of its members to government on such matters as securities regulation; as an SRO, it regulates the conduct of investment dealers and takes enforcement action against member firms and individual salespeople for breaches of IDA rules.

In its Draft Report, the Five-Year Review Committee recommended that trade association and SRO functions be carried out by two separate bodies. However, after receiving comments on the Draft Report, the Committee concluded that the cost of implementing its original recommendation outweighed the benefits, and decided to not recommend the separation of SRO functions in its final report.

One of the reasons the Five-Year Review Committee changed its position was the creation, in the period between the release of its draft and final reports, of the Financial Services OmbudsNetwork to handle complaints by customers of investment dealers. This agency operates at arms-length from industry participants, such as the IDA. The review committee decided that this development, combined with the arbitration process previously established by the IDA, "should address many of the concerns we heard from aggrieved investors."[19]

Several witnesses disagreed with the Crawford Report's conclusion. One suggested that the Report's reasoning was inconsistent with its earlier comments on the importance of the perception of conflict at the Ontario Securities Commission.

A litigation lawyer told the Standing Committee that the IDA "gives the appearance of being expert and impartial, when in fact it is neither." His experience in representing investors who have lodged complaints with the IDA is that in virtually all cases, the IDA simply repeats the response from the brokerage firm, taking the financial advisor's explanation without question. In addition, the IDA routinely gives legal advice to investors, when it is in no position to be doing so.[20]

Some witnesses recommended that responsibility for consumer protection be completely removed from the industry and given to an independent consumer protection authority, funded by fees paid by industry registrants and staffed by non-industry individuals.

One witness, referring to information provided in the Five-Year Review Committee's Draft Report, drew our attention to recent regulatory changes in the United Kingdom. In 2001, the Financial Services Authority (FSA) became the single regulator of financial services, banking and insurance, and assumed responsibility for supervising firms formerly regulated by SROs. As a result, there is no reliance on SROs under the new regulatory scheme. We heard that one of the reasons the UK abandoned self-regulation was that SROs were viewed as associations that represent their members' interests over those of the investing public.[21]

The Standing Committee's Recommendation

The testimony received by the Standing Committee revealed a deep-seated scepticism on the part of the investing public. They simply are not confident that complaints will always be handled in an objective manner under a system of self-regulation.

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[19] Crawford Report, p. 119.
[20] See the submission of John Hollander, 19 August 2004.
[21] See *Five-Year Review Committee Draft Report: Reviewing the Securities Act (Ontario)*, p. 69.

The Crawford Report itself stated, "we remain concerned about [this] issue . . . . Investors must feel that when they have a complaint against an IDA member they receive fair and unbiased treatment from the IDA in addressing their complaint."[22]

In view of the concerns about self-regulation expressed by the Five-Year Review Committee (in both its draft and final reports), and by witnesses appearing before the Standing Committee, we cannot fully endorse the recommendations concerning SRO enforcement powers (Recommendation 36) and separation of self-interest and regulation (Recommendation 38).

We believe the question of whether SROs should be given more powers or, indeed, whether they should have any powers at all, should be the subject of further review by a task force established to examine this specific issue.

Recommendation 9

The government should establish a task force to review the role of SROs, including whether the trade association and regulatory functions of SROs should be separated.

CIVIL LIABILITY FOR CONTINUOUS DISCLOSURE

The Crawford Report Recommendation

Recommendation 40 reads:

> 40. We support the CSA proposal to create a statutory civil liability regime for continuous disclosure and urge the Government of Ontario to move forward as soon as possible to proclaim the legislation in force. We also encourage the governments of the other CSA jurisdictions to adopt the same regime.

Discussion

In its Draft Report, the Five-Year-Review Committee recommended that Ontario enact a statutory civil liability regime for continuous disclosure, modelled on draft legislation published by the Canadian Securities Administrators in 2000. In response to the Draft Report, the Ontario Legislature passed Bill 198[23] in December 2002. The Bill included provisions that would give investors the right to sue a public company and other responsible parties for making a public material misrepresentation about the company or for failing to comply with disclosure requirements.

[22] Crawford Report, p. 119.
[23] The *Keeping the Promise for a Strong Economy Act (Budget Measures), 2002*.

Due to technical flaws in those provisions, they were not proclaimed. Bill 41 was then introduced to address the technical deficiencies, but died on the Order Paper when the provincial election was called in 2003.

In his presentation to the Standing Committee, Purdy Crawford identified the implementation of this recommendation as a priority matter. Observing that more than 90% of the trading in securities in Canada occurs in the secondary market, he argued that it is unreasonable that only purchasers under a prospectus (i.e., purchasers in the primary market) should have the ability to recover damages when there are misrepresentations in information disclosed by a company. In his view, a statutory right to sue for continuous disclosure would provide significant protection for investors. He recommended that the government re-introduce the amendments in Bill 41 and proclaim in force the provisions relating to civil liability for continuous disclosure.

The Chair of the Ontario Securities Commission and the Ontario Teachers' Pension Plan echoed Mr. Crawford's comments. They highlighted the fact that unlike investors in the U.S., Ontario investors face significant legal barriers in suing corporations and insiders for improper disclosure. They believe the proposed remedies would not only provide investors with a means of redress, but would also encourage compliance by corporations with their obligations to "maintain transparency."

The Canadian Bankers Association (CBA), on the other hand, considers the potential liability under Bill 198 to be "excessive." In its view, the Bill "goes well beyond" reasonable deterrence for improper disclosure practices.[24] The CBA warned that court awards under the generous liability caps in the Bill could threaten the financial stability of banks and other financial institutions, and could harm the investors who ultimately have to pay them.

The Civil Liability Coalition, representing several large public corporations, raised a number of legal and policy objections to the civil liability provisions of Bill 198. According to this group's analysis:

- The Bill's reverse onus provisions, which place the onus of proof on defendant corporations, could encourage unmeritorious lawsuits.
- The rationale for the civil liability provisions (i.e., they help to ensure compliance with continuous disclosure requirements) no longer exists, since the Ontario Securities Commission is now better funded and has new administrative and criminal enforcement powers that encourage proper disclosure.
- Rather than harmonize Ontario law with U.S. law, Bill 198 would actually create a more lenient litigation environment, which could put Ontario companies at a disadvantage.

[24] Bill 198 establishes liability caps for various types of defendants. The liability cap for an issuing company is the greater of $1 million and 5% of market capitalization.

- Bill 198 is out of step with recent developments in the U.S., where the trend has been away from private enforcement rights (e.g., class actions) and toward enhanced administrative and enforcement mechanisms.

The Crawford Report maintained that the threat of unmeritorious lawsuits would be offset by the inclusion of certain procedural safeguards in Bill 198, such as the requirement to obtain court approval to bring the lawsuit.[25] In addition, the "loser pays" principle of Ontario law requires the losing party in a civil suit to pay the legal costs of the winning party. The Report also observed that Ontario courts have recently shown "little patience" with American-style "strike suits."

The Standing Committee's Recommendation

The Standing Committee believes the civil liability provisions for continuous disclosure, as contained in Bill 198, and as amended by (former) Bill 41, would both enhance investor protection and act as a deterrent to misrepresentations and failures to make timely disclosure.

In our view, any concerns about the potential for frivolous litigation are answered by the safeguards included in Bill 198, by Ontario's "loser pays" rule, and by the reluctance of Ontario courts to approve lawsuits that do not have demonstrated merit.

As for the potential liability under Bill 198 being "excessive," we note that the liability caps imposed under the Bill represent a compromise position. One of the original proposals for reform was to establish a "full compensation" scheme, as has developed in the United States.[26]

Recommendation 10

The government should reintroduce the relevant provisions of the former Bill 41, and proclaim the civil liability provisions of Bill 198.

CORPORATE GOVERNANCE AND ACCOUNTABILITY OF PUBLIC COMPANIES

The Crawford Report Recommendation

Recommendation 61 of the Crawford Report reads:

> 61. We recommend that the Act be amended to give the Commission rulemaking authority over corporate governance matters more generally.

[25] Under Bill 198, a court may allow a suit to proceed only if it is satisfied that the suit is being brought in good faith and that the plaintiff has a reasonable chance of succeeding at trial.

[26] Full compensation was one of the alternatives considered by the Allen Committee (named after its chair, Tom Allen), established by the Toronto Stock Exchange in 1994 to examine continuous disclosure issues.

> For example, we would support giving the Commission rulemaking authority to make rules relating to the composition, functioning and responsibility of boards of directors and nominating and compensation committees.

Discussion

The Crawford Report observed that securities legislation has historically focused on disclosure of information to investors rather than on corporate management. However, the recent corporate scandals in the United States make it clear that corporate governance directly affects the integrity of securities markets.

Accordingly, the Five-Year Review Committee recommended in its Draft Report that the Ontario Securities Commission be given specific rulemaking powers. These included the power to make rules requiring that CEOs and CFOs of public companies certify the accuracy of financial statements, and rules regarding the structure of company audit committees. These recommendations have been implemented.

Recommendation 61 of the Crawford Report would give the Commission authority to make rules concerning corporate governance matters more generally, including rules to deal with such matters as the composition and operation of boards of directors and compensation committees. This would be consistent with recent reforms at the New York Stock Exchange and NASDAQ, and would reflect increased public concern over corporate governance matters generally. Purdy Crawford told the Standing Committee that the Commission has not yet received this rulemaking authority, with the result that certain governance matters are now policy initiatives, rather than binding rules. He urged the Standing Committee to support this recommendation.

We received few other submissions on this specific issue. One presenter expressed support for the recommendation, but recommended that the new rulemaking power also give the Commission power to require corporations to adopt a "business code of ethics," in which the company declares its fundamental values and beliefs.[27]

The Standing Committee notes that the Crawford Report's recommendation stems from a larger debate over the appropriate model for reforming Canadian securities law in the wake of the corporate scandals in the U.S. One school of thought holds that Canadian regulators must adopt tough new regulatory standards, similar to those implemented under the *Sarbanes-Oxley Act* in the U.S., but fitted to Canadian conditions. Proponents of this "rules-based" approach say that the voluntary corporate governance standards established by the Toronto Stock Exchange are no longer adequate. Tough regulatory standards, it is argued, are necessary to attract new capital and inspire confidence in investors. David

[27] See the submission of the Social Investment Organization, 18 August 2004.

Brown, the Chair of the Ontario Securities Commission, is one notable advocate of rules-based regulation.[28]

Opponents of the "rules-based" approach maintain that "principle-based" regulation is better suited to Canadian circumstances. This view holds that companies should be required to comply with general principles of disclosure, accountability and transparency, but that they should have discretion to decide how exactly they will comply with these principles. Proponents of this approach say cumbersome rules and regulations act as a deterrent to investment in Canada, and reduce the number of companies willing to be listed as public companies on the stock exchange. Barbara Stymiest, the former president of the Toronto Stock Exchange, favours principle-based regulation.[29]

The Standing Committee's Recommendation

The overall message the Standing Committee received from the public hearings is that recent events have undermined public confidence in corporate integrity, particularly among small investors.

We agree with the view that corporate governance has a direct impact on the integrity of securities markets, and support the Crawford Report's conclusion that clear, consistent and enforceable rules of corporate governance would help to restore investor confidence.

Recommendation 11

The Ontario Securities Commission should be given rulemaking authority over corporate governance matters generally, as recommended in Recommendation 61 of the Crawford Report.

SHAREHOLDER RIGHTS

The Crawford Report Recommendation

Recommendation 62 reads:

> 62. We support the reforms to the CBCA [*Canada Business Corporations Act*] relating to proxy solicitation. We strongly recommend that Part XIX of the Act be similarly amended to ensure that shareholders are able to communicate with each other in prescribed circumstances without having to file an information circular. We also recommend that

[28] The debate over rules-based regulation versus principle-based regulation is reviewed in Christopher C. Nichols, *The Canadian Response to Sarbanes-Oxley* (Capital Markets Institute, January 2003). This paper may be viewed at http://www.rotman.utoronto.ca/cmi/news/Canadian%20Response%20to%20SOX.pdf.
[29] Ibid.

> the Commission co-ordinate with the provincial government so as to ensure that amendments adopted under the OBCA [Ontario *Business Corporations Act*] and the Act are uniform. We further urge the Commission to consider whether it has the authority to incorporate by reference the requirements of another Canadian statute such as the OBCA or CBCA with respect to proxy solicitation, rather than stating the rules explicitly in the Act.

Discussion

The Crawford Report expressed concern that the proxy solicitation rules contained in Ontario corporate and securities laws are too restrictive, and that they could deter shareholders from communicating with each other. Of particular concern is ongoing confusion over what constitutes "solicitation." It was also noted that recent amendments to federal corporate law eliminated these interpretive difficulties. As a result, Ontario law is now inconsistent with federal law, and shareholders are even more confused about when they can communicate with each other.

The Standing Committee heard from two witnesses on this issue, the Ontario Teachers' Pension Fund and the Canadian Coalition for Good Governance. Their theme was that shareholders have a right to be informed, and that this includes being able to speak with participants in the market and with each other. Specifically, they say that when a problem arises, or when a controversial corporate proposal is made, shareholders must be able to discuss their concerns. Both groups consider the Crawford Report's recommendation to be a matter of significant importance to shareholders and urged the Standing Committee to support it.

Although beyond the scope of the Crawford Report's recommendations on proxy solicitation and shareholder communication during take-over bids, the Standing Committee would like to note an interesting submission we received on the subject of shareholder rights. This submission proposed the creation of an independent, non-profit organization of shareholders (modelled on the Citizen Utility Boards in the United States) that would be able to represent shareholder interests before regulators, the government and the courts. It was suggested that these shareholder groups could be established, at no cost to either the government or to the business sector, through a pamphlet system. Specifically, publicly traded corporations and mutual fund companies would be required to enclose a pamphlet in their annual reports to individual shareholders, stating that investors could become members of a shareholder group for a small annual fee (e.g., $30). It was estimated that even if only 4% of investors became members, this would be sufficient to establish "a broad-based, well resourced, self-sustaining group" that would be an effective advocate for individual shareholders in Canada.[30]

[30] See the submission of Democracy Watch, 19 August 2004.

The Standing Committee's Recommendation

When this proposal was first published in the Five-Year Review Committee's Draft Report, the majority of comments the review committee received were supportive; no substantive opposition was expressed. The Standing Committee heard no objections to this recommendation.

Recommendation 12

The government should introduce legislation to amend the proxy solicitation rules in Ontario's corporate and securities laws, as recommended in Recommendation 62 of the Crawford Report.

MUTUAL FUND GOVERNANCE

The Crawford Report Recommendation

Recommendation 66 reads:

> 66. We recommend that the Commission and the CSA introduce a requirement for all publicly offered mutual funds to establish and maintain an independent governance body. When, in the reasonable opinion of the independent directors, the manager has placed its interests ahead of those of unitholders of a mutual fund through self-dealing, conflict of interest transactions or other breach of its fiduciary obligations, this body should have the right either to terminate the manager or to tell the unitholders about the manager's actions and provide unitholders with a period of time within which to redeem their units at no cost.

Discussion

The Crawford Report concluded that the current structure of mutual fund governance contains an inherent potential for conflict of interest. Mutual funds are organized and promoted by a company known as the fund manager. However, because the manager is in business to be profitable for itself, there is the potential for conflict between the decisions the manager makes in its own interest and the decisions it makes in the interests of the unitholders of the mutual fund. For example, the mutual fund might, without the knowledge of its unitholders, use funds raised from investors to make investments in companies related to the management company.

To address this potential conflict, the Crawford Report recommended that the Ontario Securities Commission and the CSA require all publicly offered mutual

funds to establish and maintain an independent governance body. In addition, the independent directors should have the power to terminate the manager if, through self-dealing, conflict of interest or breach of fiduciary duty, it has placed its interests ahead of the interests of the unitholders. Alternatively, the directors should be able to tell the unitholders about the mangers actions and give them time to redeem their units at no cost.

Purdy Crawford outlined for the Standing Committee a number of developments in the mutual funds industry that have occurred since the Five-Year Review Committee issued its recommendation in early 2003:

- New York's Attorney General, Elliot Spitzer, has launched investigations into late trading and market timing by mutual funds in the U.S.
- The Ontario Securities Commission has been conducting its own reviews of late trading and market timing practices within the Canadian mutual fund industry.
- The SEC in the U.S. published a proposal for stricter governance requirements for investment funds.
- In January 2004, the CSA issued a proposal for a new National Instrument to address this issue.

Regarding this last development, Mr. Crawford remarked that critics consider the CSA proposal to be a "watered down" version of an earlier CSA proposal. The latest version proposes independent review bodies for mutual funds, but would not give these bodies real power to disagree with the fund manager.

Mr. Crawford stated that the members of the Five-Year Review Committee "continue to stand by our recommendation in the Final Report." Furthermore, he suggested that in light of recent developments, if the review committee were meeting today it would be reconsidering its decision to back away from a stronger recommendation that was included in the Draft Report. That proposal would have given the independent directors the right to terminate a mutual fund manager for poor performance of the fund (in addition to the other grounds for termination mentioned in the final recommendation).

The Investment Funds Institute of Canada, representing the mutual fund industry, told the Standing Committee that it supports the concept of independent oversight bodies, but disagrees strongly with the proposal to give such bodies the right to terminate a fund manager. In the industry's view, investors already have an effective right to terminate fund managers, since they have the right to redeem their investments on demand and to invest that money in another fund. The industry argues that giving independent governance bodies the power to terminate managers would, in effect, "subvert" investor choice.

The Standing Committee's Recommendation

The Standing Committee shares the Crawford Report's concerns about the state of mutual fund governance. Particularly compelling was Purdy Crawford's statement to the Standing Committee that in light of recent developments, the Five-Year Review Committee might well make a stronger recommendation today than it did in its final report.

Recommendation 13

The Ontario Securities Commission and the CSA should require publicly offered mutual funds to establish and maintain an independent governance body that provides for substantial investor protection.

NEW ENFORCEMENT POWERS

Power to Order Restitution and Restitution Orders under Section 128 of the Securities Act

The Crawford Report Recommendations

Recommendations 75, 76 and 77 read:

> 75. We recommend that the Commission monitor the exercise by the Manitoba Securities Commission and the FSA of their respective new restitution powers and consider the practical implications of the exercise of this power, with a view to revisiting in the future whether a power to order restitution would be an appropriate remedy for the Commission.
>
> 76. We encourage the Commission to consider exercising its discretion, in appropriate cases, to apply to the court under section 128 of the Act for a restitution or compensation order.
>
> 77. We recommend that consideration be given to the desirability and implications of amending section 128 of the Act to permit investors, in certain circumstances, to apply to the court directly for an order for restitution or compensation.

Discussion

Traditionally, regulatory agencies such as the Ontario Securities Commission do not have the power to order restitution, since the goal of regulatory legislation is protective, rather than remedial. Nevertheless, the Crawford Report recognized that the role of the regulatory agency is evolving, as demonstrated in Manitoba

and the United Kingdom, where securities commissions now have the power to make restitution orders directly.

Investor advocates and individual investors appearing before the Standing Committee supported giving the Commission the power to make restitution orders. They say existing remedies, namely, arbitration and the courts, are prohibitively expensive for the average investor, and often do not result in the recovery of lost savings. On the other side, corporate defendants typically have vast resources to defend themselves. The consequence is that obtaining justice for victims of white-collar crimes is not practical.

Securities law expert, Phil Anisman, told the Standing Committee that restitution or compensation "is the most useful form of protection for an investor who has suffered a loss as a result of a violation of Ontario securities laws," and suggested that the Five-Year Review Committee was inconsistent on this issue. On the one hand, it stopped short of recommending that the Commission be given restitution powers because the Commission's role is protective, not remedial. But on the other hand, this did not prevent the review committee from recommending in its Draft Report that the Commission be given the power to order administrative penalties and to order disgorgement (recommendations implemented by the Ontario Legislature in 2002).

Mr. Anisman downplayed the Crawford Report's concern that giving the Commission restitution powers might increase the complexity of Commission hearings, by necessitating inquiries into such matters as identifying victims and proving victim losses. He believes the Commission can minimize this problem by exercising its existing power to control its own proceedings, including deciding who may appear as a wronged investor.

The Crawford Report found that although the Commission has discretion under s. 128 of the *Securities Act* to apply to the courts for a restitution or compensation order, it has done so only once. One witness told the Standing Committee that the Commission has adopted a policy that it will not exercise its discretion under s. 128, as this would not be an appropriate role for a regulator. A number of witnesses supported the recommendation to encourage the Commission to make greater use of this power.

The Standing Committee's Recommendation

The Standing Committee believes that investors, especially small investors, need practical remedies when they have suffered a loss as a result of a violation of Ontario's securities laws, rules or policies.

Recommendation 14

The Standing Committee recommends 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. This work should take into account any measures to separate the adjudicative function of the Commission.

APPENDIX 1: RECOMMENDATIONS OF THE STANDING COMMITTEE

1. The next review committee should be struck in May 2007. The committee should deliver an interim report by May 2008 and a final report by early 2009. Thereafter, a review committee should be appointed four years after the date of the establishment of the previous committee. This recommendation is in no way intended to discourage or preclude the Minister of Finance from initiating reviews of individual issues, as necessary.

2. The Standing Committee recognizes the critical need for a single securities regulator, and strongly recommends that the Ontario government continue to work with all stakeholders, including Ministers in other provinces, toward the development of a single securities regulator. The key elements of the new regulatory system should be one new regulator, one common body of securities law and one set of fees.

3. The government should introduce securities transfer legislation modelled on revised Article 8 of the Uniform Commercial Code in the United States.

4. The Standing Committee believes that the status quo is unacceptable, and recommends that the government initiate a review of the Legislature's oversight of the Ontario Securities Commission. 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.

5. The adjudicative function of the Ontario Securities Commission should be separated from its other functions, based on the recommendations of the Fairness Committee.

6. The Ontario Securities Commission should not be given basket rulemaking authority.

7. The Ontario Securities Commission should not be given power to issue blanket rulings and orders; however, the Standing Committee recognizes that the Commission needs to be able to act in a timely manner and asks the government to study alternative mechanisms that would enhance efficiency, without sacrificing investor protection.

8. The government should closely monitor the implementation of Recommendation 28 of the Crawford Report, and should ask the Ontario Securities Commission to report on the progress in implementation in its annual report to the Legislature.

9. The government should establish a task force to review the role of SROs, including whether the trade association and regulatory functions of SROs should be separated.

10. The government should reintroduce the relevant provisions of the former Bill 41, and proclaim the civil liability provisions of Bill 198.

11. The Ontario Securities Commission should be given rulemaking authority over corporate governance matters generally, as recommended in Recommendation 61 of the Crawford Report.

12. The government should introduce legislation to amend the proxy solicitation rules in Ontario's corporate and securities laws, as recommended in Recommendation 62 of the Crawford Report.

13. The Ontario Securities Commission and the CSA should require publicly offered mutual funds to establish and maintain an independent governance body that provides for substantial investor protection.

14. The Standing Committee recommends 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. This work should take into account any measures to separate the adjudicative function of the Commission.

APPENDIX 2: WITNESSES AND SUBMISSIONS

Organization/Individual	Date of Appearance	Hansard Url
Advocis (Financial Advisors Association of Canada)	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA517
Alberta Securities Commission	Written Submission	
Anisman, Phil	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA876
Balfour, Richard J.	Written Submission	
Bazos, Anthony	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA709
Canadian Association for Retired Persons	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA879
Canadian Bankers Association	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA950
Canadian Coalition for Good Governance	Written Submission	
Canadian Depository for Securities	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA600
Canadian Public Accountability Board	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA443
Centre for Corporate and Public Governance	Written Submission	
Certified General Accountants of Ontario	Written Submission	
Civil Liability Coalition	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA646
Coady, Martha	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA832
Consumer Council of Canada	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA382
Crawford, Purdy	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA32
Democracy Watch	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA250
DeTorro, J. Edward	Written Submission	
Elford, Larry	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA704
Fried, Joel	Written Submission	
Gibson, Sandra	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA492
Hollander, John	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA776
Hutton, Gloria	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA226

Organization/Individual	Date of Appearance	Hansard Url
Investment Dealers Association of Canada	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA626
Investment Funds Institute of Canada	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA818
Killoran, Joe	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA173
Kyle, Robert	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA339
Ontario Bar Association	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA733
Ontario Chamber of Commerce	Written Submission	
Ontario Securities Commission	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA481
Ontario Teachers' Pension Plan	Written Submission	
Phillips, Gerry, Chair of Management Board of Cabinet	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA55
Rosen, Al	Written Submission	
Scavone, Robert	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA851
Scott, William A.	Written Submission	
Small Investor Protection Association	Written Submission	
Social Investment Organization	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA778
Stromberg, Glorianne	Written Submission	
Toronto Stock Exchange	Written Submission	
Urquhart, Diane	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA729
Verdun, Robert	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA924
Weissglas, William	18 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F024.htm#PARA998
Winkler, Paul	Written Submission	
Wotton, Ernest	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA574
Yudelman, David	19 August 2004	http://www.ontla.on.ca/hansard/committee_debates/38_parl/session1/finance/F025.htm#PARA313

APPENDIX 3: RECOMMENDATIONS OF THE FIVE-YEAR REVIEW COMMITTEE (THE CRAWFORD REPORT) – CURRENT STATUS

In the introduction to the Standing Committee's Report, we noted that of the 95 recommendations contained in the Crawford Report, 20 have been implemented or require no further action.

The Crawford Report's 95 recommendations are reproduced below. After each recommendation is a note on its status. Where a recommendation of the Crawford Report is addressed in the Standing Committee's report, that is noted as well.

1. We recommend that the provinces, territories and federal government work towards the creation of a single securities regulator with responsibility for the capital markets across Canada. To this end, we strongly encourage the Government of Ontario to actively support the Wise Persons' Committee recently established by the Federal Finance Minister. *(Requires legislation and structural change. See Report of the Standing Committee: "A Single Securities Regulator")*

2. In the meantime, we recommend that certain steps be undertaken by securities regulators to simplify the current regulatory regime in Canada: (i) We recommend that securities regulators continue to harmonize securities regulation across Canada; (ii) We recommend that securities regulators be given the authority to delegate any power, duty, function or responsibility conferred on them to another securities regulatory authority within Canada, and that they actively engage in delegation among themselves. We therefore recommend the Act be amended to give the Commission this delegation authority, and that the necessary consequential amendments to the immunity provisions in the Act be made; (iii) We recommend that securities legislation across the country be amended to provide for 'mutual recognition' so that the rules of the jurisdiction having the closest connection to a transaction or market participant will govern that transaction or market participant, and other affected jurisdictions will recognize and allow those rules to be applied in place of their own. *(Requires legislation)*

3. We strongly encourage the move by both Canadian regulators and standard setters to International Accounting Standards and hope that Canada will continue to play a role in this area with the ultimate goal of permitting both domestic and foreign issuers to report under IAS without a reconciliation to Canadian GAAP. *(Requires Commission rule)*

4. We recommend that the Commission and the CSA permit both foreign and Canadian companies to prepare their financial statements in accordance with U.S. GAAP. Issuers who prepare their financial statements in accordance with U.S. GAAP should be required to reconcile the statements to Canadian GAAP during a transitional period. The duration

of the transitional period should be determined by the regulators taking into account whether significant comparability issues will arise if no reconciliation is provided. *(Requires Commission rule)*

5. We strongly encourage the Commission and the CSA to continue developing securities transfer legislation modelled on revised Article 8 of the Uniform Commercial Code in the U.S. and we urge governments across Canada to ensure that such legislation is adopted on a uniform basis as soon as possible. *(Requires legislation. See Report of the Standing Committee: "Uniform Securities Transfer Legislation")*

6. We encourage the Commission to continue its ongoing participation in IOSCO initiatives and urge the Commission to adopt, in a timely fashion, changes to its rules to implement the international standards emanating from IOSCO. *(Requires Commission rule)*

7. We recommend that the CSA, provincial and territorial governments and the federal government move to adopt a system of harmonized functional regulation across Canada, whereby all Canadian capital market activities, products and conduct are regulated in a similar fashion and are subject to similar standards despite the differences between the various institutions or market participants offering the products or services to the marketplace. In the interim, we encourage continued regulatory co-operation and co-ordination in the financial services area through participation in endeavours such as the Joint Forum of Financial Regulators. *(Requires legislation and structural change)*

8. We recommend that the Minister of Finance and the Commission consider whether studies of specific aspects of the Commission's operations, similar to those conducted of the SEC by the General Accounting Office in the U.S., should be undertaken. *(Requires government action. See Report of the Standing Committee: "The Ontario Securities Commission")*

9. We recommend that the current structure of the Commission as a multi-functional agency be given further thought and study by the Commission and the Minister on a priority basis. *(Requires legislation and structural change. See Report of the Standing Committee: "The Ontario Securities Commission")*

10. We recommend that section 2.1 of the Act be amended to include the following additional principles to be considered by the Commission in pursuing the purposes of the Act:

    - Effective and responsive securities regulation should promote the informed participation of investors in the capital markets.

- Capital markets are international in character and it is desirable to maintain the competitive position of Ontario's capital markets.

- Innovation in Ontario's capital markets should be facilitated.

- The administration and enforcement of Ontario securities law should not unnecessarily impede or distort competition among persons carrying on regulated activities.

(Requires legislation)

11. We recommend that the Act be amended to the extent necessary to ensure that the basic principles relevant to securities legislation are contained in the Act. *(Requires legislation)*

12. We recommend that the Commission, together with the Government of Ontario, seek to streamline the Act by incorporating detailed requirements in the rules. In addition, we believe that the Act should accurately reflect current law. This may result in certain exemptions being removed from the Act altogether where they have been superseded by a rule. *(Requires legislation)*

13. We recommend that the Act be amended to give the Commission 'basket' rulemaking authority that is substantially identical to that conferred on the Lieutenant Governor in Council pursuant to clause 143(2)(b) of the Act. The Commission should be given the authority to make rules respecting any matter that is 'necessary or advisable for carrying out the purposes of the Act.' *(Requires legislation. See Report of the Standing Committee: "Rulemaking")*

14. We recommend that the Minister indicate the names of commenters who have raised concerns about a particular proposed rule during the Ministerial review period and the nature of the concerns raised. This, in turn, will permit the Commission to satisfy its statutory obligation to make public the fact that a rule has been rejected or returned by the Minister and why. *(Requires government action)*

15. We recommend that the Act be amended to require that the Commission republish for comment a proposed rule where the Commission proposes material changes to the rule, having regard to:

a. the nature of the changes proposed to the rule as a whole; and

b. whether the final rule is a logical outgrowth of the rulemaking process when viewed in light of the original rule proposal and request for comments. We further recommend that a similar test be adopted for republication of proposed policies. *(Requires legislation)*

16. We recommend that the Commission publish black-lined versions of its rules and policies when (i) making changes to existing rules and policies; and (ii) republishing for comment a proposed rule or policy. *(Requires Commission action)*

17. We recommend that the Commission limit the number of projects that it takes on and focus its resources on fewer critical policy issues. We further recommend that the Commission streamline its internal rulemaking process by establishing internal standards for the development of rule and policy proposals, including benchmark timeframes for reviewing and responding to comments on a rule or policy proposal. We recommend that the Commission publish these internal standards and report on its performance against such standards. *(Requires Commission action)*

18. In order to enhance the timely implementation of policy changes, we encourage the Commission and the CSA to be willing to adopt practical, if not perfect, solutions. *(Requires Commission action)*

19. When the Commission is conducting cost-benefit analyses of proposed rules, as required under the Act, we recommend that the Commission conduct or commission empirical studies to assess the effectiveness, costs and benefits of the proposed rule. *(Implemented by Commission action)*

20. We recommend that each cost-benefit analysis which the Commission conducts concerning a proposed rule should specify whether a proposed rule contributes to harmonizing securities laws across Canada and should discuss the expected effect of the new rule on harmonization and co-operation. If adoption of the new rule is expected to lessen harmonization or co-operation, the Commission should describe why it should nevertheless be adopted. *(Requires Commission action)*

21. We recommend that the Act be amended to allow the Commission to issue blanket rulings and orders that provide exemptive relief only. *(Requires legislation. See Report of the Standing Committee: "Rulemaking")*

22. We recommend that the Commission publish exemption orders granted from the requirements of securities rules. We also recommend that the Commission provide notice when applications for exemptive relief are not granted, and of the reason for the refusal, subject to keeping the name of the applicant confidential. *(Requires Commission action)*

23. We recommend that the Act be amended to require that future review committees be appointed five years after the date of delivery of the final report of the previous committee. We also recommend that Committee membership represent a diversity of backgrounds and interests relevant to

the capital markets. *(Requires legislation. See Report of the Standing Committee: "Introduction")*

24. We recommend that the CSA consider whether NP 11-201 *Electronic Delivery of Documents* and NP 47-201 *Trading Securities Using the Internet and Other Electronic Means* conflict with provincial legislation such as the ECA. We believe that the CSA should ensure that its guidance continues to be relevant and should issue a communiqué to market participants setting out its views. *(Requires Commission action)*

25. In light of investor protection concerns, we believe that it would not be prudent to eliminate the need for dealer registrant involvement in Internet offerings. *(No action required)*

26. The CSA should monitor the success of the limited form of access-equals-delivery contemplated by proposed National Instrument 51-102 *Continuous Disclosure Obligations* with a view to determining whether the access-equals-delivery model can be expanded to encompass additional documents which securities legislation requires be delivered to investors. *(Requires Commission action and rule)*

27. We recommend that the registration requirement relating to trading in securities should be moved to a model requiring the person or company to be 'in the business' of trading. However, we would only support such a change if it were to be adopted across the country. *(Requires legislation)*

28. We believe that the Act should continue to distinguish between the requirement to be registered to advise concerning securities and the requirement to be registered to trade in securities (or, as we propose in our earlier recommendation, to be in the business of trading in securities). However, we recommend that the Commission and CSA carefully review the proficiency, experience and suitability requirements applicable to dealers and employees to ensure that they are sufficiently flexible to permit various models for delivering advice while at the same time ensuring that they are sufficiently rigorous to match the increasingly important role of 'incidental advice' provided by dealers and salespersons. *(Requires Commission action and rule. See Report of the Standing Committee: "Regulation of Market Participants")*

29. We encourage the Commission, together with the CSA, to continue to monitor the use of financial portals by market participants, and to facilitate their development where appropriate. Where portals conduct activity in violation of the requirements of the Act, regulators can address this conduct through enforcement proceedings where appropriate. *(Requires Commission action)*

30. We recommend that securities legislation in the provinces be amended to provide consistent substantive registration requirements across the

country. We further recommend that the NRD be modified following its launch to permit investors to access relevant information about registrants, including industry experience, any previous disciplinary proceedings to which the registrant was subject, and the products which the registrant is licensed to sell. *(Requires Commission action and rule)*

31. We recommend the Act be amended to eliminate the universal registration requirements. *(Requires Commission rule and possible legislation)*

32. We recommend that the Act be amended to authorize the Commission to require SROs to apply for recognition where an SRO is taking on activities which are properly discharged by, or subject to the oversight of, the Commission if the SRO has not otherwise applied to be recognized. *(Requires legislation)*

33. We recommend that clearing agencies should be required to obtain recognition through an amendment to section 21.2 of the Act to provide that 'No person or company shall carry on business as a clearing agency unless recognized by the Commission.' We also recommend that the Commission re-examine the definition of 'clearing agency' in section 1(1) of the Act to ensure that it properly captures the activities which should trigger the requirement to be recognized. In this regard, we suggest that consideration be given to the definition of 'clearing agency' under U.S. legislation. *(Requires legislation)*

34. We recommend that the Commission and the CSA consider whether to require quotation and trade reporting systems to obtain recognition under securities legislation and to develop a harmonized approach to quotation and trade reporting systems, including re-examining the current definition of a quotation and trade reporting system in the Act. *(Requires legislation)*

35. We believe that the Canadian Unlisted Board merits regulatory review and urge the Commission to complete its review of the Canadian Unlisted Board as soon as possible, focusing particular attention on concerns relating to transparency and reducing the Canadian Unlisted Board's exposure to abuse. *(Implemented by Commission action and rule)*

36. We recommend that the Commission study whether the Act should be amended to give SROs the following statutory powers:

    - jurisdiction over current and former members or 'regulated persons' and their current and former directors, officers, partners and employees;

    - the ability to compel witnesses to attend and to produce documents at disciplinary hearings;

- the ability to file decisions of disciplinary panels as decisions of the court;

- statutory immunity for SROs and their staff from civil liability arising from acts done in good faith in the conduct of their regulatory responsibilities;

- and the power to seek a court-ordered 'monitor' for firms that are in chronic and systemic non-compliance, close to insolvency or for other appropriate public interest criteria.

In considering these issues, the Commission should consider what checks and balances, if any, are necessary to ensure procedural fairness and protections are available to those who will be subject to the new statutory powers. *(Requires Commission action and legislation. See Report of the Standing Committee: "Regulation of Market Participants")*

37. We recommend that stock exchanges and recognized SROs be required to report to the Commission any breaches or possible breaches of securities law that they believe have occurred or may have occurred. *(Requires Commission action)*

38. We recommend that the IDA consider whether improvements can be made to certain of its structures, such as the composition of its disciplinary panels and the membership of its board of directors, to lessen perceptions of conflict of interest in self-regulation. *(Requires Commission action. See Report of the Standing Committee: "Regulation of Market Participants")*

39. We strongly support the CSA's initiative to harmonize Canadian continuous disclosure requirements and encourage the CSA to assign a high priority to this proposal to ensure its timely adoption across Canada. *(Implemented by Commission rule)*

40. We support the CSA proposal to create a statutory civil liability regime for continuous disclosure and urge the Government of Ontario to move forward as soon as possible to proclaim the legislation in force. We also encourage the governments of the other CSA jurisdictions to adopt the same regime. *(Requires legislation. See Report of the Standing Committee: "Civil Liability for Continuous Disclosure")*

41. We recommend that the Commission study the appropriateness of amending the existing primary offering civil liability regime to parallel the civil liability regime for continuous disclosure in the following areas:

    - changing the joint and several liability scheme to a proportionate liability scheme;

    - extending a due diligence defence to the issuer;

- and introducing a safe harbour for forward-looking information.

(Requires Commission study and legislation)

42. We encourage the CSA to proceed with further reforms to the prospectus exemptions and the closed system with the goal of harmonizing and simplifying the requirements relating to private placements. *(Requires Commission rule)*

43. Once other reforms are implemented, such as civil liability for continuous disclosure, enhanced continuous disclosure standards for all reporting issuers, and a more integrated disclosure system overall, we believe hold periods for securities of reporting issuers could be eliminated without sacrificing investor protection while contributing significantly to more efficient capital markets. *(Requires Commission rule)*

44. We believe the need for seasoning periods in the case of reporting issuers should also be revisited with a view to their elimination if the reforms we contemplate in this Report are implemented. *(Requires Commission rule)*

45. Hold periods and seasoning periods should continue to apply to non-reporting issuers. *(No action required)*

46. We recommend the Commission examine the practice whereby control block holders reduce applicable hold periods through the use of derivatives and other monetization structures. *(Requires Commission action)*

47. We recommend that the Act's timely disclosure provisions not be amended to require disclosure of 'material information.' *(No action required)*

48. We recommend that the Commission study whether the current definition of 'material change' and timely disclosure reporting obligations should be amended to encompass:

    - a broader scope of discloseable events;

    - itemized particular company-specific events requiring timely disclosure similar to the SEC's 8-K approach;

    - and a requirement that agreements relating to the reported disclosure be filed as a schedule to the public report. *(Requires Commission action)*

49. We recommend that the existing materiality standard should be changed for all purposes under securities legislation to a reasonable investor standard which is consistent with the materiality standard in the U.S. *(Requires legislation)*

50. Except as noted in Recommendation 51, we do not believe that legislative change is required in Ontario to address the issue of selective disclosure and we support the CSA's policy statement and an increased emphasis on enforcement in this area. *(No action required)*

51. We recommend that the CSA introduce a 24-hour safe harbour for 'unintentional' selective disclosures along the lines of the safe harbour that exists in the U.S. under Regulation FD. *(Requires Commission action)*

52. We support the CSA's proposal to reduce the filing period for filing annual financial statements to 90 days after the fiscal year end for senior issuers, and 120 days for junior issuers. We also support the CSA's proposal to reduce the filing period for filing interim financial statements to 45 days after the quarter end for senior issuers, and to maintain the current 60-day deadline for junior issuers. We recommend, however, that the CSA reconsider whether to use the TSX non-exempt company criteria to separate senior issuers from junior issuers. Instead, we recommend that the CSA consider classifying senior issuers as those issuers whose securities are listed on the TSX and junior issuers as those issuers whose securities are listed on the TSX Venture Exchange. *(Implemented by Commission rule)*

53. We recommend that in due course the CSA consider shortening even further the filing deadlines for annual and interim financial statements to 60 and 35 days respectively to parallel recent rule changes made by the SEC. *(Requires Commission rule)*

54. We recommend that Ontario securities legislation be amended to require that quarterly financial statements must be reviewed by the issuer's external auditor. We endorse in principle providing junior issuers with an exemption from this requirement. The nature and scope of the exemption should be determined by the Commission, taking into account the costs and benefits associated with the requirement with particular attention being paid to the type of issuer and the stage of development of the issuer. We also recommend, however, that any issuer subject to an exemption from the requirement should be required to disclose that its quarterly statements have not been reviewed by an external auditor. *(Implemented by Commission rule)*

55. We recommend that Ontario securities law be amended to require that all news releases of reporting issuers must be filed on SEDAR. *(Implemented by Commission rule)*

56. We recommend that the GAAP exemption available to banks and insurance companies in subsection 2(3) of the Regulation to the Act be removed. *(Implemented by regulation)*

57. We urge the Commission and the Public Interest and Integrity Committee of the Canadian Institute of Chartered Accountants to adopt auditor independence standards on a priority basis, to proactively monitor ongoing U.S. developments relating to auditor independence and to consider what further reforms are necessary to ensure that Canada does not fall behind international standards. *(Implemented by Canadian Institute of Chartered Accountants)*

58. We recommend that the Commission adopt amendments to proxy disclosure rules to require public companies to disclose in their proxy statements their expenditures for both audit and non-audit services. Amendments to proxy disclosure rules should be undertaken once the Public Interest and Integrity Committee of the Canadian Institute of Chartered Accountants has finalized its proposed independence standards and should take into account those standards as well as recent proposed SEC rule changes for auditor independence. *(Implemented by Commission rule)*

59. We endorse the recent amendments to the Act that, when proclaimed in force, will give the Commission rulemaking authority to address all aspects of the certification regime recently adopted by the SEC. In this regard, we urge the Government of Ontario to proclaim the rulemaking amendments in force on a timely basis to permit the Commission to embark on rulemaking in this area. *(Implemented by Commission rule)*

60. We endorse the recent amendment to the Act that, when proclaimed in force, will give the Commission rulemaking authority to prescribe requirements relating to the functioning and responsibilities of audit committees of reporting issuers. We encourage other CSA jurisdictions to give their commissions similar powers, and we urge the CSA to work together on an expedited basis to establish standards for audit committees that will make Canadian audit committees 'best in class' internationally. We also encourage the CSA to be sensitive to the needs and resources of small-cap issuers in crafting any rule proposals. *(Implemented by Commission rule)*

61. We recommend that the Act be amended to give the Commission rulemaking authority over corporate governance matters more generally. For example, we would support giving the Commission rulemaking authority to make rules relating to the composition, functioning and responsibility of boards of directors and nominating and compensation committees. *(Requires legislation. See Report of the Standing Committee: "Corporate Governance and Accountability of Public Companies")*

62. We support the reforms to the CBCA relating to proxy solicitation. We strongly recommend that Part XIX of the Act be similarly amended to ensure that shareholders are able to communicate with each other in prescribed circumstances without having to file an information circular.

We also recommend that the Commission co-ordinate with the provincial government so as to ensure that amendments adopted under the OBCA and the Act are uniform. We further urge the Commission to consider whether it has the authority to incorporate by reference the requirements of another Canadian statute such as the OBCA or CBCA with respect to proxy solicitation, rather than stating the rules explicitly in the Act. *(Requires legislation. See Report of the Standing Committee: "Shareholder Rights")*

63. We recommend that the Commission, together with the CSA, undertake further study to determine whether amendments to securities law to relax the requirements relating to communications with and among shareholders in the context of a take-over bid should be enacted. *(Requires Commission action)*

64. Nothing has come to our attention that would support the need to regulate arrangements and take-over bids in an identical fashion. We believe that, as a matter of public policy, parties to commercial transactions should have the freedom to structure transactions to achieve their business purposes as long as these transactions, and the legislation that governs these transactions, are fair to all interested parties. *(No action required)*

65. We recommend that the Commission prepare a policy statement setting out guidance as to the factors to consider in determining when, in the context of take-over bid, a poison pill should be terminated. *(Requires Commission action)*

66. We recommend that the Commission and the CSA introduce a requirement for all publicly offered mutual funds to establish and maintain an independent governance body. When, in the reasonable opinion of the independent directors, the manager has placed its interests ahead of those of unitholders of a mutual fund through self-dealing, conflict of interest transactions or other breach of its fiduciary obligations, this body should have the right either to terminate the manager or to tell the unitholders about the manager's actions and provide unitholders with a period of time within which to redeem their units at no cost. *(Requires Commission rule. See Report of the Standing Committee: "Mutual Fund Governance")*

67. We recommend that the process by which potential directors of mutual fund governance bodies are identified and nominated be expanded so as to include a broader range of potential directors. We further recommend that the majority of directors be independent of the management company. Lastly, the potential liability and defences available to directors of fund governance agencies needs to be settled in the legislation. *(Requires legislation and Commission action)*

68. We believe that the mutual fund governance body should have certain characteristics, including: independence from the manager; a majority of independent directors; the right to retain counsel and other independent advisers; the right to set its compensation and establish the obligation of each member to disclose annually all fees received from the fund and all affiliated funds; and the right to terminate the manager in specified circumstances. *(Requires Commission rule)*

69. We believe that it is important to identify certain fundamental responsibilities of the mutual fund governance body. We believe these responsibilities should include, at a minimum, overseeing the establishment and implementation of policies related to conflict of interest issues; monitoring fees, expenses and their allocation; receiving reports from the manager concerning compliance with investment goals and strategies; reviewing the appointment of the auditor; meeting with the fund's auditor; and approving material contracts. *(Requires Commission rule)*

70. We urge regulators and the mutual fund industry to work together to determine what standards or requirements should be satisfied by mutual fund managers before they are permitted to establish, promote and run a publicly offered mutual fund; who is best positioned to establish those standards or requirements and to monitor compliance with them; and whether registration of mutual fund managers is necessary and justifiable, from a cost-benefit point of view, as a means of imposing and monitoring compliance with the applicable standards or requirements for mutual fund managers. *(Requires Commission rule)*

71. We recommend that subsection 143(31) of the Act be amended, if required, to give the Commission the necessary authority to address mutual fund governance reform through its rulemaking power. *(Requires legislation)*

72. We recommend that the Commission provide guidance, in the form of a set of principles or guidelines, setting out the considerations that may be taken into account in determining the appropriate sanction to be applied in the context of administrative proceedings under section 127 of the Act. *(Requires Commission action)*

73. We suggest that consideration be given to whether it would be appropriate for the Commission to have rule-making authority to deal with issues relating to the administration and distribution of money ordered by the Commission to be disgorged. *(Requires legislation)*

74. We recommend that a new offence be created under section 122 of the Act, for failing to fulfil, or contravening, a written undertaking to the Commission or the Executive Director. We also recommend that the Commission ensure that persons giving written undertakings to the

Commission or the Executive Director are made aware that contravening or failing to fulfil such undertakings is an offence. *(Requires legislation)*

75. We recommend that the Commission monitor the exercise by the Manitoba Securities Commission and the FSA of their respective new restitution powers and consider the practical implications of the exercise of this power, with a view to revisiting in the future whether a power to order restitution would be an appropriate remedy for the Commission. *(Requires Commission action. See Report of the Standing Committee: "New Enforcement Powers")*

76. We encourage the Commission to consider exercising its discretion, in appropriate cases, to apply to the court under section 128 of the Act for a restitution or compensation order. *(Requires Commission action. See Report of the Standing Committee: "New Enforcement Powers")*

77. We recommend that consideration be given to the desirability and implications of amending section 128 of the Act to permit investors, in certain circumstances, to apply to the court directly for an order for restitution or compensation. *(Requires legislation. See Report of the Standing Committee: "New Enforcement Powers")*

78. We recommend that, as a condition of its recognition of an SRO, the Commission should require the SRO to require its members to participate in and agree to be bound by any national complaint-handling system that is in place, as well as any industry-sponsored dispute resolution program that may be applicable. We favour transparency in connection with such programs and strongly encourage the publication of statistics relating to the use of the programs as well as particulars concerning the outcomes of cases or the resolution of complaints. *(Implemented by Commission action)*

79. We encourage the financial services industry to monitor the national complaint-handling system, in particular in the first year of its operation, to ensure that it is working as intended. Assuming that the system is successfully implemented, we recommend that the financial services industry then consider establishing a dispute resolution system on a similar, national basis. *(Requires SRO action)*

80. We strongly encourage SROs that have or may be contemplating alternative dispute resolution programs to, at a minimum, require their members to advise customers of the availability of such programs. *(Implemented by SRO action)*

81. We recommend that paragraph 127(1)7 of the Act be amended to authorize the Commission to order that a person resign one or more positions that the person holds as a director or officer of an issuer,

registrant or manager of a mutual fund (changes in italics). *(Requires legislation)*

82. We recommend that paragraph 127(1)8 of the Act be amended to authorize the Commission to order that:

    - a person be prohibited from becoming or acting as a director or officer of any issuer, *registrant or manager of a mutual fund*; and

    - *a person or company be prohibited from becoming or acting as a manager of a mutual fund or as a promoter fund* (changes in italics). *(Requires legislation)*

83. We recommend that a new paragraph be created under subsection 127(1) of the Act, authorizing the Commission to order that a person or company:

    - comply with or cease contravening:

        i. Ontario securities law; or

        ii. a direction, decision, order or ruling made under a by-law, rule or other regulatory instrument or policy of a recognized SRO or exchange.

    - comply in the future or take steps to ensure future compliance with Ontario securities law, or a direction, decision, order or ruling made under a by-law, rule or other regulatory instrument or policy of a recognized SRO or exchange. *(Requires legislation)*

84. We recommend that paragraph 127(1)2 of the Act be amended to expressly provide that 'trading' in securities for purposes of that paragraph includes the purchase of securities. *(Requires legislation)*

85. We recommend that section 122 of the Act be amended to include a provision permitting the Ontario Court of Justice to make an order, where appropriate, that the defendant compensate or make restitution to persons who have suffered a loss of property as a result of the commission of an offence by the defendant. *(Requires legislation)*

86. We recommend that the Commission issue a policy statement providing interpretive guidance on the scope of the confidentiality provision in section 16 of the Act and clarifying the process for making an application for disclosure under section 17 of the Act, including the issue of standing to bring such an application. *(Requires Commission action)*

87. We recommend that once the provisions of the 2002 Amendments are proclaimed into force, the CSA amend subsection 3.1(2) of National Instrument 23-101 *Trading Rules* to provide that the anti-fraud and market

manipulation provisions in the Act will apply in Ontario. *(Requires legislation and Commission rule)*

88. We recommend that, in appropriate cases, the Commission consider pursuing alternative enforcement mechanisms available under sections 127 and 128 of the Act as a regulatory response to illegal insider trading. *(Requires Commission action)*

89. We recommend that the Government of Ontario consider amending the Act to broaden existing insider trading civil liability provisions by deleting the privity requirement in section 134 of the Act. We further recommend that consideration be given to including a provision that limits liability under this section to the amount of profit gained or loss avoided by the insider as a result of the transaction or transactions in question. Any such liability should also be reduced by the amount required to be disgorged pursuant to an order by the court, or the Commission, if applicable, in a proceeding relating to the same transaction or transactions. *(Requires legislation)*

90. We recommend that the CSA consider further reducing the time period for filing insider reports (from the current requirement to file within 10 days of the date of the trade) once SEDI is operational. *(Requires Commission rule)*

91. We recommend that Ontario securities law be amended to require insiders to report any effective change in, or disposition of, their economic interest in an issuer. *(Implemented by Commission rule)*

92. We recommend that the issues raised with respect to the continuation of freeze orders under section 126 of the Act be studied further with the benefit of public input. In particular, we suggest the following issues, at a minimum, would require consideration:

    - whether the Commission or the court should authorize the continuation of a freeze order; and

    - what is the appropriate test to be applied in determining whether to continue a freeze order. *(Requires legislation and Commission action)*

93. With respect to the current power to order costs under section 127.1 of the Act, we recommend that the Commission develop policies or guidelines regarding how costs should be established and in what circumstances they may be ordered. We also recommend that costs orders made under section 127.1 should be subject to assessment on the application of a respondent. *(Requires legislation and Commission action)*

94. We recommend that consideration be given, on any future review of the Act, to whether it would be appropriate for the Commission to have the discretion to order costs payable to a respondent in Commission proceedings, and, if so, in what circumstances. *(Requires government action)*

95. We support whistle-blower protection in principle, but note that it does not necessarily belong in the Act. Such provisions might more appropriately be included in corporate or employment-related legislation, for example. *(Requires legislation)*