Notices / News Releases 1999/09/17 — TSE By-law No. 694 Concerning the Trading of Index Participation Units and Index Options The Toronto Futures Exchange By-law No. 64 Concerning the Trading of TFE Index Futures Contracts Notice of Commission Approval

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The Toronto Stock Exchange By-law No. 694 Concerning the Trading of Index Participation Units and Index Options the Toronto Futures Exchange By-law No. 64 Concerning the Trading of TFE Index Futures Contracts Notice of Commission Approval

On August 31, 1999, the Commission approved By-law No. 694 Concerning the Trading of Index Participation Units and Index Options and the accompanying resolution with the exception of section 5 of the resolution (which deals with contract specifications). By-law No. 694 amended various sections of the General By-law with respect to the trading of index participation units and index options to facilitate the introduction of index participation units and index options based on the S&P/TSE 60 Index. A copy and description of By-law No. 694 was published on February 26, 1999 at (1999) 22 OSCB 1465.

Staff were informed that, as it is not anticipated that any derivatives based on the S&P/TSE 60 would be traded on the Toronto Futures Exchange, approval was no longer required for By-law No. 64 Concerning the Trading of TFE Index Futures Contracts. A copy and description of By-law No. 694 was published on February 26, 1999 at (1999) 22 OSCB 1460.

Notices / News Releases 1999/09/17 — Reprint of Remarks By The Honourable Howard Wetston, Q.C., Vice Chair, OSC Strategic Management of Investor Relations, Richard Ivey School of Business/Canadian Investor Relations Institute — August 11, 1999

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Remarks By The Honourable Howard Wetston, Q.C., Vice Chair, Ontario Securities Commission Strategic Management of Investor Relations, Richard Ivey School of

Business/Canadian Investor Relations Institute Toronto

August 11, 1999

Thank you. It will come as no surprise to you that the Ontario Securities Commission is addressing many issues that affect you as investor relations professionals.

Before I begin, let me briefly explain the mandate of the Ontario Securities Commission. Our mandate can be broken down into two simple components: first, it is our job to protect investors from unfair, improper or fraudulent practices; and second, we have a mandate to foster fair and efficient capital markets in Ontario and to ensure confidence in the integrity of those markets. This mandate is becoming increasingly national and international in scope

Fulfilling this mandate is particularly important in today's environment, where there is increased public interest in the securities market. The general public's participation in secondary markets has increased dramatically during the past few years, and is at record levels in the investment fund sector.

Investors are becoming increasingly active in seeking information and education about investments. These trends present a challenge to the OSC, as the regulator, and to you as the conduit of information between your company and the market. The challenge is to effectively inform and protect market participants and meet the elevated need for clear and continuous disclosure of information to investors.

A strong investor relations function within a company can add value for shareholders. If the market has confidence that a company's financial statements can be trusted, if the market has confidence that management is being straightforward with investors, I suggest that company will have an advantage in today's competitive markets.

I want to focus my remarks today on three particular issues:

- aggressive accounting;selective disclosure; andcontinuous disclosure

Aggressive Accounting

In recent years, there has been tremendous pressure on public companies to meet analysts; earnings expectations. The consequences of missing earnings targets can mean significant volatility in share price or market camp. Faced with this pressure, some companies have resorted to “aggressive accounting” methods.

In our view of financial statements, staff regularly encounter situations in which reporting issuers and their auditors interpret of accounting standards unreasonably.

In some cases, the issue is overstatement of current income, perhaps by use of aggressive and inappropriate revenue recognition practices. For example, a company faced with a weak quarter or year of earnings may be tempted to recognize and report earnings prematurely. In this instance, the company may claim earnings from a transaction that is not yet fully complete, or recognize revenue before the products are delivered. This practice exaggerates earnings by recognizing income from transactions that are not yet final or complete.

There is much that the accounting profession can do to rectify these types of situations. We have made it clear that we expect the profession to take action, and we will work with them and with public companies to provide guidance and assistance. But we will also act on our own. We will address specific issues with individual companies as they arise.

If we find a trend towards the use of an aggressive accounting practice in a specific industry, then specific industries will be examined more extensively.

When necessary, we will ask companies to re-state their financials. In the end we are also prepared to use administrative sanctions to curb especially aggressive practices.

Selective Disclosure

While aggressive accounting involves the manipulation of information that is available to all market participants, selective disclosure means sharing specific information with certain market participants, such as analysts or professional investors.

You are all familiar with the critical role that analysts play on the street. Their opinions are eagerly sought by the news media and dealers compete for their services. Consequently, it is in your best interest to be responsive to an analyst who is following your company. In the same way, it is important for analysts seeking a competitive edge to maintain good relations with officials of the public companies they are tracking.

Sometimes, this relationship becomes too friendly, and public companies engage in “selective disclosure” by discussing corporate affairs during closed conference calls with analysts or by providing material to large investors which is not released publicly.

The issue of selective disclosure was identified in 1997 when the Allen Committee released its report to the TSE. The report states, quote: “The committee remains concerned that private meetings with analysts and professional investors have resulted in selective disclosure of information that should have been disclosed on a general basis. Quite apart from any questions of compliance with securities laws, this causes unfairness in the marketplace.”

This matter was recently discussed in a recent insider trading case.

In that case the CEO of a TSE-listed company contacted a research analyst (Gordon Gee of Marleau, Lemire Securities) and told him there might be a problem with the company's operations in a Latin American company, resulting in a material loss.

He asked the analyst to hold back his research report on the company pending a resolution of the problem. A few days later, the analyst told other members of the firm about the conversation during a regular morning meeting. Shortly after the meeting, one of the firm's senior traders (Gary George) sold short more than 2,000 shares of the company. He purchased the same amount of shares the next day at a lower price.

The Commission ruled that it had not been established that the trader was at the morning meeting, and so he did not violate the Securities Act. However, the panel found that the disclosure of material information to research analysts that has not been generally disseminated to the public is, quote: “both illegal and improper.”

Selective disclosure is unacceptable and will be acted upon.

Continuous Disclosure

Clearly, the growth of the secondary market and the impact of home computers and Internet-based technology have created a tremendous hunger for information about public companies.

To assure investors that they are receiving the most up-to-date, accurate information, the OSC is taking action on a number of fronts:

- first, we have created a new entity, the Continuous Disclosure Team.and second, we are working with other Canadian regulators to create what we call an “integrated disclosure system.”

As you are aware, after filing a prospectus tied to its initial public offering, a public company is required to file documents on an ongoing basis with securities regulators and with the stock exchanges on which the securities are listed for trading.

These continuous disclosure requirements include a long list of reports: an Annual Information Form, Material Change Reports, Insider Trading Reports, Proxy Solicitations, annual audited financial statements accompanied by Management Discussion and Analysis and unaudited interim financial statements.

These on-going continuous disclosure documents provide the basis for all trading in secondary markets — where more than 94 percent of securities trading now occurs.

Accordingly, we came to the conclusion that the capital markets would benefit from a higher degree of oversight. As a result, we have formed a separate Continuous Disclosure Team, which has several goals:

- The first goal is to monitor and improve the quality of financial reporting and disclosure. This is being done in two ways: first, by examining the appropriateness of accounting policies and practices adopted by issuers and the adequacy of disclosure in financial statements; and second, by resolving any deficiencies or concerns.
- The second goal is to provide feedback to the issuer community to aid companies in achieving satisfactory compliance.
- And our third goal is to identify emerging issues and innovative transactions to determine if new standards or other guidance is required.

This is not an easy task. To accomplish these goals, staff plan to review, on average, all 5,029 reporting issuers in Ontario once every five years through a combination of targeted and random reviews.

In addition, staff will review areas of importance and integrate them into the review programs. For example, areas of importance may be reporting trends or issues such as selective disclosure and — as I noted earlier — aggressive accounting. Or, staff may target new disclosure areas to ensure compliance with new disclosure standards.

As part of the review process, staff will also identify issues that should be examined by the OSC's Enforcement Branch. In addition, results of the reviews will be published to provide feedback to public companies to assist you in achieving satisfactory compliance.

Integrated Disclosure System

The next step we are proposing is the establishment of an integrated disclosure system. The integrated disclosure system, as its name implies, would integrate the information which reporting issuers are required to provide to investors in both the primary and secondary markets. The goal is to make it simpler for companies to access the market while providing enhanced disclosure for investors.

The foundation of the system would be an upgraded “continuous disclosure base” that offers the public information relating to an issuer and its business, comparable to the information that is currently provided in a prospectus. This will provide benefits to both investors and companies that want to issue securities.

Investors would benefit from being able to access a comprehensive, timely base of information; companies would be able to respond immediately to opportunities in the primary market by using an abbreviated offering document that incorporates the continuous disclosure base and undergoes streamlined regulatory screening.

Working with other regulators, we propose to introduce the integrated disclosure system on a pilot basis after issuing the proposal publicly and receiving comment. However, legislation will be required in a number of areas.

Some of the changes we are proposing will require legislation. Just one simple example: under current securities legislation, companies are required to file their interim financial statements 90 days after year-end and their annual statements 140 days after year-end. If regulators wanted to shorten those timeframes, legislation would be required.

Conclusion

As the people who form the link between your companies and investors, you have a role to work in making these initiatives a success.

I urge you to work closely with your financial and accounting staff to ensure that GAAP standards are achieved — not stretched beyond recognition.

I encourage you to ensure that you work toward achieving full disclosure for all investors — not just a select few.

And I ask you to be rigorous in meeting disclosure requirements and giving investors a clear picture of your on-going business — not leaving them to the whims and speculation of market rumours.

As Steven Wallman, a former SEC Commissioner, has written, “It is in everybody's best interest — issuer as well as investor, and ultimately society — to protect investor interests. Misstatements and omissions made to the public reduce the integrity of information in the market, increasing investors' risk. It doesn't matter whether the misstatement was made intentionally, recklessly, negligently or even innocently. Increased risk causes investors to demand higher returns and also raises transaction and investigation costs, all of which increase a firm's cost of capital. Investors and — in the long term — issuers suffer from misinformation. Also, any increase in the cost of capital eliminates some of the competitive advantage of the (Canadian) securities markets, and of (Canadian) competitors, in relation to overseas markets and competitors."***(1)**

Thank you.

Endnotes

1
Wallman, Steven M.H. “Regulation for a New World”. *Business Law Today*. American Bar Association, Nov./Dec., 1996.