



“The Status Quo Is Not An Option”

Keynote Address by Maureen Jensen

Chair and Chief Executive Officer, Ontario Securities Commission

Toronto Region Board of Trade

September 27, 2016

Check against delivery

Thank you, Steven, for your kind introduction. I am pleased to be here with so many people who understand and appreciate the importance of the capital markets here in Ontario.

There is no question we are all experiencing tremendous change in the financial services industry with shifting demographics, changing investor behaviour, industry consolidation, technological innovation and the globalization of our businesses.

As a securities regulator, the Ontario Securities Commission (OSC) must balance protection of investors and the integrity of the financial system—while allowing innovation and avoiding over-regulation. The need for balance has never been greater.

This is a big challenge for regulators. But it's also a massive opportunity to evolve our thinking and approach to regulation.

Quite simply, I do not believe the status quo is an option.

That said, what has not changed at the OSC is our focus on our touchstone mandate: to protect investors from unfair, improper or fraudulent practices and foster fair and efficient capital markets.

As Peter Drucker, the leadership guru, said, “Leadership is doing the right things.” Today I want to discuss working with you as leaders to do the right thing.

Investor protection

We have no greater responsibility than delivering effective investor protection to the public that we serve. That we all serve.

Globally, we are seeing securities regulators moving forward on sweeping investor protection changes. This global shift and the focus on investor protection by the Canadian Securities Administrators (CSA) have led us to propose new investor protection measures: a best interest standard and targeted reforms, which have been published, as well as a review of embedded mutual fund fees, which is soon to be published.

The research is telling us that the current models are not serving investors in the way they deserve. I acknowledge that the proposals are significant changes to this industry. They are game-changers. But they are long overdue.

Best interest standard

We no longer live in a world where investors rely on advisors solely to broker transactions. Investors increasingly rely on these professionals for advice in order to plan and to fund their life goals.

On the other hand, investors mistakenly believe they are already receiving recommendations that are in their best interest. Yet the current standard is that advisors are required to recommend products that are suitable for their clients at the point of sale. While many advisors do work in their clients' best interest—some do not.

Year after year, the most frequent investor complaint dealt with by the Ombudsman for Banking Services and Investments (OBSI) involves failures in the suitability of investments. Last year, suitability was the main issue in one-third of approximately 380 investment complaints handled by OBSI.

The CSA is working to address some of these concerns through targeted reforms that would enhance existing obligations in our rules regarding suitability, know-your-client and know-your-product requirements, as well as additional controls on conflicts of interest and standardizing business titles. These reforms should also cover incentives associated with the sale of proprietary products.

In addition to this, the OSC is consulting on putting in place a best interest standard as an over-arching principle. This would ensure that advisors understand they have a duty to put their clients' interests first. Recommendations must serve the client's needs above all else—and not just at the point of sale, but throughout the entire relationship. Remember, we are talking about their funds for their future.

Consultation is critically important to this process. We need to find an appropriate way forward—one that will work for investors and their advisors. Together with the CSA, we will review the comments that come in on our paper. The OSC will also be hosting a CSA roundtable on December 6, and other roundtables will be scheduled across the country.

As I've said, we do not believe the status quo is an option. Personally, I believe that introducing a best interest standard is the right thing to do. An industry that puts the interests of their clients first is an industry that investors will have confidence in. And it's something both investors and industry professionals will benefit from.

Embedded fees

The time has also come to rethink embedded mutual fund fees. Research we published last year found compelling evidence that embedded fees create conflicts that are detrimental to investor outcomes.

For example, our research found that funds that pay higher trailing commissions attract more client money, even when those funds are underperforming. In other words, embedded fees incent advisors to select funds with higher fees, regardless of performance of the fund—putting the

advisor's interest ahead of their clients'. This is not acceptable. I think we can all agree that the interests of advisors need to be better aligned with their clients.

The impact of these fees on investor returns is quite significant. According to a study of Canadian fund dealer clients by the National Bureau of Economic Research, the investment returns of advised clients lagged passive benchmarks by two per cent to three per cent per year. Fees and unsuitable portfolio construction accounted for most of the underperformance. Investors experiencing this kind of outcome on a consistent basis would never break even and would, in fact, be worse off.

The current compensation model consists of fees set by fund managers to incent sales by advisors. This does not put the interests of the client first, and that's a fundamental flaw that needs to be addressed.

I believe that investors must be able to understand the true costs of their investments—the costs of buying and holding their investments, and the cost of the advice that they receive.

I also believe that advisors *must* be compensated for the advice they give and the services they provide—it's the *how* that needs to be discussed and explored.

You are all familiar with the Point of Sale and Client Relationship Model reforms. These are critically important changes that have and will improve disclosure to clients. But disclosure alone is not enough.

With that in mind, the CSA will be publishing a consultation paper by the end of the year that will set out the potential impacts of banning embedded fees as a possible option. But, we are also open to considering other options to eliminate these conflicts.

We know this would be a major change for advisors and firms, as well as investors. And so we must be confident that any reforms are appropriate for the Canadian market. That's why input from all of our stakeholders is necessary throughout this process.

We are looking for leadership within the industry to work with us to find the right solutions. Only by working together can we find the right path forward.

We are already seeing positive developments in the marketplace. Some firms are recognizing the need for cost transparency and the value of reducing conflicts—and they are moving away from embedded compensation models. We are encouraged by innovations such as platform-traded funds, online advice and the use of D-series funds with discounted fees for do-it-yourself investors.

I want to applaud Investors Group for their recent announcement to discontinue the DSC or deferred sales charge option on all of their mutual funds, starting January 1, 2017. This is the kind of leadership we're talking about. This change will deliver positive outcomes for their clients, and they have also mapped a path that benefits their advisors. It's a win-win situation.

Our motivation for both the best interest and embedded fee initiatives is simple: do the right thing for investors.

That said, it's not easy. We are challenging long-held business models. And working through the issues will not be easy.

Industry is a fundamental part of getting this right, and if we continue to work together, we can arrive at solutions that will ultimately benefit investors and the Canadian marketplace. We have to do this.

Enforcement

We know that investors place a great deal of trust in their relationship with their advisor, but in addition they must have trust in the system as a whole. That's why enforcement is always a top priority for us.

Investors must be confident that those who don't play by the rules will not benefit from their misconduct. Those who violate the rules must know that they will be prosecuted and sanctioned.

The OSC is targeting more complex cases and serious violations of securities law. So it is critical that we have the tools to support this effort.

In 2013, we launched the Joint Serious Offences Team (JSOT) to handle criminal activity such as fraud. JSOT is an enforcement partnership between the OSC, the RCMP's Financial Crime program and the OPP's Anti-Rackets Branch.

In 2014, we introduced no-contest settlements, a first for a Canadian securities regulator. Our program allows market participants to settle without admitting to wrongdoing if they meet strict eligibility requirements, including self-reporting the violation and compensating harmed investors.

To date, we have approved five no-contest settlements, resulting in approximately \$200 million being returned to investors. And that investor compensation not only covers losses, but opportunity costs as well.

This summer, we launched our Office of the Whistleblower, the first paid whistleblower program by a Canadian securities regulator. This is a game-changer in Canada. We're offering compensation of up to \$5 million to whistleblowers who come forward with information about significant violations of Ontario securities law, such as insider trading, market manipulation, and serious accounting and disclosure violations.

The program has been fruitful right out of the gate.

I am pleased to report that we have already received more than 30 tips. People know about this Office and are coming to us. I am very encouraged by these early results. New enforcement tools like this will help us resolve issues much more quickly and effectively.

Innovation in regulation

I spoke earlier about disruption in the financial services industry. The rise of fintech has played a large role in this disruption. We have seen change on an ongoing basis, but now we are seeing something different.

In the past, the focus was on incumbent financial institutions adopting new technology. We are now seeing a wave of start-up firms that have niche technology-based products or services, and are seeking to compete directly or partner with existing financial institutions.

Consumer expectations are transforming as well. People want services that are fast, convenient and mobile. Delivering these services is a big departure from the traditional business models of in-person sales and paper-based client communications that our rules are based on.

Some of the new fintech businesses and platforms don't fit neatly into our regulatory framework. And some of our requirements may not make any sense in the context of their business. We recognize that we have to keep pace with the changes brought on by fintech and not prevent promising business models from coming to market. Our objectives of investor protection and fair and efficient markets are unchanged, but the approach we take needs to evolve.

That's why I am pleased to announce OSC LaunchPad, the first innovation hub by a Canadian securities regulator. This pilot project will be unveiled in a few weeks with a team dedicated to working directly with fintech companies to help them navigate our regulatory framework.

Over the past couple of years, we have worked with 40 firms that are registered or are seeking registration, including online advising, peer-to-peer lending, crowdfunding platforms and angel investor organizations. With OSC LaunchPad, we will work to tailor regulation and oversight to their unique business models, as long as investor protections are in place.

We invite firms to come to us with their business proposals. Based on our experience so far, fintech companies often “don’t know what they don’t know” about operating in a regulated industry, and that can threaten their ability to launch their business model. For example, many of these companies start out as IT solution providers and are not aware of investor protections that need to be in place. In order to succeed, they need to work with securities experts from day one.

We encourage entrepreneurs to get in touch with us early, even in the idea phase. What we learn in LaunchPad will be applied to our registration model and compliance expectations for all registrants as we go forward.

Regulatory burden

While we want to support innovation in the capital markets, we are also committed to supporting all market participants in meeting their regulatory obligations.

The “tsunami of regulation” that hit the global financial sector after the financial crisis was intended to address regulatory concerns, such as systemic risk. But it also created the potential for excessive regulation and negative impacts on companies and economies.

Given the size of the Ontario Securities Act, its rules and regulations, there’s no question there is a compliance burden. When considering new regulations, we are cognizant of the need to remove as much as we add. The challenge is to craft regulation that doesn’t get in the way of business and still protects investors.

We are committed to re-examining our rules to ensure they are appropriate, necessary and relevant. In short, we are looking to reduce regulatory burden, where possible. This means finding opportunities to streamline requirements for market participants—as long as investors are protected.

We have already implemented significant reforms in the exempt market to increase access to capital. And we've taken steps to make capital raising easier in the public market by streamlining requirements for venture issuers and providing more flexibility in public offerings.

But we can do more. Together with the CSA, we are looking to streamline disclosure requirements, eliminate duplication and improve the public offering process.

This work is a priority, and we intend to consult with industry on it. The CSA will publish a Staff Notice in early 2017 describing the areas we are studying and we will invite comments.

As long as appropriate safeguards for investors are in place, we believe our markets are better able to compete, innovate and flourish under streamlined requirements. Work with us on this to help us help you.

Women on boards

Lastly, I couldn't leave the podium without talking about women on boards. I want to update you on our efforts to improve the representation of women in corporate leadership roles, specifically in the boardroom and the executive suite. Tomorrow, we will be releasing the results of our second review since our "comply or explain" disclosure requirements came into effect for TSX-listed companies in late 2014.

I am pleased to report that we are seeing progress and some encouraging trends. A key finding is that companies that have policies or targets in place have a higher percentage of women on their boards. That makes common sense. Companies that commit to a greater representation of women are making progress. And why? Because what gets measured gets done.

Other changes we're seeing are incremental. For example:

- The number of women on boards has increased in all size categories of issuers, with large issuers still leading the way.
- Fifty-five per cent of issuers have at least one woman on their board, up six per cent from last year.
- Twenty-four per cent of boards have two or more women, up from 21 per cent last year.
- Twelve per cent of all board seats are occupied by women, only up by one per cent from 11 per cent last year. This translates into an increase of 47 board seats occupied by women out of more than 5,200 board seats in total.

But, we are also seeing some results that are confounding. This year, the OSC looked at board vacancies and how they are being filled. The results here were disappointing. Of the 521 board seats vacated¹ last year, just 15 per cent (or 76 seats) were filled by women. The remaining eighty-five per cent of seats were filled by a man, left vacant or eliminated. Without an improvement here, we will never reach 30 per cent female board representation.

Board turnover is the time when companies can provide leadership to get serious about increasing gender diversity. The people in this room are corporate Canada. You are the people who are making the choices. We are asking you to make a difference and make gender diversity a priority on your board.

¹ Vacancies factor in all board changes, including vacancies not filled.

Conclusion

There is no doubt that the changes we've seen in the financial services industry over the past 10 years have been transformative. Everything and every business in this sector has been challenged.

The capital markets are a vital and fundamental part of our economy. Technology will continue to challenge the role of intermediaries. In particular, there will be pressure on existing firms to demonstrate the value they add for their clients. Consumers increasingly expect to access financial services when they want and how they want. And not everyone will be ready for, or want, a totally digital experience.

What worked in the past, does not work today. It will take leadership from all of us—regulators and the industry—working together to foster an environment that is competitive and attractive for Ontario's businesses and investors.

Thank you.

-30-