

Chapter 6

Request for Comments

6.1.1 OSC Notice 11-762 (Revised) – Request for Comments Regarding Statement of Priorities for Fiscal Year Ending March 31, 2010

REQUEST FOR COMMENTS REGARDING STATEMENT OF PRIORITIES FOR FISCAL YEAR ENDING MARCH 31, 2010

The *Securities Act* requires the Commission to deliver to the Minister and publish in its Bulletin by June 30 of each year a statement of the Chairman setting out the proposed priorities of the Commission for its current fiscal year in connection with the administration of the Act, the regulations and rules, together with a summary of the reasons for the adoption of the priorities.

In an effort to obtain feedback and specific advice on our proposed objectives and initiatives, the Commission is publishing a draft Statement of Priorities which follows this Request for Comments. The Commission will consider the feedback, and make any necessary revisions prior to finalizing and publishing its 2009/2010 Statement of Priorities.

The Statement of Priorities, once approved by the Minister, will serve as the guide for the Commission's ongoing operations. At that time we will also publish a report on our progress against our 2008/2009 Priorities on our website.

Comments

Interested parties are invited to make written submissions by June 1, 2009 to:

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May 1, 2009

ONTARIO SECURITIES COMMISSION
2009-2010
STATEMENT OF PRIORITIES

JUNE 2009

Introduction

The *Securities Act* requires the Ontario Securities Commission (OSC) to publish in its Bulletin and to deliver to the Minister by June 30 of each year a statement by the Chair setting out the proposed priorities for the Commission for the current financial year. The OSC remains committed to delivering its regulatory services in a businesslike manner and to working closely with its colleagues within the Canadian Securities Administrators (CSA) and with market participants to ensure that the regulatory system remains relevant to the changing marketplace.

Our Vision

To be an effective and responsive securities regulator – fostering a culture of integrity and compliance and instilling investor confidence in the capital markets.

Our Mandate

The OSC's mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. The mandate is set by statute.

Our Goals

The Statement of Priorities is an annual document required under the *Securities Act*. To meet its mandate, in 2007 the Commission identified four strategic goals over the five-year period ending in 2012. This year's Statement of Priorities sets out the Commission's strategic goals along with specific initiatives for the 2009-10 fiscal year in support of each of those goals:

1. Identify the important issues and deal with them in a timely way;
2. Deliver fair, vigorous and timely enforcement and compliance programs;
3. Champion investor protection, especially for retail investors; and
4. Support and promote a more flexible, efficient and accountable organization.

Our Environment

In furtherance of our mandate, we face the following key challenges to:

- pursue specific initiatives that demonstrate our commitment both to protect investors from fraud and misleading sales practices and to incorporate their views in the development of regulatory changes;
- integrate a macroprudential dimension into our regulatory framework while operating effectively in a rapidly evolving regulatory environment;
- understand the long term impacts of market changes;
- focus on compliance as an integral part of ongoing regulatory enforcement; and
- develop strategic performance benchmarks against which to assess progress in achieving our dual mandate and our strategic goals.

Focus on Investors

Investor protection is a critical element of our two part mandate. We recognize that to serve the interests of all investors, especially retail investors, it is important to obtain their input on matters related to securities regulation. We also believe that informed investors are better equipped to protect themselves and to help regulators protect them. Therefore, we will continue to review our internal processes for adequately addressing investor concerns during the development of securities regulation.

Focus on the Macprudential Regulatory Framework

Recent market events highlight the potential adverse outcomes that can result from regulatory coverage focused on specific industry segments or entities rather than financial markets as a whole. An assumption that 'regulation' is sufficient when each regulatory agency applies its rules to its constituents, however, fails to recognize the interconnectedness of our financial markets. We need to examine opportunities to better align our disclosure regime and compliance and enforcement approaches internally, in concert with recognized self-regulatory organizations (SROs) and other entities, as well as more broadly to improve the ability of the regulatory system to recognize and address risks that emerge as a consequence of the convergence of financial markets and products.

Focus on Market Developments

Capital markets are evolving at rates that often exceed the ability of both market participants and regulators to fully appreciate the consequences of these changes. Innovative financial instruments can be misunderstood by both institutional as well as retail investors and result in adverse impacts upon market efficiency and investor confidence.

The emergence of multiple marketplaces can bring benefits from increased competition but is also accompanied by increased costs associated with fragmentation. To address these risks we need to examine how we currently regulate different marketplaces and whether changes should be made to the regulatory framework for exchanges and alternative trading systems. We need to clearly understand the impacts of our regulation, especially any unintended consequences to market stability or efficiency, and how our actions support investor protection.

Focus on Compliance

Financial markets in Canada and around the world are going through an unprecedented period of turmoil. Neither market participants nor regulators are insulated from the economic realities of the market place. During economic downturns, cost management programs in the securities industry tend to focus first on non-revenue generating activities; typically back office functions, including compliance and internal control systems. As a result, we need to apply our own resources in the interests of investor protection. Increased reliance on risk assessment tools for allocating our resources most effectively will be part of the solution. We will continue to focus on things that really matter. At the same time we will continue to actively encourage market participants to be vigilant and proactive in preventing, detecting and correcting compliance issues as they have primary responsibility for compliance and control systems.

Strategic Performance Measurement

The OSC's focus on accountability has included establishing, monitoring and reporting on effective use of our resources in managing various aspects of securities regulation. We recognize the importance of delivering our services as effectively and efficiently as possible. Consequently, we are in the process of upgrading our performance measurement programs beyond our traditional activity measures and service delivery parameters to include assessments of the outcomes against our strategic goals. We will work to identify and establish suitable measures for which reliable and appropriate data is available and develop performance benchmarks to enhance both our operational transparency and our accountability framework.

GOAL 1 – Identify the important issues and deal with them in a timely way.

Our goal is to deal with today's concerns, while anticipating tomorrow's challenges. We want to be a strategic leader in fulfilling our mandate to Ontario investors and the Ontario marketplace. We will:

- Consult and collaborate with investors, issuers, intermediaries, other industry participants and professionals to identify important issues;
- Identify trends and emerging issues, and develop solutions to address them efficiently and effectively;
- Work with the Government of Ontario, other securities regulators and market participants to strengthen the Canadian securities regulatory system. We will support efforts to move towards a common securities regulator. We will also continue to further harmonize, streamline and modernize securities laws and ease the regulatory burden on market participants;
- Continue to examine alternative securities regulatory approaches that provide a balanced regulatory approach and adopt best regulatory practices from other Canadian and international jurisdictions to support Ontario markets and investors. We will work to enhance the global competitiveness of our capital markets as well as foster co-operative relationships with securities and other regulators;

- Use the full range of tools available to achieve our mandate, and assign priorities to all our work based on our strategic goals; and
- Ensure our priorities are communicated in a timely and effective manner.

Specific initiatives for 2009-10 include:

- Contribute to strengthening the registration regime by finalizing our proposals designed to harmonize, streamline and modernize current registration requirements, including:
 - (i) drafting National Instrument 31-103 *Registration Requirements*, its Companion Policy and accompanying Notice and comment summary/response document and consequential amendments to national registration system rules, exemption rules and other regulations;
 - (ii) supporting the Ministry in finalizing legislative amendments that would, if approved, support the new registration regime; and
 - (iii) finalizing and implementing the new registration regime, subject to the Minister approving National Instrument 31-103 *Registration Requirements*.
- Continue to work with other Canadian and international regulatory authorities to develop a proposed framework to improve the ability of the regulatory system to recognize and address risks that may emerge as a consequence of the interconnectedness of global financial markets;
- Manage the transition to International Financial Reporting Standards (IFRS) including:
 - (i) amending our rules (most notably National Instrument 52-107 *Acceptable Accounting Principles and Auditing Standards*), as well as our policies and notices, to eliminate references to the existing Canadian generally accepted accounting principles and include appropriate IFRS terms and references;
 - (ii) providing guidance for reporting issuers on disclosure expectations in the periods leading up to adoption of IFRS; and
 - (iii) providing training to OSC and CSA staff to develop a high level of technical competency in IFRS.
- Continue to address issues related to asset backed commercial paper (ABCP) and develop proposals for a regulatory regime for credit rating agencies by:
 - (i) completing our review of comments on the ABCP consultation paper of the Canadian Securities Administrators (CSA);
 - (ii) proposing legislative rule-making amendments, drafting a proposed rule on credit agency regulation, and subject to receipt of rule-making authority, publishing the proposed rule for comment;
 - (iii) amending NI 45-106 - *Prospectus and Registration Exemptions* to reflect the final recommendations of the CSA's working group and publish for comment.
- Support IOSCO Task Force initiatives relating to the G20 Action Plan; and
- Complete consultations with the industry with respect to implementing a trade-through rule to improve market efficiency.

GOAL 2 – Deliver fair, vigorous and timely enforcement and compliance programs.

Timely and appropriate compliance and enforcement are integral to fostering confidence in capital markets and preventing harm to investors. We will:

- Continue our focus on compliance reviews of market participants to identify and prevent violations of Ontario securities law and ensure effective coordination among OSC branches in addressing improper market conduct;

- Identify gaps in the enforcement framework and co-operate with other regulators and agencies to find practical solutions;
- Improve the effectiveness of our enforcement work by completing investigations and bringing regulatory proceedings forward in a timely manner;
- Provide leadership and assistance to improve collaboration among Canadian and international regulatory agencies and criminal law enforcement agencies;
- Foster inter-jurisdictional co-operation to improve the coordination of investigative efforts, enforcement, and legal tools for enforcement; and
- Increase transparency through timely and effective communications of enforcement actions where warranted.

Specific initiatives for 2009-10 include:

- Refine our enforcement case selection and management processes to better identify activities seen as posing the greatest risks to investors and their confidence in the capital markets, and focus enforcement resources on those matters;
- Leverage our enforcement resources by promoting greater use of our existing systems and examining potential new tools, techniques and methodologies;
- Focus compliance efforts on new and high-risk market participants; and
- Execute focussed on-site compliance reviews of a representative sample of hedge fund managers.

GOAL 3 – Champion investor protection, especially for retail investors.

The interests and needs of investors, particularly retail investors, will continue to be strongly reflected in all the OSC's operations. In addition to our enforcement activities, investor education and awareness and timely access to accurate information are important components of investor protection. We will:

- Continue to reflect investor interests in all that we do;
- Continue to support investor education initiatives;
- Continue to support plain-language investor communication initiatives;
- Work with the self-regulatory organizations (SROs) to improve investor access to timely and affordable means of complaint handling and redress. This includes improving investor awareness of, and access to, existing mechanisms for resolution of complaints and restitution, such as those offered by the Ombudsman for Banking Services and Investments (OBSI);
- Work with the SROs and lead or support initiatives that recognize the importance of the adviser to the retail investor, and strengthen and improve the adviser/retail investor relationship;
- Communicate our understanding of and commitment to investor protection;
- Increase and enhance targeted outreach efforts to investors; and
- Increase the involvement of other industry groups, such as SROs, through collaboration and information exchange.

Specific initiatives for 2009-10 include:

- Expand internal capabilities and sensitivities to investor issues, particularly those of the retail investor, by:
 - (i) Establishing an Investor Secretariat to be a coordinating body within the OSC to better identify and address issues of interest and concern to investors, especially retail investors;
 - (ii) Continuing to work with the other members of the Joint Standing Committee on Retail Investor Issues to coordinate investor-related initiatives and to engage retail investors in the regulatory process;

- (iii) Exploring opportunities to gather feedback from investors on OSC regulatory initiatives;
 - (iv) Enhancing investor outreach programs by supporting the Investor Education Fund and other channels; and
 - (v) Collaborating with the CSA Investor Education Committee to distribute investor education materials in a consistent and timely manner;
- Develop proposals to modernize investment fund rules in order to achieve more consistent, fair and functional regulation of all investment funds and reduce the number of exemption applications;
 - Publish for comment proposals designed to modernize the rules governing scholarship plan operations and enhance the disclosure provided to scholarship plan holders;
 - Publishing for comment rules for point-of-sale disclosure for mutual funds and segregated funds that would require clear, concise and plain-language product and sales fee disclosure for investors; and
 - Continue to improve processes for investor complaint handling by the Investor Assistance section of the OSC Inquiries & Contact Centre so that issues are dealt with efficiently and effectively.

GOAL 4 – Support and promote a more flexible, efficient and accountable organization.

The OSC's strength is its people. We will make the best use of all our resources, including people, technology, research and financial, to achieve timely and effective execution of all that we do. We expect OSC Commissioners and employees to maintain the highest standards of conduct and personal integrity and to deal openly and fairly with all of our stakeholders. We will continue to constantly improve our business competence and effectiveness. We will:

- Continuously monitor and improve the efficiency and effectiveness of our operations;
- Be responsive and flexible as an organization and treat all stakeholders with respect and fairness;
- Identify skills requirements and ensure that we attract, retain and motivate staff who possess the required skills, and continue improving and enhancing our succession plans;
- Leverage information technology effectively to support our operations and optimize our electronic interface with our stakeholders;
- Secure the most appropriate resources and justify their acquisition through cost- benefit analyses and similar tools;
- Increase the knowledge management and risk analysis capabilities of the OSC; and
- Supplement OSC staff resources with external resources where appropriate.

Specific initiatives for 2009-10 include:

- Improve regulatory accountability by further refining our measurement and reporting culture (including identifying, designing and/or developing measures) to ensure that we continue to be aligned with the priorities of the Commission as well as those of market participants and investors;
- Accelerate the adoption of an internally consistent approach to risk based regulation;
- Develop an enterprise risk management framework; and
- Continue implementation of our IT Strategic Plan including:
 - (i) improving and integrating branch tools and systems;
 - (ii) completing the first implementation phase of our document management system; and
 - (iii) improving reporting tools for branch/information analysis for management.

2009-10 Financial Outlook

OSC Revenues and Surplus

The economic environment is expected to continue to have a material impact on our revenues and expenses. As an organization we strive to operate on a cost recovery basis. Capital market participants fund our operations through fees they pay. Our aim is to have our revenues equal our costs. This is difficult because while our revenues fluctuate in proportion to market activity, most of our costs are relatively fixed.

Variability of our revenues has been the key source of our surpluses. Our fee rates were last set in April 2006. At that time we projected revenues of \$181.4 million for the three fiscal years ending March 31, 2009. Actual revenues for the three fiscal years were \$217.8 million, \$36.4 million or 20.1% above those forecast in 2006. This was due to higher than anticipated growth in the financial markets.

Actual expenses for the same period were \$221.0 million, \$0.4 million or 0.2% above our forecast of \$220.6 million. This resulted in a surplus for the period, as at March 31, 2009, of \$46.8 million.

On October 3, 2008, we published proposed fee rules for public comment. Since publishing the draft rule, the economic situation in Ontario and around the world worsened. Following a careful review of the comments from respondents, and in light of current market conditions, on March 12, 2009 we announced our decision to maintain participation fees and activity fees at current rates for one year. As a result, fee rates are not at levels sufficient to recover our costs for fiscal 2010 and we project a revenue shortfall of \$22.0 million over the next fiscal year. We plan to use our surplus to offset this deficit.

Over the next year, the OSC will further review issues related to the fee model so we can return to fully recovering our costs in ways that remain fair and transparent to market participants. We are committed to maintaining fees at current levels for the year ending March 31, 2010. Future increases to fee rates will need to be sufficient to fully recover the Commission's costs of operations, and market participants should anticipate future increases.

OSC 2009-2010 Budget Approach

The current economic environment presents a range of risks to investors and our capital markets. Our budget priorities reflect our assessment of these risks and their potential impacts. These challenging economic conditions continue to generate significant pressures for those that we regulate as well as increased demands on our own operations. Immediate issues include:

- Volume and complexity of continuous disclosure work is increasing as issuers struggle with disclosure in the current financial environment. The importance of disclosures related to going concern, pension liabilities, fair valuation, leverage and other disclosures are all magnified during downturns;
- Potential strains arising due to recent adverse market conditions may distract market participants from focusing on compliance requirements;
- Pressures for changes to the regulation of certain products including derivatives and commodities, and certain activities such as rating agencies, commodities and short selling as well as greater needs for coordinated on-site compliance reviews (e.g. money market fund and non-conventional fund sweeps); and
- Market participants, in attempting to deal with the fallout from the market turmoil, may test regulatory and policy boundaries by creating novel products and/or requesting novel exemptive relief.

Downturns have historically exposed questionable practices and occur often at times when investors can be most vulnerable. Potential poor financial health of issuers and registrants pose major, if unquantifiable, compliance and enforcement risks. In developing our 2009-2010 budget the Commission has carefully balanced the need for cost restraint in these challenging times with its duty to take appropriate steps as necessary to pursue its mandate of providing protection to investors and fostering fair and efficient capital markets. Our budget (net of recoveries) will increase by \$4.0 million or 4.9% over 2008/09 spending. The ability to limit the increase to this level was the result of an increased focus on internal efficiencies and controllable cost areas. In particular, we held our average salary increases to 1.6% and have virtually frozen our headcount at current levels.

2010 Budget versus 2009 Actual

<i>(\$\$\$ Thousands)</i>	2008/2009		2009/2010	\$\$\$ Change	% Change
	Forecast	Actual	Budget		
Revenues	68,500		61,900	(6,600)	-9.6%
Expenses	<u>80,939</u>		<u>84,904</u>	<u>3,965</u>	4.9%
Deficiency of Revenue over Expenses (before recoveries)	(12,439)		(23,004)	(10,565)	
Recoveries	<u>2,830</u>		<u>1,000</u>	<u>(1,830)</u>	-64.7%
Deficiency of Revenue over Expenses	(9,609)		(22,004)	(12,395)	
Capital Expenditures	5,238		1,758	(3,480)	-66.4%

Salaries and benefits, which comprise \$63.3 million or 74.6% of the budget reflect an increase of \$2.1 million or 3.5%. Most of the increase in salaries and benefits cost reflects prior staffing decisions including the full year costs for staff hired during 2008/09, the planned filling of previously approved positions and the impact of performance-based salary increases. Salaries and benefits is the only area of expenditure that exceeds 10% of expenses. Increased staff costs are partially offset by a \$830,000 or 17.2% reduction in professional services costs. Amortization costs for 2009/10 will be \$1.6 million higher. This non-cash cost explains about 40% of our total budget increase. Our actual spending in 2008/09 was reduced significantly due to recovery of \$2.8 million in costs through enforcement settlements. These amounts were about \$1.8 million higher than the average for the previous five years.

The decrease of \$3.5 million or 66.4% in the capital budget is due to the completion of the expansion and renovation of our premises in 2008/09. The resulting increase in our capital base has generated the increase in our amortization cost noted above.