

April 7, 2010

LEGISLATIVE REPORT HIGHLIGHTS “PUBLIC INTEREST” MANDATE OF OSC - Committee calls for reassessment of the role of OSC in investor protection

The Ontario Legislative Assembly’s Standing Committee on Government Agencies (the “Committee”) released a 37-page report ([the “Report”](#)) on the Ontario Securities Commission, based on its review of the OSC in late 2008 and early 2009.

The Report provides an insightful analysis into the role of the securities commission and key investor protection issues. While the Report is being published a number of months later than expected, it was well worth the wait. **We encourage everyone with an interest in securities regulation and investor protection in Canada to read the Report.**

The OSC made presentations to the Committee on [December 2, 2008](#) and [February 23, 2009](#). Stakeholders presentations were made on [February 23, 2009](#) and the OSC returned on [April 7, 2009](#) to respond to the presentations. FAIR Canada filed a [submission](#) with the Committee and made a presentation.

Public Interest Jurisdiction and Accountability

The Report acknowledged steps taken by the OSC in response to the financial crisis, but was critical of its low visibility in protecting investor rights, including in the ABCP crisis.

In considering this very complex issue, it is obviously not the role of this Committee to second-guess decisions relating to the technical aspects of the securities regulation...

More generally, however, we believe it is appropriate to comment on the Commission’s general mandate to protect the public interest. In particular, we believe it is important that the agency charged with protecting the public interest be seen to be taking a leadership role when there is a major disturbance in the markets that threatens the interests of retail investors. In this respect, we have some concern that the Commission may have adopted a narrow interpretation of its public interest jurisdiction in responding to the ABCP crisis. (Page 10 of Report)

In its first recommendation, the Committee called on the OSC to “reassess the way in which it exercises its public interest jurisdiction, with a view to improving the Commission’s effectiveness and accountability.” The second recommendation called on

the Ontario Ministry of Finance to review the statutory scope of the OSC's public interest jurisdiction. The Committee also called for more effective parliamentary oversight of the OSC.

Retail Investor Input

In a section entitled "Investor Protection", the Committee agreed with FAIR Canada and other investor advocates that the OSC should: (a) establish an investor advisory body along the lines of the U.K. Financial Services Consumer Panel, and (b) to appoint a commissioner who would bring a better understanding of the retail investor perspective to the OSC's Board of Directors.

The Committee agreed with the FAIR Canada submission that the appointment of a commissioner with a greater understanding of retail investor issues would not conflict with the OSC charter and was no different than the OSC reserving a position on the Commission's board for an individual from a listed company.

(Note: The OSC announced its decision to create an [Investor Advisory Panel](#) on February 26, 2010.)

Investor Protection and Enforcement Recommendations

Other Committee investor protection recommendations included:

1. tightening credit rating agency regulation;
2. barring sales of ABCP and complex debt products to retail investors except by prospectus;
3. placing restrictions on the way in which complex debt products are sold to retail investors;
4. granting the OSC statutory power to make restitution; and
5. establishing an industry-wide compensation fund.

The Committee also made recommendations to bolster enforcement:

1. creating a dedicated capital markets crime unit with specialized staff to investigate and prosecute criminal misconduct in capital markets; and
2. implementing legislative amendments to strengthen the legal basis of regulatory enforcement.

Self Regulation

The Report quotes extensively from FAIR Canada's submission to the Committee. In two sections relating to improving the performance of Self-Regulatory Organizations and addressing concerns about conflicts of interest at the TSX, sections from FAIR Canada Executive Director's testimony were quoted verbatim. With respect to the TSX conflict of interest concern, the Report called on the OSC to "review the potential for conflicts of interest between the

regulatory and commercial functions at the TSX and [that it] take the steps necessary to address any problems indentified.”

The Report also endorsed the creation of a national securities regulator.

Re-thinking Role of Securities Regulators

The Committee’s Report is a unanimous, non partisan call to rethink the OSC’s role as a regulator charged with responsibility for investor protection. A reassessment of the role of the regulator in protecting investors and the public interest is overdue.

The OSC has [announced](#) that it will carefully study the recommendations in the Report. Investors look forward to hearing the response of the Honourable Dwight Duncan, Minister of Finance, and the Commission to the Committee’s thoughtful recommendations.

Editorial Comment: Regulators Must Go Beyond Disclosure

Regulators in leading developed countries are actively re-examining their role in investor protection and deciding that they must take a more substantive and proactive role in protecting investors. (See FAIR Canada’s note entitled [Putting Client’s Best Interests First](#) which discusses developments in the US and UK where regulators are rethinking the financial-advisor/client relationship and the role of regulators.)

It is not enough for regulators to point to complex legalistic disclosure in a prospectus or other document and shift responsibility onto unsophisticated investors to protect themselves. Regulators reliance on disclosure to protect retail investors is increasingly being seen as too narrow an interpretation of its mandate. Disclosure may work well in the context of listed companies whose documents are carefully examined by analysts and other professionals who translate the complex financial and legalistic language for the market. However, even here the disclosure paradigm has been questioned in light of the recent financial crisis, Enron and similar failures of the last decade.

Disclosure in lengthy, complex and legalistic documents provided to retail investors is not an effective mechanism for investor protection, particularly when retail investors are dealing with sophisticated industry professional “advisors” intent on selling product to clients rather than putting their client interests first. While plain language disclosure is an important and necessary part of investor protection, disclosure alone is inadequate. It is highly doubtful that retail investors would have had any better understanding of the risks if ABCP had been sold by prospectus. Financial products (such as structured products, [SPACs](#), [CFDs](#), [leveraged ETFs](#) and leveraged forex) are often very high risk and have become too complex to simply place reliance on disclosure. Some high risk complex financial products should simply not be permitted to be sold to all retail investors without regard to their level of financial sophistication.