

# INVESTOR ADVISORY PANEL

April 27, 2018

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*By Email*

Dear Mr. Day,

## **Re: IAP Response to OSC Draft Statement of Priorities for 2018-2019**

The members of the Investor Advisory Panel (IAP) welcome this opportunity to respond to the Ontario Securities Commission Notice 11-780 – *Statement of Priorities* for 2018-2019. The IAP is an initiative of the Ontario Securities Commission (OSC) to enable investor concerns and voices to be represented in its rule and policy making process.

We regard the Statement of Priorities (SoP) as a well-conceived, thoughtful and aspirational document. It sets out a balanced agenda that identifies key areas of focus and many worthwhile initiatives. We are particularly pleased to see the emphasis on investor protection in commitments for reforming titles and proficiency requirements, maintaining support for the Investor Office, implementing a Seniors Strategy aimed at reducing financial exploitation of the elderly, offering educational outreach for new Canadians, and assuming oversight of syndicated mortgages.

We cannot, however, ignore the fact that many of the most important investor-protection initiatives have remained unfinished items on the OSC's list of priorities for years while several market-focused or industry-centred initiatives (for instance, crowdfunding, exempt market expansion, no-contest settlements, gender parity on boards) have received fast-track treatment through the OSC's policy process. Based on commentary in the draft SoP, we fear this state of affairs is going to continue as few, if any, of the investor-protection initiatives are slated to be brought to completion in 2018-2019.

We are concerned that the persistently slow pace of investor protection initiatives may reflect badly on the OSC and could breed public cynicism about market regulation. The OSC can, and should, address this problem in the coming year by translating more of its priorities into actionable proposals. Accordingly, our submission identifies a number of priority items that we believe the OSC should pursue more vigorously than proposed in the draft SoP.

## **Best Interest Standard and Targeted Reforms**

We applaud the OSC's decision to move forward on adopting a best interest standard by publishing proposed regulatory provisions creating that standard.

This vitally important initiative has, in our view, been thoroughly researched, reviewed and discussed. Forward progress requires translating all of that into something concrete. Therefore, we encourage OSC staff to publish a fully-formed rule together with detailed guidance, rather than just a conceptual or exploratory proposal.

We also support the OSC's plan to embed a new client/advisor standard in the targeted reforms under NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*, on the understanding that this new client/advisor standard (in Ontario at least) will incorporate the principles of a best interest standard.

It must be kept in mind, however, that incorporating best interest principles in the targeted reforms is not a substitute for adopting an overarching best interest rule. Such a rule is necessary to provide foundational clarity and interpretive guidance to fill the gaps that inevitably will arise in situations not envisioned or anticipated by the targeted reforms' specific provisions.

### **Embedded Commissions**

The IAP does not support holding more consultation on how to mitigate the harm caused by embedded commissions. The negative impact of embedded commissions – both on investors and on market efficiency – has been clearly and comprehensively documented. All the mitigation options have been canvassed extensively in submissions, media articles and public forums; and those opposed to the options have fully pressed their case that “unintended consequences” may flow from them.

We have reached the point where nothing new is being said or remains to be said on this subject.

The time has come, therefore, for the OSC, along with other CSA members, to bring closure to this debate. We encourage regulators to get on with the task of eliminating embedded commissions, notwithstanding the adjustments to existing business models this will precipitate. These business models are already being redesigned (in response to disruptive effects of fintech, robo-advisers and ETFs), so now is actually an opportune moment for incorporating changes necessary to provide fundamental investor protection.

The investment industry is dynamic and fully capable of adapting to these changes. What it cannot adapt to, however, is uncertainty perpetuated by regulatory indecision.

### **OBSI and Compensation for Harmed Investors**

We support the OSC's stated intention to work with its Joint Regulators Committee (JRC) colleagues on strengthening the Ombudsman for Banking Services and Investments (OBSI). A meaningful response to the recommendations contained in the 2016 Independent Evaluator's report is long overdue and should remain a high priority for the OSC. Several of the recommendations warrant implementation but there is an urgent need for effective measures to address lowballing – a practice that leaves nearly one-fifth of wronged claimants with significantly less compensation than OBSI deems fair. Lowballing seriously undermines the credibility of OBSI's dispute resolution process.

As the Independent Evaluator's report noted, the key to strengthening OBSI lies in giving it the ability to make compensation orders binding on member firms. We urge the OSC to formulate and publicly champion a specific proposal to make OBSI a fully functional ombudservice with binding decision-making authority.

Pending adoption of such a proposal, we suggest that the OSC take steps to reinforce Joint CSA Staff Notice 31-351, IROC Notice 17-0229, MFDA Bulletin #0736-M - *Complying with requirements regarding the Ombudsman for Banking Services and Investments* by directing the OSC's Compliance and Registrant Regulation Branch to regard any firm as presumptively acting unfairly and in bad faith if they pay compensation substantially below the amount recommended by OBSI, and by directing that a fitness for registration hearing be conducted in all such cases.

We also encourage the OSC to utilize its own powers to make compensation orders more often – indeed, whenever possible. These orders bring tremendous efficiency to the process of redressing investor harm by obviating the need for parallel civil proceedings and by leveraging the OSC's knowledge and expertise regarding industry standards, loss causation and loss quantification.

It is important to ensure, however, that the OSC's orders fully compensate investors for the harm they have suffered. Care should be taken to assess this in detail in all cases – especially those where respondents seek benefits of the “no-admission” program on the basis that compensation has been paid or will be paid – and this assessment process should be transparent in order to provide public accountability.

### **Continuous Disclosure**

In line with the commitment to improve the efficiency and effectiveness of its compliance, supervision and enforcement processes, we encourage the OSC to focus specifically on the high rate of deficiency in issuer continuous disclosure. Annual reports from the Canadian Securities Administrators over the past eight years have documented a disturbing and deteriorating trend in this area. That trend needs to be reversed through more stringent enforcement, since guidance has not proved to be sufficiently effective.

We also urge the OSC to address the proliferating use of potentially misleading non-GAAP metrics in issuer disclosure.

### **Deterring Fraud**

More robust efforts to collect fines may discourage non-compliance by registrants, but it will not deter securities fraud. Only the likelihood of arrest, prosecution and imprisonment can accomplish that. Accordingly, we encourage the OSC to be both more aggressive and highly consistent in pursuing criminal prosecutions and seeking substantial prison sentences for securities fraud. We also urge the OSC to underscore its commitment to this approach by demonstrating openly that meaningful financial and personnel resources are being directed at identifying, apprehending and prosecuting fraudsters.

## **Evaluating Effectiveness of Disclosure-Based Initiatives**

We agree that the OSC should prioritize an evaluation of the effectiveness of the CRM2 and Point-of-Sale initiatives. This evaluation should not be framed, however, as a cost-benefit analysis. Instead, it should be part of a broader examination of the efficacy of disclosure-based initiatives as an investor protection technique (i.e., does disclosure actually work to protect retail investors?). We consider this approach to be consistent with the OSC's stated priority of adopting an evidence-based approach to policymaking that draws on insights from behavioural research.

We recognize that the Investor Office and other branches of the OSC contribute significantly to research used in formulating policy, but we also feel that the OSC's evidence-based approach could be significantly enhanced through investments in independent research. The IAP would be pleased to explore this further with OSC management and staff.

We thank the OSC for this opportunity to comment on its draft Statement of Priorities for 2018-2019, and we look forward to continued dialogue on how it can best advance its investor-protection initiatives.

Sincerely,

***"Letty Dewar"***

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Letty Dewar  
Chair, Investor Advisory Panel