

REQUEST FOR COMMENTS
REGARDING STATEMENT OF PRIORITIES
FOR FISCAL YEAR ENDING MARCH 31, 2003

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 the proposed objectives and initiatives, the Commission is publishing a draft of the 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 2002/2003 Statement of Priorities.

The Statement of Priorities, once approved by the Minister of Finance, will serve as the guide for the Commission's ongoing operations.

Comments

Interested parties are invited to make written submissions by June 3, 2002 to:

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THE ONTARIO SECURITIES COMMISSION

STATEMENT OF PRIORITIES FOR FISCAL 2002/2003

Request For Comments

Introduction

The *Securities Act* requires the Ontario Securities Commission (OSC) to deliver to the Minister, and to publish in its Bulletin by June 30 of each year, a statement by the Chair setting out the proposed priorities for the Commission for its current financial year.

In the May 2, 2000 Ontario Budget, the Minister of Finance announced that the Ontario Securities Commission and the Financial Services Commission of Ontario (FSCO) will be merged to provide regulation of the capital markets and financial services sectors. The legislation required to create the proposed new organization and specify its regulatory responsibilities and powers is expected to be introduced during 2002. This merged entity will provide more integrated regulation of capital markets and financial services sectors and will provide strong consumer and investor protection and education across all financial sectors. It will also contribute to timely regulatory responses to the changing structures of the capital markets and financial services industries.

In a separate initiative, the OSC has set up a working group to advise the Commission on ways to restructure its activities to eliminate impediments to efficiency and reduce costs. The Commission remains committed to delivering its regulatory services in a businesslike manner and to working closely with its CSA colleagues and market participants to ensure that the regulatory system remains relevant to the changing marketplace. The 2002/2003 Statement of Priorities articulates the business strategy and priorities the Commission has set to accomplish these goals.

Business Strategy

Our Vision Canadian financial markets that are attractive to domestic and international investors, issuers and intermediaries because they are safe and cost efficient.

Our Mandate To provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity.

Our Approach We will be:

- Proactive, innovative and cost effective in carrying out our mandate,
- Rigorous and fair in applying the rules to the marketplace, and
- Timely, flexible and sensible in applying our regulatory powers to a rapidly changing marketplace.

Key Challenges

The OSC recognizes that it must address a number of key trends and changes affecting our business environment, capital markets, market participants and the global regulatory framework.

Global Integration of Markets and Market Participants

Financial markets are global. Borders no longer serve as barriers to capital flows. Those seeking to invest and those seeking capital go where they see the opportunity for the best returns for the risks assumed. As capital flows become global, so do the market intermediaries and infrastructure servicing the business. Many of the largest intermediaries are global conglomerates combining banking, insurance and securities services in one entity.

Changing Investor Demographics

The past decade has seen significant growth in the investor community in Canada. Institutional investors are becoming larger and more sophisticated, while investment in the markets by retail investors has grown explosively, both directly and through the purchase of investment funds. Both groups need to have confidence in the integrity of the capital markets, but their informational and educational needs may be very different.

Rapid Pace of Innovation

Competition is driving market innovation and the creation of ever more sophisticated financial products, trading techniques and strategies. Technology facilitates these changes, making innovative products and services easier and cheaper to design, market and deliver to the consumer. The functions of intermediaries are changing. Trades can be executed directly from any location. The emergence of direct links into existing trading platforms, bypassing investment dealers, and the proliferation of alternative marketplaces has fundamentally altered the structure of the financial environment.

What This Means for the OSC

For Canadian financial markets to be attractive to all market participants, they must be, and be seen to be, fair and efficient while maintaining protection for investors. Given the trends and challenges outlined above, the OSC needs to find creative and innovative solutions to new issues and be willing to re-evaluate existing practices in light of changing circumstances. In particular, we need to focus on:

- Making decisions at the pace at which our markets are changing,
- Building on our relationships in the regulatory community, both domestic and international, making use of the best lessons from each and relying on their expertise where practicable,
- Educating consumers so they can help protect themselves,
- Insisting that investors receive the understandable, accurate and complete disclosure they need to make informed investment decisions,
- Enforcing clear rules in a consistent and visible manner, and
- Facilitating the safe and efficient operation of exchanges, clearing and settlement functions and other elements of the market infrastructure.
- We need to be able to deliver efficient and effective regulation that is integrated seamlessly into the global market.

Our Goals

The OSC is committed to achieving our vision. To do so, we have developed a four-year strategic plan. In implementing it, we will at all times act consistently with our mandate.

Fundamentally, the OSC will focus on making our capital markets safer, more efficient and easier to access and use for market participants. Our plan calls for stepping up our efforts in the following areas:

- Promoting harmony and less overlap between regulators,
- Undertaking prevention-oriented activities, including proactive public education,
- Taking a risk-based approach to regulation, and
- Being less prescriptive where doing so promotes efficiency without undermining safety.

Across the planning horizon we will strive to achieve the following outcomes:

- 1. Ontario's capital markets and financial services regulatory system will be fully consolidated, harmonized nationally and coordinated internationally.**

We will continue the following key initiatives to achieve this outcome:

- a) Complete the CSA project to develop a proposed Uniform Securities Law,
- b) Develop legislative proposals to permit delegation of powers and duties among Canadian securities regulators and a comprehensive delegation model in support of it,
- c) Support implementation of the merger of the OSC and the FSCO,
- d) Participate actively in International Organization of Securities Commissions (IOSCO) and Council of Securities Regulators of the Americas (COSRA) initiatives and, where appropriate, provide leadership.
- e) With the Joint Forum of Financial Regulators (Joint Forum), develop and propose harmonized financial services regulatory solutions in the following areas:

- i) proficiency standards for financial intermediaries,
- ii) common licensing requirements,
- iii) capital accumulation plans, and
- iv) individual variable insurance contracts and mutual funds.

We will measure success in achieving this outcome by the following:

- Market participants will utilize one "window" to access the regulatory system in Canada.
- Regulatory impediments to market access will be minimized.

2. Regulatory interventions in Ontario will be timely, balanced and proportionate to the risks involved.

We will undertake the following key initiatives towards achieving this outcome:

- a) Initiate and foster initiatives which reduce the use of off shore trading to circumvent securities laws,
- b) Reduce inter-jurisdictional impediments to information sharing and enforcement support,
- c) Make appropriate changes to our practices as a result of the recommendations of the Regulatory Burden Task Force, and
- d) Work with the provincial government and our CSA colleagues to implement legislative changes that may be made as a result of the recommendations of the Five-Year Review Committee.

We will measure success in achieving this outcome by the following:

- It will be clear to investors, issuers and intermediaries that the benefits of regulation appreciably outweigh the costs of regulation.
- There will be numerous examples of the OSC fostering and implementing non-regulatory alternatives where such action is supported by a better cost/benefit relationship than new regulation.
- The effective cost and burden of regulation will be consistently below the average of our peers, but investor protection will not be undermined.
- Impediments to investigation and enforcement initiatives created by international boundaries will be substantially reduced as a result of increased harmonization of international disclosure laws and procedures.

3. Investors, issuers and other market participants who use the Ontario capital markets will be afforded access, protection, education and information at levels similar or superior to those of the best of our peer group.

We will undertake the following key initiatives towards achieving this outcome:

- a) Foster the implementation of the Industry Analyst's Standards Report (Setting Analyst Standards: Recommendations for the Supervision and Practice of Canadian Securities Industry Analysts) recommendations, where appropriate.
- b) Foster the implementation of the Saucier Report (Beyond Compliance: Building a Governance Culture) recommendations, where appropriate.
- c) Tailor the form and method of access to OSC communications to the needs of OSC constituents, including implementing predominantly electronic-based communications vehicles and redesigning the OSC Website.

We will measure success in achieving this outcome by the following:

- Domestic and international investor confidence in the integrity of the Ontario regime continues to improve.
- 100% of OSC communications will be accessible electronically by 2005.

2002/2003 Financial Outlook

The Commission revenue forecast for 2002/2003 is \$63.3 million, which is 19% lower than the \$78.2 million collected in 2001/2002. The Commission plans to implement a restructured fee schedule during 2002/2003, however, as the timing is uncertain no provision has been made in the forecast. The forecast includes an estimated impact of a further

proposed 10% fee decrease that will be presented to the Minister of Finance for approval during 2002/2003. The forecast also reflects a reduction in fee revenues due to an expected continued decline in market activity, particularly in the mutual funds sector. Registration revenue will also be lower as 2001/2002 revenues were artificially high due to partial implementation of uniform registration dates.

The Commission has budgeted total 2002/2003 operating expenditures of \$53.7 million, a 3.1% increase over the 2001/2002 budget. The key budget component is salaries and benefits costs, which are projected to rise by 9.7% to \$37.4 million. This increase primarily reflects the annualized cost impact of previous hiring. Total staffing is projected to reach 367 by March 2003. The budget includes a substantial reduction in professional services costs reflecting greater reliance on internal resources. The Commission has budgeted \$3.6 million for professional services costs in 2002/2003, a 38.4% decrease from the 2001/2002 budget.

Report on 2001/2002 Organizational Priorities

Operational priorities for 2001/2002 for each area have been established which will support achievement of the initiatives set out above as well as delivery of our ongoing regulatory services. A summary of the performance of the Commission in meeting the goals and priorities identified in the 2001/2002 Statement of Priorities is provided below.

1. Redefine Approaches to the Financial Regulatory Framework

Significant progress was achieved towards completing the reformulation of major OSC rules and policies. The following rules/policies came into force during 2001/2002:

41-502: Prospectus Requirements for Mutual Funds,
44-801: Implementing NI 44-101 Short Form Prospectus Distributions,
55-101: Exemption from Certain Insider Reporting Requirements,
45-101: Rights Offerings,
33-102: Regulation of Certain Registrant Activities,
51-601: Reporting Issuer Defaults,
33-105: Underwriting Conflicts,
11-715: Policy Reformulation Project - Table of Concordance,
11-601: The Securities Advisory Committee to the OSC
45-102: Resale,
45-501: Exempt Distributions,
57-603: Cease Trade Order Policy

The following rules/policies were published for comment during 2001/2002:

72-502: Continuous Disclosure and Other Exemptions Relating to Foreign Issuers,
33-109: Registration Information Requirements (under the Securities Act),
81-104: Commodity Pools,
62-501: Prohibited Transactions in Connection with Take-Over Bids,
51-101: Standards of Disclosure for Oil and Gas Activities (and Proposed Repeal of National Policy Statement No. 2-B and Proposed Consequential Amendments)
41-601: Capital Pool Companies
12-602: Deeming a Reporting Issuer in Ontario
46-201: National Escrow Policy

- ◆ Frequently Asked Questions on New Rules (FAQs): During the year FAQs were issued on NI 43-101 (Mining), 41-501 (Long Form Prospectuses), NI 44-101 (Short form prospectuses)
- ◆ Small Business Financing: The Exempt Distributions Rule 45-501 was amended to incorporate the recommendations of the Task Force on Small Business Financing. The regime includes two new registration and prospectus exemptions, the "accredited investor" and the "closely-held issuer" exemptions. A number of pre-existing exemptions were also removed.
- ◆ A Memorandum of Understanding regarding oversight of the Canadian Venture Exchange (CDNX) and a CDNX Exemption was completed in December.
- ◆ A survey of registrants was completed to quantify the estimated benefits of the National Registration Database project. Terms and conditions of registration were posted on the OSC Website. Implementation of the Registration Database has been delayed.

- ◆ In consultation with Ontario Ministry staff, it was decided that an interim conflicts of law measure should be achieved through the current Hague Conference on Private International Law process rather than through technical amendments to the *Ontario Business Corporations Act* or *Personal Property Security Act*. Staff have been very involved, as observers on behalf of IOSCO and through participation with the Canadian delegation led by the Federal Department of Justice, in the deliberations and drafting of the proposed convention. It is expected that a final draft will be presented for approval to a Diplomatic Conference of the Hague in December 2002.
- ◆ A draft Uniform Securities Transfer Act (USTA) was prepared and consequential amendments to the PPSA, to implement changes to Conflict of Law re: tiered holdings and T+1, have been drafted for consultation. Publication of a consultative draft USTA and CSA position paper is planned for September 2002.
- ◆ At year-end 2001, the Five Year Legislative Review Committee had completed its review and consultation process relating to the list of identified issues. Work on the draft report continued throughout this year to publish for comment in Summer 2002.
- ◆ The recommendations of the Analysts Standards Report have been analyzed and those requiring actions by the Commission are being addressed.
- ◆ The following rules were completed to address issues related to the growing usage of Alternative Trading Systems: 23-501 Designation as a Market Participant, 21-201 Marketplace Operations and 23-101 Trading Rules.
- ◆ The OSC, through its role as a member of the Joint Forum, supported the creation of a national Financial Services OmbudService. This new service, which is planned to be in place by July 1, 2002 will provide more than 95 per cent of Canada's financial services consumers with single-window access to recourse for concerns or complaints.
- ◆ On December 5, 2001, the Responsible Choices for Growth and Fiscal Responsibility Act (Budget Measures), 2001 received Royal Assent. This Act included amendments to the *Securities Act* which harmonize with the requirements of other Canadian securities regulators.

2. Strengthen the Compliance - Enforcement Continuum

- ◆ Compliance staff completed the development of the risk assessment model for market participants. The next phase of the risk assessment project is implementation. In order to implement the model, Compliance staff developed and distributed a questionnaire to gather information from market participants. Data will be collected by May 2002.
- ◆ The OSC Surveillance team has been fully staffed. The Intelligence database has been created and all documents have been scanned with key-coding continuing. Three matters have been referred to the Investigation Team as a result of matters reviewed by the Intelligence Analysts. Enforcement has seconded two investigators to joint criminal investigations involving organized crime groups in the Ontario capital markets. Several presentations have been made to various law enforcement agencies and market participants on the mandate of the new unit.
- ◆ The CSA has commenced quarterly status meetings with the Investment Dealers Association (IDA) to obtain updates on the IDA's regulatory activities and to discuss potential improvements.
- ◆ Memoranda of Understanding (MOU) with the IDA, Canadian Investor Protection Fund (CIPF) and for CSA oversight of RS Inc. were finalized. MOU's for oversight of exchanges and Quotation Trade Reporting Systems are expected to be completed by April.
- ◆ A joint CSA oversight program for the Mutual Fund Dealers Association (MFDA) is currently being drafted.
- ◆ The OSC is continuing to actively monitor MFDA membership status. Staff have received an application from the Mutual Fund Dealers Investment Protection Corp. for approval of an investor protection plan. Staff have drafted criteria for approval and are currently discussing potential issues with other CSA members.

3. Enhance the Quality of Continuous Disclosure by Reporting Issuers

- ◆ The reporting issuer Default list is now published on the OSC's Website (osc.gov.on.ca). The list is consistently in the top five "hits" on the Website.

- ◆ Additional staffing for the continuous disclosure team allowed almost twice as many reviews to be conducted during 2001/2002. The reviews of revenue recognition and interim reporting were completed and the continuous disclosure (CD) review program met its target of reviewing 20% of Ontario based reporting issuers.
- ◆ NP 51-201, which provides guidance on selective disclosure, corporate disclosure practices and related issues, was issued for comment during the year. A finalized policy will be published in April 2002.
- ◆ Staff completed a series of consultations with stakeholders on proposed Rules 54-101 Communications with Beneficial Owners of a Reporting Issuer and 54-102 Interim Financial Statement and Report Exemptions. The comments received were considered and appropriate revisions were made. The proposed rules were approved by the Commission and have been forwarded to the Minister for review.
- ◆ Implementation of the System for Electronic Disclosure by Insiders (SEDI) was delayed several times due to system development issues. While SEDI was fully launched in January 2002, it was brought down after 10 days due to system performance issues. Significant progress was made on further refinements to the insider reporting regime in the areas of "title inflation" and equity monetization".
- ◆ A draft national rule to harmonize and update continuous disclosure requirements (CD rule) across the CSA will be issued in May 2002. Work on developing an integrated disclosure system has been deferred until completion of this initiative.
- ◆ OSC staff worked with other CSA staff to develop a proposed rule to improve financial disclosure for investment funds. The proposed rule may also be expanded to include all continuous disclosure requirements for investment funds. The proposed rule is expected to be published for comment in Spring 2002.

4. *Improve Secondary Market Regulation*

- ◆ A concept paper outlining options related to the filing of financial statements using U.S. or international accounting standards was published for comment in Spring 2001. Resulting proposals will be included in the CD rule to be issued for comment in May 2002.
- ◆ Proposed amendments related to the staff notice on the revocation of cease trade orders were completed and will be presented to the Commission in Spring 2002

5. *Foster the Development of Harmonized Regulation and Cooperative Review Mechanisms among Canadian Financial Regulators*

- ◆ The prospectus Mutual Reliance Review System (MRRS) policy was amended early in 2002. The applications MRRS committee is planning to request approval of non-material amendments to National Policy 12-201 early in fiscal 2002/03. The Chairs approved the development of an MRRS training program scheduled for Fall 2002.
- ◆ The Continuous Disclosure MRRS committee has finalized a notice on harmonized cease trade order procedures and is now studying harmonized procedures more generally.
- ◆ The re-architecture of the System for Electronic Document Analysis and Retrieval (SEDAR) was deferred as additional resources were focussed on implementing SEDAR Release 7 (released Fall 2001).
- ◆ The Joint Forum published a concept paper outlining proposed regulatory principles for capital accumulation plans in April 2001. More than 40 comment letters were received. Members of the Joint Forum working committee met with market participants to discuss the proposals. Recommendations on next steps are to be presented to the Joint Forum in April 2002.

6. *Implement Fee Reduction Strategy*

- ◆ Work continued on the proposed re-engineering of the OSC fee structure. Based on impact analysis, proposed fees have been adjusted to improve efficiency and fairness as well as to minimize the potential volatility of OSC revenue. A finalized draft rule is expected to be released for comment by May 2002.

7. *Enhance Investor Protection Through Education*

- ◆ Staff are working closely with the Investor Education Fund (IEF) to enhance the Commission's efforts to protect investors through education. To ensure the best use of resources and avoid duplication, OSC resources are targeted on outreach and communications, while the IEF is focussed on working with third-parties to develop new tools for investors and educational programs geared towards enhancing financial literacy.
- ◆ The Communications Branch took the lead in establishing a Plain Language training program for staff, which will continue into the next fiscal year. In order to ensure follow-through on the training, staff are working with other CSA jurisdictions to create a Plain Language reference manual and a mentoring program.
- ◆ OSC staff increased the amount of print and Website resources available to investors. Examples include the development of various brochures such as "Borrowing to Invest" and the "Spot the Bull" investment fraud quiz on the OSC Website. Planning began during the current fiscal year to expand Investor Education Week to a full month in April 2002. Projects are also underway to dramatically increase outreach activities by working more closely with established community groups, who will serve as local agents to market OSC material.

8. Foster Development of an Improved Mutual Fund Regulatory Framework

- ◆ CSA Concept Proposal 81-402 titled "*Striking a New Balance: A Framework for Regulating Mutual Funds and their Managers*" was released for comment March 2002. Comments are due by June 2002.
- ◆ Changes to Proposed National Instrument 81-104 Commodity Pools were published for comment December 2001. Comments are due by March 2002.
- ◆ Proposed amendments to NI 81-101 and 81-102 concerning funds of funds have also been developed. The amendments are expected to be published for comment in Spring 2002.
- ◆ Rule 45-501 Exempt Distributions came into force November 2001. This Rule creates an exemption for private pooled funds to maintain the status quo for trading in these securities. A request for comments on the nature and use of pooled funds and if these pooled funds should be subject to a unique regulatory regime is being developed.

9. Support the Implementation of the OSC/FSCO Merger

- ◆ The Ministry released draft legislation for comment until June 29, 2001. OSC staff met with Ministry of Finance staff to discuss comments received and options for addressing them. The draft legislation outlines the corporate governance model of the new entity, enforcement powers, and the ability to collect fees and assessments and the proposed parameters of rule-making authority.

10. Continue the Role of OSC as a Key Member of the International Securities Regulatory Community.

- ◆ OSC staff led the development of a COSRA working party project on securities settlement systems in the Americas. Staff coordinated meetings, prepared various working documents and completed a final draft COSRA report for approval at the COSRA general meeting in February 2002.
- ◆ Based on the comments received in response to the discussion paper "Financial Reporting in Canada's Capital Markets", the OSC is developing proposed rules to permit foreign issuers coming to Canada to file financial statements prepared in accordance with International Accounting Standards without reconciliation to Canadian standards.
- ◆ Foreign Issuers: Rule 72-502 was published for comment. This proposed rule is expected to be incorporated into a national rule to be published Spring 2002 concurrent with the Continuous Disclosure rule. A review of the IOSCO International Disclosure Standards was completed by staff. The national long form prospectus committee is currently considering allowing foreign issuers to use these standards to offer securities in Canada.
- ◆ OSC Chair, David Brown, has played a key role in the international regulatory community for the past two years as Chair of the Technical Committee of IOSCO. The Technical Committee, comprised of 16 senior securities regulators from developed markets, is the principal policy arm of IOSCO. He is also a member of the IOSCO Executive Committee and represents IOSCO on the Financial Stability Forum, a group assembled by the G-7 Finance Ministers to help identify and respond to vulnerabilities in world financial markets.

- ◆ OSC staff participates actively in all five IOSCO Standing Committees: Multinational Disclosure and Accounting, Regulation of Secondary Markets, Regulation of Financial Intermediaries, Enforcement, and Investment Funds. The Standing Committees are a forum for sharing information among jurisdictions but also undertake work assignments to examine issues and produce papers providing either information or guidance to both regulators and market participants. OSC staff also participate on project teams examining issues related to the Internet and the role of securities analysts.

Through participation in these Committees, OSC staff gain useful knowledge and insights to apply to their work and share with their colleagues at the Commission, cultivate important contacts that can be valuable sources of information and assistance, and contribute to the international body of knowledge in the area of securities regulation. The increased communication and sharing of experiences and ideas with international colleagues contributes to the gradual evolution of an international consensus on key areas of regulatory concern.

- ◆ OSC Staff has been an active participant in the international Joint Forum of Financial Regulators since its inception in 1996. This Forum unites representatives from securities regulators (IOSCO), banking regulators (the Basle Committee on Banking Supervision – BCBS), and insurance regulators (the International Association of Insurance Supervisors – IAIS). As financial regulatory frameworks continue to evolve world-wide, the Joint Forum is the ideal venue for assessing cross-sectoral issues, making cross-sectoral comparisons and sharing experiences in merging supervisors or dealing with regulatory overlap.

11. Continue to Develop and Implement Accountability Mechanisms

- ◆ Ipsos-Reid completed a survey of OSC stakeholders. The survey results indicated a positive perception and a high degree of satisfaction among registrants and issuers. Significant improvements were noted in OSC customer service ratings. For example, 74% of those who had contact with the Inquiries & Contact Centre rated our overall customer service as excellent representing a 14% improvement from the last survey.

12. Foster the Continued Development of the OSC as an “Employer of Choice”.

- ◆ The OSC’s annual employee satisfaction survey was conducted by the HayGroup in November, 2001. Seventy three percent of staff completed the survey, indicating a high level of engagement. On nine of the ten factors measured, the OSC results exceeded the private sector norm. The OSC results exceeded the public sector norm on all ten factors.
- ◆ The OSC commissioned a comprehensive custom compensation survey in December, 2001 to ensure its compensation package remains competitive. The results were received in February 2002 and changes to the compensation system will be implemented at the beginning of the 2002/03 fiscal year.
- ◆ The Commission completed work on its competency dictionary in the spring of 2001. To assess training requirements, all management staff took part in a 360 review process in the early summer. During 2001/02, eight competency training modules were delivered as part of the Commission’s integrated management training program, “Focus”. In addition, performance contracts for 2001/02 were redesigned to include measures on key aspects of behaviour to support the competency program.