

**“Securities Regulators’ Leadership in Protecting Investors
and Promoting Market Confidence”**

**Mary Condon
Vice-Chair, Ontario Securities Commission**

**Remarks to the Compliance & Risk Management Strategies Summit for
Portfolio Managers and Fund Managers
June 13, 2012**

Check Against Delivery

1. Introduction

Good morning. I want to thank the Strategy Institute for inviting me to be the opening speaker of this conference for portfolio managers, fund managers and compliance professionals. I am pleased to be invited to participate in a conference dedicated to compliance, because in my view, promoting compliance with securities rules is one of the core functions of the OSC. Fostering a culture of compliance among registrants and reporting issuers is vital to the success of our regulatory mandate.

We expect registrants and issuers to comply with their regulatory requirements, such as standards of conduct, rules of disclosure and suitability requirements. Meanwhile, our obligation as regulators is to ensure, as best we can, that the rules we are seeking compliance with are as clear as possible, that we are explicit about the goals we are seeking to achieve with those rules, and also, that if we put rules in place, that this is not the end of the story. We should, in my view, assess on an ongoing basis whether our goals are being achieved by the rules we impose.

Some of these aspirations are now represented in the OSC's new strategic direction. So let me, in my remarks today, talk first about that strategic direction, and then describe some of the current specific initiatives that are being considered in order to better achieve regulatory goals. To foreshadow where I am going, the specific initiatives that I want to touch on are:

1. the CSA's cost disclosure and performance reporting initiative;
2. the OSC's focus on suitability;
3. an update on fiduciary duty; and
4. an update on the Ombudsman for Banking Services and Investments (OBSI).

2. OSC Strategic Direction

So, to start with the OSC's new strategic direction, obviously this all begins with our mandate, which is to provide investor protection, to foster confidence in our capital markets and to foster markets that are fair and efficient. How the OSC administers and enforces securities law is being shaped by our more strategic approach to fulfilling that mandate.

As the capital markets undergo fundamental changes, we are changing *how* we work to continue delivering effective regulation in the best interests of investors, market participants and the economy. Our strategic direction is influencing the entire OSC but today I'll talk briefly about how we're working differently to strengthen our capabilities

in a number of areas such as research, risk management, policy coordination and investor engagement.

Research and Analysis

During the OSC's strategic review last year, we decided to improve our research capabilities to help us better understand the direction of the markets and the issues facing investors, and thereby support policy-making. You all know that investment products, trading strategies and platforms have become much more complex, as has the global reach of market participants and issuers of securities. A new Research and Analysis Group has been created within the OSC to keep abreast of the regulatory implications here and to spearhead a more nuanced and sophisticated approach to policy-making. This may involve research being undertaken by the OSC itself, or collaborating on projects with the Canadian Securities Administrators (CSA) or third-party researchers. We have seconded Mark Adams from the Australian Securities & Investments Commission (ASIC) as a Special Advisor of Research, Strategy and Risk to create a plan and set out the priorities for the Research and Analysis Group. Mark has impressive experience in research, policy development and risk management and we are delighted to have him with us.

The OSC has obviously conducted research in the past, such as our involvement in the investor study for the cost disclosure and performance reporting initiative, but we are now committing resources to expanding our research function. In fact, several research projects are underway, including:

- A review of exempt market activity to better understand how the exempt market is used to raise capital; and
- An analysis of the cost of market data in Canada.

We believe that a stronger commitment to evidence-based decision-making will help the OSC fulfill its mandate. Therefore, we are relying more heavily on qualitative and quantitative evidence, including investor research, to support policy decisions.

Risk Identification and Management

Enhancing how we identify and manage risks will also help us keep pace with market developments, innovation and investor concerns, and this is, I know, also a concern for the conference participants here. Indeed, last month, David Wright, Secretary General of the International Organisation of Securities Commissions (IOSCO), said securities regulators have to do a better job, collectively, of identifying and managing risk. From the OSC's perspective, having a better understanding of emerging risks is another crucial aspect of understanding developments in the capital markets.

Some examples of efforts we have made in this respect already are, (i) our review of issues related to emerging market issuers, which was published in March 2012, (ii) our survey of hedge funds in 2009 which was in aid of the collection of information at the international level about possible sources of systemic risk, (iii) and our approach to consideration of the application by Maple to purchase the TMX and CDS, where part of our analysis focused on possible risks to the Canadian capital markets and we considered carefully how best to mitigate those.

Going forward, we are developing a formal framework for identifying and managing risks, especially risks that emerge from markets and products. This framework will also strengthen our internal capabilities as we co-operate with international regulators and other agencies to promote financial stability.

Investor Engagement

The last part of our strategic direction that I want to mention is the Office of the Investor, which will play a key role in helping the OSC engage investors more effectively. The Office is taking shape – we hope to hire a Director soon and then commence operations shortly thereafter. The Branch will develop and implement programs and processes that focus on investor interests and work to ensure those interests are appropriately considered in OSC policy-making and operations. The idea here is to enhance the coordination of policy initiatives that are focused on investor protection and to ensure a consistent and efficient approach across the whole organization.

As many of you know, almost two years ago now, the Commission established the Investor Advisory Panel (IAP), which was motivated by the desire to increase our engagement with investors and provide them with a mechanism for contributing to our ongoing policy agenda. You will later hear from Anita Anand, Chair of the Panel, about her perspective on the work of the IAP over this period. The establishment of the Office of Investor internally is intended to deepen the effort at investor engagement and to

leverage the gains already made by the IAP, as well as by the Investor Education Fund, another entity supported by the OSC.

Expanded research, enhanced risk management, improved policy coordination, better investor engagement... they are all interconnected parts of our strategic direction.

Let me turn then to the specific initiatives that I mentioned earlier, starting with the CSA's proposals for cost disclosure and performance reporting.

3. Client Relationship Model, Phase 2

Over the coming days, we expect to publish for public comment revised proposals under this initiative, which is also referred to as the "Client Relationship Model, Phase 2".

Many of you will know that the initial proposal to amend National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (NI 31-103) was published last June. The proposal would require registered dealers and advisers to deliver enhanced disclosure about the costs of investing and adds a new requirement to deliver investment performance reports to their clients.

The proposal that is expected to be published tomorrow revises aspects of the original proposal in response to public comments and consultations. It also adds some new requirements to make the information investors receive more complete. The revised proposal will be out for a 90-day comment period and we are aiming to finalize

amendments for publication early in 2013. After that, new requirements will be phased in over three years.

Elizabeth King will have more to say about the details of some of the changes in the proposal, in the next session, but let me say a few words about the policy rationale here. The proposal is intended to provide information about what it costs to be an investor and how investments have performed. With respect to costs, this means relevant information at the relevant time, including among other things, an annual report showing not only the client's costs, but also other incentives the registrant received – such as the actual dollar amount of trailing commissions paid in respect of a client's mutual funds. With respect to investment performance, this means an annual report on performance over the past year, over each of the preceding three-, five- and 10-year periods, as well as since the account was opened.

The purpose of these proposed amendments is to deliver on one of our key investor protection goals: to provide more useful and targeted information to investors.

Information about the costs and performance of their investments is essential information to enable investors to assess progress toward their investing goals and the value of professional advice that they receive. At present, some investors, mostly at the higher end of the income spectrum, receive some of this information, but most investors do not. The initiative is also intended to:

- correct some of the information asymmetry between retail investors and their dealers or advisers;

- Create better-informed investors who will be more likely to make responsible financial decisions, such as by having more comfort to discuss the suitability of an investment with their dealer or adviser; and
- impose a clear and specific conduct standard for all registrants in terms of the information they provide to clients.

The proposals to be published tomorrow are fact-based and were informed by:

- Investor research;
- Industry consultations and comment letters;
- Consultations with the OSC Investor Advisory Panel;
- Document testing of the model performance report; and
- The assistance of expert advisers.

We carefully considered all of these inputs in developing the revised proposal. In particular, investor research confirmed empirically what many have long suspected: a large proportion of retail investors do not really understand many of the costs associated with their investments – especially when it comes to mutual funds – and they are not getting enough to help them understand how their investments are performing. We also learned that investors want and understand simple information about their accounts. Investor advocates have strongly supported the proposals that have been shaped by that research.

For its part, industry has expressed concerns about:

- Implementation costs;
- The time it will take to build and roll-out new reporting systems; and
- Consistency with requirements for investment dealers and mutual fund dealers set by their self-regulatory organizations.

These concerns are understandable and we have extended some of the proposed transition periods to allow firms more time to get ready. Also, we're working with the SROs to address harmonization issues. We appreciate the fact that IIROC and the MFDA have developed their own performance reporting requirements and have suspended their implementation so that harmonized requirements can be introduced.

Notwithstanding concerns about the costs of implementing these new requirements, the OSC and our CSA counterparts believe strongly in going ahead with them. We will be interested in improving our proposals based on the comments received.

We think that with this information about cost and performance in their hands, investors will be empowered to have informed discussions with their advisers about the advice they are getting and thereby deepen the adviser-client relationship. Our cost disclosure and investment performance initiative is an opportunity for industry to demonstrate the "value for advice" proposition. In the end, better-informed investors should benefit both businesses and investors.

4. OSC Suitability Sweep

The CSA's cost disclosure and performance reporting proposal is also consistent with the OSC's focus on suitability. This year, we are especially focused on compliance with Know Your Product (KYP) and Know Your Client (KYC) requirements.

As part of their gatekeeper role, registrants are required to establish the identity of, and conduct due diligence on, their clients under the Know Your Client obligation. KYC information forms the basis for determining whether trades are suitable for investors. KYC requirements are stated in the Companion Policy to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*.

Starting this month, the OSC is planning the largest suitability sweep ever of exempt market dealers (EMDs) and portfolio managers. Our Compliance and Registrant Regulation Branch expects to review a total of about 80 firms that have Ontario as their principal regulator.

We're doing this sweep because the OSC has seen a large number of significant deficiencies in this area over the last couple of years. On-site compliance field reviews have found:

- KYC information that is either not accurate, incomplete or not up to date;
- Inadequate processes for ensuring clients are accredited investors; and, in some cases,
- A failure to even collect KYC information from clients.

The upcoming sweep will be focussed on the requirements of National Instrument 31-103. It will also assess compliance with two staff notices that were recently issued:

- CSA Staff Notice 33-315 *Suitability Obligation and Know Your Product*; and
- OSC Staff Notice 33-735 *Sale of Exempt Securities to Non-Accredited Investors*.

In undertaking the sweep, OSC staff are making two enhancements to our current field review process. First, we're expanding the number of client files we review for KYC, KYP and suitability issues. Second, we'll also start to call *clients* of registrants to confirm the KYC, KYP and suitability practices of the registrants who advise them.

The ultimate outcome of the sweep will depend on the findings of the reviews and our assessment of those findings. The possible outcomes could include more guidance to registrants or more rules.

Participation as a registrant in Ontario's capital markets is a privilege that comes with significant responsibilities to investors and the public at large. Registrants are obligated to understand the general investment needs and objectives of their clients and to fully understand the products recommended to them. From our perspective, the suitability obligations of registrants are key protections for investors.

5. Fiduciary Duty

Let me turn to the topic of fiduciary duty, which is an area of focus for the OSC because of its importance to investors. This is an idea which has gained some traction in other

jurisdictions, and is certainly a topic of interest to investors and investor advocates. We recognize that the issue needs to be carefully considered, including by conducting research on a variety of fronts. We are therefore looking at:

- Examining the current standard of conduct applicable to advisers and dealers;
- Identifying investor-protection concerns with the current standard of conduct;
- Reviewing what the U.S., the United Kingdom and Australia are doing in relation to fiduciary duty, and
- Reviewing the benefits and competing considerations of imposing a statutory fiduciary duty.
- Getting a better understanding of current investor expectations about the level of responsibility owed to them by their advisor or dealer.

Based on this research, our staff are considering whether an explicit statutory fiduciary duty, or other new standard, should apply to advisers and dealers in this province. We are currently in the advanced stages of preparing a consultation paper on the standard of conduct owed to clients. We will be consulting with our CSA colleagues shortly and will decide on next steps accordingly. Any direction we take on fiduciary duty will have, at its core, the interests of investors in mind, given the critical importance of the relationship between the client and the advisor.

6. OBSI Update

A final topic that may be of interest to this group is our initiative on the provision of dispute resolution services to clients. As you likely know, this is a topic of considerable

interest to financial services firms, as well as to investors. Currently, the provider of most independent dispute resolution services in the investment space in Canada is the Ombudsman for Banking Services and Investments (OBSI). Last year, the operations of OBSI were reviewed by Phil Khoury, an expert in the field of dispute resolution. In turn, the CSA has reviewed Khoury's report carefully, to the extent that some of his recommendations were directed at regulators. Since that report, the CSA has publicly indicated its support for a single provider of dispute resolution services for investment complaints, for various public policy reasons. We have been observing closely the efforts that OBSI is making to respond to stakeholder input. We have also been considering carefully the recommendation in the Khoury report that we mandate a single provider of services across the entire spectrum of registrants. We are meeting with a number of stakeholders to discuss these issues with them, including PMAC and the EMDA, and have also been discussing with the SROs the issues that arise from this recommendation.

7. Conclusion

The OSC has made it a key priority to deliver strong investor protection in everything we do – it's at the core of our strategic approach to fulfilling our mandate. This requires more effective engagement with investors and a greater focus on incorporating investor concerns more directly into our policy agenda. We are addressing both areas as we challenge ourselves to deliver effective regulation on behalf of investors. As a member of the CSA, we play an active role in working on a number of significant investor-related policy initiatives, including the ones that I have discussed today. In cooperation with the

CSA, we endeavour to sustain a robust securities regulatory framework that fosters fair, efficient and competitive capital markets for all Canadians.

Thank you.