



Remarks by David A. Brown, Q.C.

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Check Against Delivery

I would like to thank you for the opportunity to speak to you and respond to your questions relating to the Five Year Review Committee. I am joined today by Susan Wolburgh Jenah, one of the two Vice-Chairs of the Ontario Securities Commission. In her previous role as General Counsel to the Commission she served as a member of the Five Year Review Committee.

The OSC is pleased to participate in the Five Year Review process, and the opportunity to take a periodic look at the laws, rules, structure and operational policies that characterize securities regulation in this province. The review process, which was mandated under the *Securities Act* in 1994, provides something very valuable: a recurring, pro-active opportunity to take a close look at a system that is functioning well, to determine ways in which it can be made to function even better.

No public institution can hope to rest on its laurels. Emerging issues and needs often prompt new ways of doing things. Our response is to pursue a fundamental principle: The OSC is always prepared to embrace change in order to meet change.

And we are committed to seeking the widest participation in the regulatory process. Our priorities include accountability and transparency. We pro-actively seek critical review. That includes maintaining 16 standing advisory committees with broad stakeholder representation, and commissioning ad hoc task forces that include a wide range of market participants.

Before discussing some of the issues raised by the Five Year Review Committee, let me start by providing some background on the Commission itself.

We are proud of the organization we have in place, and of the way it advances the Commission's statutory mandate: to provide protection to investors from unfair, improper and fraudulent practices and to foster fair and efficient capital markets and confidence in them.

We have also made it a priority to raise the level of investor education and fraud awareness. We have worked with government organizations and community groups to broaden our audience and increase our direct contact with Ontario investors. A particular focus has been communicating an anti-fraud message to Ontario seniors. We were one of the first securities regulators in North America to launch an Investor Education Fund, which has provided ground-breaking research and education tools.

To carry out its mandate, the OSC is organized into 10 core branches. We seek to recruit and retain staff who have the skills and expertise to carry out individual responsibilities as well as to work together as a team in areas of common concern.

I'm happy to remind you that in Ontario securities regulation places no demands on the public purse. The Commission receives its funding from market participants, based on their participation in the market and their use of our services.

The expertise and quality of our regulatory regime has been recognized internationally. The OSC is often called upon to play lead roles in international bodies such as the International

Organization of Securities Commissions (IOSCO), and spearhead projects by regulators around the world. We work closely with our counterparts in other provinces and with the U.S. SEC, the Financial Services Authority in the U.K. and regulatory bodies in other countries, in order to bring best practices to Ontario and Canada while exporting our knowledge and expertise.

At the same time, we have been successful in improving our enforcement capabilities here at home. As business grows in complexity so does the scope for fraud and other market manipulation.

In the past five years, the OSC has poured considerably more resources into enforcement while cooperating closely with law enforcement agencies such as the RCMP, OPP and crown.

In the last fiscal year, we opened 216 new enforcement cases. In recent years, about half of the cases investigated have resulted in regulatory action or were directed to other regulators or law enforcement agencies.

The three most frequent types of securities violations investigated over the past few years have been misconduct by market registrants, illegal insider trading or tipping and trading securities without registration.

Recent investments in enforcement have also made the OSC more efficient and more effective: cutting the average length of an investigation by one-third, from 20 months to 13, while reducing the average time involved in bringing a case to trial from 15 months to 11.

These statistics are encouraging, but they do not fully reflect the impact of our enforcement activities. They do not show the number of times our Enforcement Branch has been able to prevent harmful conduct by identifying dubious operations in their early stages. Our Enforcement Branch is one of the first in North America to establish an Intelligence Team – and it has already registered successes in stopping activities that could have harmed investors.

But in all of our activities, we recognize that laurels are not something to rest on, they are something to build on. Many of the challenges the Commission faces are in a constant state of flux. We are committed to change; to be pro-active, not just reactive; and to welcome innovative ideas and approaches.

That leads me back to the report of the Five Year Review Committee.

First, I want to express my appreciation to the members of the Review Committee. The OSC was pleased to support their work. And we were impressed by the breadth of their recommendations and the depth of the thinking behind them.

The Review Committee's recommendations covered legislation, rules, and structural and operational issues. I would like to discuss a few which are priorities for the Commission and for the integrity of capital markets in Ontario.

It makes sense to begin with the recommendation that the Committee identified as the “most pressing securities regulation issue in Ontario and across Canada” – what it called the (quote) “urgent need for a single Canadian securities regulator.”

I do not have to dwell on this issue, as the Premier and Minister Phillips have both done an excellent job of articulating the reasons Canada needs a single securities regulator. I will emphasize just one point – the competitive disadvantage of being out of step with the world.

Ours is the only advanced national economy in the world that does not have a national securities regulator – and one of only two countries among more than 100 in IOSCO. Can we really afford this competitive disadvantage?

Canada’s current system of 13 regulators with 13 separate sets of rules and regulations is costly, cumbersome and carries the risk of marginalizing Canadian interests in an increasingly global marketplace, where capital flows across national borders with few restrictions.

We estimate that approximately 10 per cent of our operating budget is consumed trying to make a fragmented system work. We do it because we have to. Issuers and registrants have options – they can go elsewhere.

In an effort to address this fragmentation problem, the OSC has worked closely with our fellow provincial and territorial securities regulators on the Uniform Securities Legislation (USL) project. We have contributed considerable resources to this significant initiative, which the CSA launched more than two years ago with the objective of developing uniform securities legislation.

But it is important to keep in mind, while USL is a positive step forward, it is no permanent substitute for a single securities regulator.

Canada simply cannot afford the duplication and overlap of 13 separate regulators when every country Canadians compete with has one.

About two-thirds of the Report’s 95 recommendations are directed to the OSC and the Canadian Securities Administrators. About one-third call for legislative or structural reform, study or other action by the Legislature or the Government. Recommendations in both categories have been implemented or are in progress. I am tabling a document that outlines the status of Review Committee recommendations.

Of those requiring legislative action, we would urge this Committee to consider on a priority basis endorsing recommendations in four critical areas:

First, we urgently need proclamation of amendments to the *Securities Act*, which were enacted in December 2002. The amendments would create a regime for statutory civil liability for secondary market disclosure. This is recommendation No. 40 at page 133 of the Committee report. It would also make it an offence under the statute to commit fraud, and market

manipulation and misrepresentation. This is referred to on pages 242-246 of the report. Unlike investors in the United States, Ontario investors face significant hurdles in suing corporations and their insiders for false or misleading disclosure. The proposed civil remedies will both provide investors with a means to seek redress, plus encourage compliance by corporations and others with their obligations of transparency. The prohibitions against fraud, market manipulation and misrepresentation will enable us as regulators to seek quasi-criminal sanctions against those who would undertake that activity in our markets. We'll get tools we need to help protect investors in this province. These measures will give us means to fulfill an important element of our statutory mandate: protecting investors.

Second, we need better tools and flexibility to achieve more effective cooperation with other Canadian securities regulators. The ultimate goal of a single regulator for Canada will obviously take some time. In the meantime, market participants are demanding that we work together with our CSA counterparts to achieve greater harmonization of regulatory requirements. To do that, we need some legislative steps, including statutory amendments to facilitate inter-jurisdictional delegation of decision-making where a common approach to issues has been agreed upon, recommendation 2 at page 41.

Third, we need the ability to reduce regulatory burden. In particular, I'm referring to the Review Committee's recommendation to facilitate quick responses to new situations that have not been expressly provided for in existing rules. Too often, market participants are caught in a regulatory time warp. They want to do something that the rule-makers never intended to prevent, or even anticipated. But it takes nine to 18 months to change a rule. In the meantime, market participants need to come back to us each and every time for an exemption. Other Canadian jurisdictions are able to issue blanket exemptions. The Review Committee's recommendation to introduce similar authority in Ontario would eliminate a regulatory burden, and enhance our ability to take a common CSA approach to issues as they arise, recommendation 21, page 85.

Fourth, there is a clear need to modernize Ontario's commercial law dealing with the transfer and pledging of securities. Canadian law in this area has fallen behind the U.S. and the European Union, and we need to catch up. All of the Canadian securities regulators endorse the "Uniform Securities Transfer Act", and we urge the Committee to recommend that Ontario play a leadership role with regard to this important legislation to better serve Ontario investors, recommendation 5, page 50.

There is one other issue that the Review Committee identified that I would like to comment on. That is the recommendation that the structure of the Commission as a multi-functional agency be given further consideration. Unlike most of the other areas covered in the report, the Review Committee made no recommendation in this one. However, it did call for further thought and study.

I fully support this re-assessment. It is essential that the structure of the Commission be periodically reconsidered to ensure that it is the most suitable and effective for the Commission to discharge its mandate. Our current structure and any alternatives under consideration should

be measured against the benchmark of our mandate to provide protection to investors and to foster fair and efficient capital markets and confidence in our capital markets.

Under the Commission's current integrated structure, which is codified in the governing legislation, it performs multiple functions such as developing policy, conducting investigations, prosecuting cases and adjudicating cases which come before it. Contrast this with a bifurcated model, under which the adjudicative function of the Commission would be hived off to a separate, independent tribunal that has no involvement in policy making, investigations or prosecutions.

In this context, I am tabling materials that we commissioned to help inform the debate around this issue. These materials include a report by a committee chaired by the Honourable Coulter A. Osborne and legal opinions by the law firms Torys LLP and McCarthy Tétrault. I'd like to walk through the advantages and disadvantages of each model.

Let me start with the two principal *disadvantages* of our current integrated model.

First, it allows for a greater risk of perception of bias on the part of the Commissioners exercising their adjudicative function as a result of the Commission's involvement in policy-making and oversight of the Enforcement branch. This issue is extensively discussed in the report the OSC commissioned from the committee chaired by Coulter Osborne. In particular, it is noteworthy that the report focuses on the perception of bias as opposed to actual bias, reporting that: "Critics of the existing structure contend that the perception of bias works to erode the credibility of the Commission."

The Commission is concerned about the issues raised. We take perceptions very seriously, even if they are only held in some quarters. This perception problem is inherent in the integrated model for administrative agencies; candidly, no one has figured out a way to eliminate it entirely. But we have many safeguards in place, and are always looking for ways to enhance them.

The second disadvantage results from one of these safeguards – the separation of the Commissioners from the day-to-day decision making of the Enforcement Branch. Currently the Commission fulfills its responsibility to oversee enforcement activities without becoming involved in case or fact-specific decisions about investigations and prosecutions of individual cases. This practice is in effect for obvious reasons, as some of the Commissioners may end up sitting on the panel that adjudicates the matter. As Chair, I get involved in investigation and prosecution decisions – and therefore do not sit on any hearing panels. These are tough decisions, and I would welcome the input of my fellow Commissioners. The bifurcated model would allow this input because the matter would end up being heard by a different set of people.

Knowing that these are disadvantages in the current model, why did the Legislature nonetheless decide that this model is best for Ontario? Indeed, why is this the chosen model for so many regulatory and administrative agencies across Canada and beyond the realm of securities regulation? I think the answer is because its main benefit is the enhanced expertise that is inherent in it.

By hearing and deciding real cases, the Commissioners gain a hands-on experience that informs their development of policy. And by developing policy, Commissioners gain an insight and understanding of the public interest underlying the policy that informs their decisions when adjudicating cases. At the same time, by offering potential Commission members the prospect of a broader, more challenging range of functions, the pool of candidates from which the government must draw expands, as does their range of expertise, skills and knowledge.

It is important to keep in mind that when Commissioners adjudicate cases, they are not just deciding whether someone broke a rule. The *Securities Act* requires that the Commission exercise its sanctioning powers in the public interest. For example, when suspending a dealer, or when restricting a person from acting as a director of a public company, or when imposing a fine, or when ordering a person to hand over the profit they earned from their misdeeds, the Commission must make a determination that such orders are necessary in the broader public interest. The policy development process gives Commissioners insight into the public interest – insight that is invaluable in the adjudication process.

As well, the integrated model reflects the roles and responsibilities of an administrative agency/regulator as distinct from a court. Administrative agencies were developed to fulfill roles that were very different from, and not appropriate to, the courts – often resolving issues in accordance with a statutory mandate to pursue or protect the public interest. In connection with such a mandate, they may be empowered to formulate policy or make rules that have the force of law.

The Supreme Court of Canada has not only endorsed the legality of the integrated model of regulation in Canada. Our highest court has also recognized, in the words of Chief Justice McLachlin, “... the overlapping of investigative, prosecutorial and adjudicative functions in a single agency is frequently necessary for [an administrative agency] to effectively perform its intended role”. (*Ocean Port*, a 2001 decision.)

That leads me to the other side of the balance sheet: the disadvantages of moving to a bifurcated model. What will have been lost? First and foremost, the expertise that the Commission gains precisely from performing those multiple functions. The Supreme Court of Canada recently commented on the impact that hiving off the adjudicative function can have on the expertise of a tribunal. In the recent *Monsanto* decision, in reviewing a decision of the Ontario Financial Services Tribunal, the Court said “involvement in policy development will be an important consideration in evaluating a tribunal’s expertise.”

The challenge for our elected officials in reassessing the Commission’s structure is to balance the advantages and disadvantages of different models and determine whether the current structure continues to best serve Ontario investors and participants in Ontario’s capital markets.

One of the reasons this issue is being revisited now is that the Commission recently acquired new powers to assess administrative penalties of up to \$1 million and order people to disgorge profits earned from their misdeeds. The Osborne Report raised the question of whether these new

powers changed the legal environment for an integrated commission. We thought this was an important question, so we asked the law firm Torys LLP to examine the issue. The Torys opinion addressed the issue of apprehension of bias, and concluded that the Commission's new powers do not detract from the legality of the integrated model and do not compromise the right to a hearing before an impartial tribunal.

The Osborne Report also raised the issue of whether the structure of the OSC properly allows the Commission to exercise its statutory oversight responsibilities, particularly with regard to enforcement. As I mentioned, the Commissioners do not get involved in day-to-day decisions on investigations and prosecutions. Does this still pass the test in today's corporate governance environment? And does it satisfy our statutory oversight responsibilities as a board under the legislation? We asked the law firm McCarthy Tétrault for their legal opinion on this key issue.

Their conclusion? The OSC's structure and internal processes do not in any way conflict with the Commission's responsibility to oversee enforcement matters.

Clearly, the question of the best structure for the Commission is complex. It requires consideration of the broader Canadian context, under which the integrated structure is the predominant model, not only for securities regulatory agencies but in other areas as well. In that regard, it is worth noting that in 1987 Alberta tried restructuring its securities commission into two entities, found it didn't work, and reverted to a structure identical to ours.

I should note that I believe a somewhat stronger case could be made for a separate tribunal if we were to establish a single securities regulator for Canada. Such a tribunal would likely have a significant case load with national reach, enabling it to attract and build a base of qualified experts. The tribunal would also have the flexibility to conduct their hearings wherever in Canada it is appropriate.

As I said at the outset of my remarks, the OSC is always prepared to embrace change in order to meet change. As a regulator of financial markets in a period of rapid transformation, we can do no less.

We are presented here with a unique opportunity that is unavailable to most securities regulators around the world. On a periodic basis opinion leaders from our markets and investor community are asked to review our practices and procedures and our legislative underpinning and to make recommendations for improvement. These are important initiatives for Ontario's capital markets and for the whole of Canada. Indeed, the world is watching.

Mr. Chairman, I have provided to the Clerk of the Committee the documents I alluded to in my remarks. I look forward to Members' questions. Indeed, should the Committee find it useful, I would be happy to return at the end of your hearings to answer further questions, as other issues relevant to securities regulation in this province may emerge during your deliberations.

Thank you.