INVESTOR ADVISORY PANEL

September 3, 2020

Walied Soliman
Chair, Capital Markets Modernization Task Force
Ministry of Finance
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Dear Mr. Soliman,

RE: CONSULTATION – MODERNIZING ONTARIO'S CAPITAL MARKETS

On behalf of the Ontario Securities Commission's Investor Advisory Panel (IAP), I am pleased to present our comments in response to the consultation report issued by the Ontario Capital Markets Modernization Task Force on July 9, 2020 ("the Task Force report"). The IAP is an initiative by the OSC to bring investor perspectives into its policy development and rule-making process.

The Task Force report contains many thoughtful and worthy ideas. In particular, we endorse and strongly encourage you to move forward with your proposals in these areas:

- Empowering the Ombudsman for Banking Services and Investments (OBSI) to make binding compensation awards (proposal #47);
- Mandating that funds collected pursuant to disgorgement orders must be distributed to harmed investors (#46);
- Fortifying the OSC's investigative tools (#38), penalty limits (#37) and fine collection capabilities (#35); and
- Automatically initiating reciprocal enforcement of regulatory orders for registration bans and suspensions (#34).

Our comments on these proposals and the others that we consider most helpful for investors are set out below under the heading **Proposals Conducive to Investor Protection**.

In a separate section entitled **Problematic Proposals**, we identify our concerns about the implications of a number of your other recommendations, especially those:

- Requiring the OSC to pursue "a public policy imperative of growing the capital markets in Ontario" (proposal #1);

- Expanding use of the accredited investor exemption (#5, 14 and 33) while also widening the distribution capability of exempt market dealers (#11); and

- Imposing limits on OSC investigations as well as allowing affected individuals and firms to launch court challenges requiring the OSC to justify, publicly, the purpose and scope of its investigations (#39, 40, 42 and 45).

Under **Elements of Other Key Proposals**, we provide comments on some of the remaining recommendations, including those relating to investment industry self-regulatory organizations (SROs). In particular, we note the importance of:

- Fostering investment in small business as a critical means of rebuilding Ontario's economy in the wake of the COVID-19 pandemic; and

- Ensuring that SROs in future are designed to serve the interests of investors and the investment industry as a symbiotic community.

Lastly, in a section entitled **Additional Comments**, we present our views on a number of matters that were not mentioned in the Task Force's proposals but that we believe should be addressed in the final report, including:

- Essential measures to ensure the OSC's independence;

- An evaluation of the relative merits of Ontario proceeding with the CMRA project or merging the OSC and FSRA; and

- Statutory recognition of the IAP as an integral and essential component of the OSC's regulatory framework.

Overall, we commend the Task Force's members for the breadth and depth of their efforts on this project. There is much here to consider. Also, it's apparent that many of your 47 proposals are meant to be read together, as a set of ideas intended to achieve balance. We have analyzed the report with that in mind. Unfortunately, as the report does not contain all of your recommendations, we are not in a position to assess the proposals comprehensively.

PROPOSALS CONDUCIVE TO INVESTOR PROTECTION

Proposal 47:
Give the power to designated dispute resolution services organizations, such as the Ombudsman for Banking Services and Investments (OBSI), to issue binding decisions ordering a registered firm to pay compensation to harmed investors, and increase the limit on OBSI's compensation recommendations

We endorse the Task Force's recommendations regarding OBSI.

We strongly support enabling OBSI to issue compensation awards that bind its member firms. Binding decisions will remove a significant current limitation on OBSI's effectiveness by ensuring its process leads to a final resolution in every case. This, along with OBSI's independence, will foster greater public confidence that Ontario's capital markets are fair and aim to provide investors with appropriate protections – thereby making our markets more attractive and robust by aligning them with best practices in jurisdictions where ombudservices are empowered to make binding awards (e.g., the U.K., Australia, New Zealand, India).

We also agree that OBSI's monetary award limit should be increased to $500,000 in order to bring it in line with IIROC's arbitration program; and we support the proposal for inflation-adjusting this limit periodically.

Finally, we offer qualified support for the proposal that OBSI's process should incorporate reasonable procedural safeguards, including a right to seek reconsideration or judicial review of awards. Our qualification – and it is a significant one – is that these safeguards must balance fairness with efficiency, cost-effectiveness, practicality and timeliness. This is particularly important for complainants who already have endured a lengthy and stressful complaint process. But it also is relevant in the context of OBSI's typical complaints, which often involve relatively modest sums.

By way of illustration, the following table details OBSI payment recommendations for investment complaints over the past 10 years. As can be seen, the cumulative average payment is less than $20,000 ($19,717) and the cumulative median amount is just $7,336.

OBSI Investment Compensation Recommendations
(Source: OBSI Annual Reports 2010 – 2019)

Year	Total	Average	Median	Lowest	Highest	Cases
2019	$2,515,218	$14,291	$2,114	$50	$280,000	180
2018	$2,929,205	$21,698	$4,238	$50	$350,000	135
2017	$2,426,973	$16,180	$5,167	$75	$250,000	150
2016	$2,363,929	$15,552	$5,000	$21	$253,602	150
2015	$4,358,747	$26,258	$11,836	$20	$425,629	166
2014	$4,112,408	$18,608	$8,300	$141	$181,178	221
2013	$4,677,415	$26,728	$10,000	$100	$275,000	175
2012	$3,640,695	$22,613	$11,000	$50	$193,943	161
2011	$2,691,721	$16,118	$7,500	$154	$220,000	167
2010	$3,346,138	$19,121	$8,205	N/A	N/A	N/A
10 YR AVG	**$3,306,245**	**$19,717**	**$7,336**			

Further, when the outcomes for each year are viewed in light of the year's highest amount and total compensation, it is apparent that a very small number of large claims skew the averages each year. This suggests the vast majority of OBSI payment recommendations falling above the annual median do not exceed that amount by very much.

These numbers underscore the need for OBSI's adjudicative processes to be efficient. The numbers also suggest that enhanced procedural safeguards and judicial review options likely will come into play in very few OBSI cases, since most involve sums too small to warrant firms expending yet more time, resources and money to pursue such procedures during an investigation or after OBSI issues its decision.

We have some concerns, however, about the potential abuse of judicial review applications to leverage settlements substantially below the amounts awarded by OBSI. To mitigate this problem, we suggest the OSC should be required to monitor all post-award payments and assess in each case whether the threat or commencement of a judicial review application extracted a lowball settlement in violation of OSC Rule 31-505's duty to deal with clients fairly, honestly and in good faith.

Lastly, we wish to add a comment about the Task Force's use of the phrase "designated dispute resolution service organizations, *such as* … OBSI." We trust these words were not meant to imply that other dispute resolution services should be designated in addition to or in place of OBSI for investment complaints. Rather, we assume the Task Force merely intended to acknowledge the OSC's ability to designate others in future if the OSC determines that doing so is in the public interest.

The OSC and its CSA partners already have determined the public interest is best served by there being a single dispute resolution provider for investment matters, and they've acknowledged OBSI as being best positioned at present to do the job. The Task Force should clarify their recommendation by confirming that they share this view.

Proposal 46:
Require that amounts collected by the OSC pursuant to disgorgement orders be deposited into court for distribution to harmed investors in cases where direct financial harm to investors is provable

Where disgorgement orders relate to profits or gains made inappropriately at the expense of investors, it's only right that funds recovered under such orders should be returned to the investors who were harmed. However, as your report notes, a number of practical considerations must be addressed in order to operationalize this proposal.

- *What should the distribution process look like? For example, how can the process balance efficiency with fairness to individual claimants?* – A key threshold issue is whether the distribution should be handled by the OSC or by a court-appointed receiver. Fees charged by receivers can significantly diminish the funds available to compensate harmed investors, so consideration should be given to establishing capacity within the OSC for administering distributions.

  Regardless of who administers the distribution, guidance can be taken from court-approved plans for allocating settlement funds in securities class actions. Such plans typically describe (i) eligibility requirements to participate in the distribution, (ii) the method of filing claims, and (iii) the method of calculating a claimant's entitlement. The party seeking to have the plan of allocation approved must convince a judge that it is fair. Consequently, such plans typically recognize differences in entitlements between claimants based on strength of claims, timing of investments, and other distinctions.

- *What process should be used to resolve disputed claims?* – In distributions administered by the OSC, the validity of investor claims could be determined by an OSC staff member appointed by the Commission to act as a referee. Alternatively, consideration should be given to using a dispute resolution services organization, such as OBSI, for this purpose.

- *What criteria should the OSC use to determine when a receiver would be appointed or what amounts are too small to distribute to investors?* – A significant benefit of building capacity within the OSC to administer distributions (thereby eliminating the need to incur receiver's fees) is that it will result in few, if any, collected amounts being too small to distribute to investors. However, a receiver might still be necessary in extremely large cases that would overwhelm the OSC's capacity or in rare cases where an allegation of regulatory bias could make it inappropriate for the OSC to manage the distribution.

- *How should the OSC communicate information relating to potential distributions?* – As an integral part of its enforcement proficiency, the OSC needs to develop and maintain the ability to determine the full extent of harm done to investors in any given case and, hence, the ability to identify who those investors are. Accordingly, the OSC should be fully capable of informing affected investors that disgorged funds are available for distribution.

Proposal 38:
Strengthen investigative tools by empowering OSC Staff to obtain production orders and enhancing compulsion powers

We agree with the Task Force that the OSC needs to be equipped with the full set of modern investigative and enforcement tools that market regulators utilize today, both in Canada and internationally. This is critically important, not only for maintaining the OSC's basic operational capability, but also to preserve its ability to participate in joint investigations with agencies in other jurisdictions.

Furthermore, given the need to adapt to the rapid and accelerating pace of technological change affecting capital markets, the Task Force's recommendations in this area should be regarded as templates for establishing an ongoing process to upgrade the OSC's investigative and enforcement tools in future.

Proposals 35 and 37:
Improve the OSC's collection of monetary sanctions
Increase the maximum for administrative penalties to $5 million

Meaningful enforcement depends on meaningful administrative penalties and effective collection of monetary sanctions.

The Task Force's observation about the inadequacy of the OSC's current penalty limit is apt: "Certain sizeable registered firms or other very large entities would not be deterred by a $1 million sanction because, for example, $1 million could be an acceptable cost of doing business for such firms." But those large firms may be equally unfazed by a $5 million penalty – so consideration should be given to empowering the OSC to impose monetary penalties that exceed whatever financial benefit the firm derived from its non-compliance. That would more likely deter misconduct, while also depriving wrongdoers of all ill-gotten benefits.

The Task Force might also wish to specifically articulate how fine money placed in the OSC's Designated Fund may be used. The possibilities should include investor education, investor research, financial support for investor advocacy groups and investor protection clinics in the province and, if applicable, the whistleblower program. In addition, subject to proposal 46 (returning disgorged profits), monies from the Designated Fund might be used to help establish an investor compensation program for victims of securities fraud.

Proposal 34:

Consider automatically reciprocating the non-financial elements of orders and settlements from other Canadian securities regulators and granting the OSC a streamlined power to make reciprocation orders in response to criminal court, foreign regulator, SRO, and exchange orders

We support this proposal, but we believe it can and should be extended to apply to registration bans and suspensions issued by any Canadian financial services regulator or SRO, including those in the insurance, banking, pensions, mortgage financing and financial planning sectors.

As we stated in a February 2019 letter to the OSC:

> *Reciprocal enforcement is a laudable and important measure for curbing serial misconduct within the sphere of activity governed by provincial and territorial securities legislation. However, it is a measure designed to operate only within the securities "silo" and not as an integrated mechanism to help curtail wrongdoer migration into other financial sectors such as insurance, banking, pensions, mortgage financing and financial planning. The IAP would like to suggest that this can and should be improved by broadening the effective ambit of reciprocal enforcement.*
>
> *To state the matter simply: No one who lacks integrity or who has proven themselves ungovernable should be permitted to provide financial services of any sort, nor should they be allowed to advise the public about any type of investment. In our view, therefore, a ban or suspension imposed by any Canadian financial services regulator, including one of the SROs, should normally translate immediately and automatically into an equivalent ban or suspension by all federal, provincial and territorial financial services regulators and SROs across the country.*

Proposal 27:
Amend securities law to provide additional requirements and guidance on the role of independent directors in conflict of interest transactions

Strong independent director committees are essential for investor protection, and we believe it is a very good idea to codify best practices for independent committees.

To enhance the utility of this proposal, we suggest the Task Force consider recommending a prohibition against board, managerial or controlling shareholder actions that impede the adoption of those best practices.

Proposal 17:
Increase access to the shelf system for independent products

We regard this proposal as significant since it addresses shortcomings in the recently adopted Client-Focused Reforms (CFRs), namely:

> (a) The CFRs' best interest principles require dealers and advisors to consider the suitability of an investment product only in comparison to other products available on the particular dealer's shelf, instead of investments readily available elsewhere; and
>
> (b) Although the CFRs require dealers with mixed shelves to avoid instilling bias toward their proprietary/affiliated products, those dealers are not required to put independent products on their shelf that can compete effectively with their proprietary/affiliated products.

Proposal 17 would fortify the CFRs in these areas. However, we do not know why the proposal's applicability has been limited to bank-owned dealers, and it concerns us that this limitation may cause the proposal to be rejected, not because it lacks merit, but because it unfairly singles out one sector of the investment industry.

We suggest that the Task Force extend the proposal to cover all dealers, or at least all large independent ones as well as those owned by banks.

With regard to the Task Force's specific questions on this proposal, our responses are as follows:

- *Would these requirements increase the access of independent and alternative products for retail investors?* – Yes, provided advisors receive equivalent KYP information and support for the independent and alternative products, and provided the sales incentives are equivalent.

- *Should [a representative of] any entity that sells only proprietary products be labeled a sales person?* – Generally speaking, we consider it inappropriate and misleading to portray this activity as "advice". If the individual is limited to offering and recommending only proprietary products, we believe "salesperson" is accurate and appropriate. However, we recognize that some dealers may offer proprietary products along with comprehensive financial planning or discretionary portfolio management services performed by individuals who are bound by a statutory fiduciary duty or its equivalent under a credentialing body's standards. Those situations are more aligned with the provision of professional advice than the mere selling of investment products. It would be helpful and opportune for the Task Force to formulate a recommendation that appropriately captures these situations. In doing so, the Task Force could suggest amending the Securities Act to require that "salesperson" must be used for individuals operating under the suitability standard, while "advisor" may be used only by those bound by a statutory fiduciary duty or equivalent standard.

- *Should there be a prohibition against charging a fee to gain access to a shelf, including no advice channels?* – In theory, a reasonable standardized fee to cover the cost of conducting KYP due diligence might be justified for full-service dealers (there is no equivalent cost for no-advice dealers). However, such fees likely would act as barriers to entry for new investment product producers or small ones – so, for policy reasons, we believe these fees should be prohibited.

- *Should there be a review of redemptions from high performing third party funds into proprietary funds and report on those as well?* – Yes. That should be part of regular OSC compliance reviews to ensure systemic bias in favour of proprietary/affiliated products is not being instilled.

Proposal 15:
Expediting the SEDAR+ project

We support this proposal, with one caveat: regulators need to ensure that the new system is user-friendly for retail investors, including those with limited financial literacy skills.

To that end, we recommend that SEDAR+ be developed to operate with two distinct user interfaces – one for institutional investors, sophisticated retail investors and industry users (maximizing input efficiency), and a simpler interface for use by less sophisticated retail investors.

Ideally, the latter interface should be designed to support better investor decision-making through embedded links to education resources, especially those created and curated by the OSC's Investor Office.

Proposal 13:
Prohibit short selling in connection with prospectus offerings and private placements

We support this proposal to curb an abusive market practice.

Proposal 9:
Transitioning towards an access equals delivery model of dissemination of information in the capital markets, and digitization of capital markets

We agree in large measure with the Task Force's recommendations on this topic. As stated in our February 24, 2020 letter to the CSA commenting on *Consultation Paper 51-405 – Access Equals Delivery*:

- Electronic delivery of prescribed documents is appropriate and it should be the default mechanism for delivery of information to investors.

- This delivery should be accomplished by means of electronic link directly to the document online, with an ability to download and print the document in PDF format.

- Delivery should not be considered accomplished by providing a directive to look for the document on the issuer's website or on SEDAR. Nonetheless, issuers should be required to maintain a website where all their prescribed documents are clearly identified and available for viewing and downloading as PDFs.

- Press releases, where required, can similarly direct investors and interested parties to the issuer website where full information is available and where required documents can be easily located for viewing and downloading.

- We recommend that some standardization be mandated for the location and presentation of these documents on issuers' websites, so investors are not forced to hunt through an idiosyncratic labyrinth of web pages in order to find documents on each issuer's site.

- We also recommend that legislation or regulations be enacted deeming delivery and notice to have taken place a reasonable time following the sending of an email to the investor or after the public issuance of a press release, so as to give the investor an opportunity to review the material or information. Investors should have the ability to designate an agent for the receipt of information.

- Email addresses should be requested of investors. For those who don't have an email address or do not wish to receive documents in electronic form, communication can be sent by mail giving summary notice of the information that is available on the issuer's website.

It must be kept in mind, however, that data networks are not robust in all corners of Ontario, and that some investors, especially older ones, may not be proficient or comfortable online. Investors therefore should retain the ability to opt out of electronic delivery by requesting that documents be mailed to them in hard copy.

PROBLEMATIC PROPOSALS

Proposal 1:
Expand the mandate of the OSC to include fostering capital formation and competition in the markets

We support this proposal insofar as it relates to fostering market competitiveness, but our support does not extend to the part suggesting that the OSC should be required to foster capital formation through "a public policy imperative of growing the capital markets in Ontario."

Fostering market competitiveness is in the public interest and it will help investors by maximizing efficiency and opportunity while reducing costs. It also will fit well with the OSC's widely supported initiative, already underway, to reduce regulatory burden wherever possible so long as it's done without compromising investor protection. But mandating the OSC to foster market growth will not complement the OSC's existing responsibilities in the same way and it could potentially jeopardize or even undermine public trust in the OSC for several reasons:

(a) It will leave the OSC's mission conflicted and disjointed – In an OSC compelled to promote market expansion, growth initiatives will be the equivalent of profit centres and, inexorably, compliance and enforcement functions will be regarded as frictions or "costs" that hinder economic progress. The likely outcome will be a regulator constantly in conflict with itself – incented, by its own mandate, to subordinate its policing of market activity in order to advance that same activity.

(b) It may interfere with professionalization of advice – A mandate to promote market growth may stymie efforts to upgrade professional standards and practices in the investment industry. The OSC already is required to justify all new regulation through a cost-benefit analysis. Typically, it is more difficult to quantify the benefit to be realized from improving standards or averting harm than it is to calculate the savings achievable by relaxing restrictions or the costs associated with imposing new restrictions. It can be expected, therefore, that in any cost-benefit analysis pitting enhanced standards against growth, growth will nearly always win out.

(c) It will cast the OSC as a biased agency – A mandate to foster market growth will place the OSC in the awkward and unenviable position of being seen as a cheerleader for Ontario's capital markets when the OSC should more appropriately be positioned as a fair and objective regulator of those markets.

(d) It may harm perceptions of Ontario's capital markets – Imposing a mandate to promote market growth could do more than just damage the image of the OSC as a regulatory agency. It may also have an adverse impact on the way Ontario's capital markets are perceived – as investors almost certainly will wonder whether offerings in this province are being adequately regulated or simply promoted. We could, as a result, find it becomes harder, not easier, to attract capital.

(e) It could impede the OSC's crucial market protection role – We also could find that an imperative to grow Ontario's capital markets will impede the OSC 's ability to take necessary market protection action and might produce completely unsatisfactory results. For instance, in the case of binary options – which presented an enormous market growth opportunity – the OSC would have been compelled to foster their development instead of banning them, likely with costly consequences.

For all of these reasons, we believe a requirement that the OSC foster market growth is a step too far, going beyond a threshold of propriety and prudence that market regulators in major international jurisdictions have been careful not to cross. Financial regulators in many countries are mandated to foster competitive markets, including those in the jurisdictions cited by the Task Force (the U.K., Australia and Singapore), but on close review we have not come across overt directives to foster market growth in those places or elsewhere.

Consequently, we urge the Task Force to reconsider its call for a market growth mandate, and exclude it from the final version of this proposal. Instead, we suggest any mandate to foster capital formation and competitive markets in Ontario should state expressly that such efforts are to be undertaken in a manner consistent with the protection of investors and their interests (as is the case in the U.K. and Nova Scotia, for example).

Proposal 5:
Mandate that securities issued by a reporting issuer using the accredited investor prospectus exemption should be subject to only a seasoning period

This recommendation appears to be aimed at concerns involving institutional investors and the small segment of retail investors who are highly sophisticated and knowledgeable.

Truly sophisticated and knowledgeable investors don't need a 4-month holding period – the proposed seasoning period would adequately protect them.

However, at the retail level, it cannot be said that all accredited investors are sophisticated or knowledgeable. Neither attribute is required to qualify for accredited status under the current definition. A certain level of income or quantity of liquid assets is all it takes.

As a result, virtually anyone who sells an average detached home in the greater Toronto area these days may qualify instantly as an accredited investor, even if they've never made an investment in the capital markets before – indeed, even if they can't manage their finances at all.

We comment further on the inadequacy of the current accredited investor definition below in the section relating to proposal 14. In the section devoted to proposal 11, we also comment on the persistent indications that exempt market dealers, as a whole, have not demonstrated that access to advice from EMDs will adequately safeguard retail investors in the exempt market.

What's needed to protect retail investors is a real threshold that keeps the exempt market open only to those investors who actually have the sophistication and knowledge necessary to evaluate the risks involved – either on their own or after being fully advised about those risks by an advisor who is sufficiently proficient, is required to advise in the investor's best interest, and does so without being in a conflict of interest.

Until such time as a meaningful threshold is put in place, unsophisticated retail investors will remain effectively unprotected in the exempt market. Replacing the 4-month hold with a seasoning requirement will do nothing to change that.

Proposal 11:
Allow exempt market dealers to participate as selling group members in prospectus offerings and be sponsors of reverse-takeover transactions

We appreciate that the proficiency of exempt market dealers ranges widely, and generalizations about their competence and practices should be avoided.

However, regulatory reviews have raised repeated concerns about many EMDs' compliance with KYC and suitability requirements. Therefore, in our view, caution should be exercised in setting the operational ambit of EMDs, and the Task Force may wish to consider qualifying this proposal in some manner to ensure that it applies only to dealers with demonstrated ability to fulfill all the requirements associated with these transactions.

Proposal 14:
Introduce additional Accredited Investor (AI) categories

We agree with the Task Force that those who are licensed to advise others on investments should be able to qualify as accredited investors without meeting specific financial thresholds. But, rather than expand the categories of AIs, we believe it would be better to develop a real benchmark for investment knowledge or financial sophistication that could serve as the test for AI status.

As noted above with regard to proposal 5, income and wealth are not valid proxies for knowledge, sophistication or ability to assess or comprehend risk. At most, income and wealth are merely indicative of capacity to withstand loss – which may be important in the exempt market, but loss capacity surely shouldn't serve as a sufficient criterion for entry.

The Consumer Federation of America recently highlighted this issue in a March 9, 2020 letter to the U.S. Securities and Exchange Commission (SEC). In particular, the Federation noted that the SEC had conducted no meaningful analysis to determine whether the current definition of accredited investor serves its intended purpose of identifying a pool of investors capable of fending for themselves without the protections afforded in public markets. The Federation also noted that a thorough analysis would have to consider:

- The impact of inflation on the definition's financial thresholds – especially in light of one SEC Commissioner's estimate that, absent tying the thresholds to inflation, approximately 22.7% of U.S. households will qualify as accredited investors within 10 years (up from the initial 1.6% when the thresholds were set in 1982) and that number will approach 6 in 10 households (57.3%) in 30 years;

- How this inflationary impact affects issuers' preferences to raise capital on private markets, thereby contributing to the erosion of public markets;

- The potential impact on Americans' retirement security – specifically the impact of encouraging the marketing of illiquid private securities to retirement savers who qualify as accredited investors based on savings they must rely on for income through several decades of retirement; and

- The potential risk to the economy posed by a huge and rapidly growing private market about which the SEC lacks even the most basic information – such as who invests, how and why they invest, how those investments fare, and what the long-term impact is on sustainable job creation and capital formation.

Canadian regulators are equally in the dark about our exempt market. We believe it would be unwise, therefore, to expand the categories of accredited investors without first ensuring – through a thorough, evidence-based analysis – that any revised accredited investor definition serves the public interest by accurately identifying the pool of investors truly capable of "fending for themselves" and does not, instead, expose millions of unsophisticated investors to potential harm from illiquid, opaque and speculative private market investments.

The Task Force has an opportunity to address this issue by recommending that the OSC conduct such an analysis. We urge that this be done in order to truly modernize and appropriately democratize the gateway leading to private equity investments.

Proposal 33:
Allow for greater access to capital for start-ups and entrepreneurs

Continuing on this same theme, we are concerned about the proposal for developing angel investor groups or networks, which the Task Force likens to "investment clubs for accredited investors."

Again, as noted above, many people qualify as accredited investors by virtue of income or wealth instead of actual investment knowledge or financial sophistication. They are not all entrepreneurs or savvy financiers. Accordingly, it should not be presumed that a group of them together are capable of playing Dragons' Den or Shark Tank, and we therefore do not support a regulatory policy that would effectively encourage investment in early stage, high-risk start-ups by people who lack the ability to assess the risks involved.

Proposal 39:
Greater rights for persons or companies directly affected by an OSC investigation or examination

We understand and appreciate the need for investigative fairness and procedural safeguards. However, this proposal – unprecedented in its purpose and scope – could compromise OSC investigations, diminish their efficacy and even undermine their viability through delays and premature exposure of investigative leads, objectives, strategies and evidence. In particular:

- It can be expected that all investigation and examination orders will be challenged as soon as they are issued. Persons affected will routinely demand to know “why do you want this information?” or “why do you need to see it?”

- Likewise, in response to each and every summons there likely will be a demand for an explanation of why the testimony is needed.

- This likely will create extensive delays, as individual challenges of each order and each summons can be taken to a hearing and then to a judicial review – slowing every investigation and subjecting each one to scrutiny that will prematurely reveal its direction, objectives and findings.

- These revelations will have to be made in a publicly accessible forum, as the proposal contemplates that affected persons will challenge orders and summonses through court proceedings. A likely consequence will be that some investigations will cease to be viable, as investigative targets will gain the ability to tailor their testimony or destroy material evidence.

- It also can be expected that this will severely hamper the OSC’s ability to conduct joint investigations with other regulators in Canada and internationally, who will not want their own investigations and proceedings to be compromised in this manner.

In our view, the fairness issues noted by the Task Force would be better dealt with through a summary process designed to maintain the integrity of investigations and preserve investigative confidentiality.

So, for example, persons affected by an order or summons could make their objections to an adjudicator and OSC Staff’s response could be heard *in camera* and *ex parte*, with the adjudicator required to direct rebuttal (if needed) without the adjudicator revealing details of the investigation. The adjudicator also could be required to render a decision on the objection within a prescribed short time, and a statutory provision could make the decision final and not subject to judicial review.

Alternatively, the parties could utilize the OSC’s procedural rules to have a commissioner appointed as a case manager to mediate any request for clarification of, or objection to, an order or summons on a non-binding basis.

Proposal 42:
Ensure proportionality for responses to OSC investigations

As with proposal #39, this recommendation raises significant concerns about diminishing the efficacy of OSC investigations. In this instance, the problem stems from the Task Force introducing a procedural concept – proportionality – into a process where it is not a good fit.

The proportionality concept is useful and appropriate in civil proceedings. It prevents pre-trial discovery processes from becoming "fishing expeditions" – but it is not apt for regulatory investigations.

In a civil lawsuit, the issues raised in the parties' statements of claim and defence set the bounds of inquiry. Those issues determine what evidence will be relevant, and in that manner they provide a way to assess whether evidentiary material being sought through discovery is necessary, unnecessary, too tangential, excessively granular or just not significant enough to warrant the cost of retrieving it.

There are no such boundary markers governing a regulatory investigation. Each one begins and proceeds as an open-ended enquiry into issues that can be enlarged or shrunk depending on what the investigation uncovers – so there is no fixed reference point from which to measure what is proportionate or disproportionate.

For this reason, proportionality is unworkable in the context of an OSC investigation. This proposal, therefore, will do nothing but inject opportunities to delay those investigations through challenges to their scope; and while we expect that these sorts of challenges will tend to fail, the delays may succeed in stalling many investigations while evidence deteriorates or disappears.

Proposal 45:
Promote prompt resolution of OSC enforcement matters by ensuring the confidentiality of dialogue between OSC Staff and parties under investigation, and protecting such investigated parties from liability for admissions made to the OSC in settlements and from liability for disclosing privacy-protected information to the OSC in the context of an investigation

The common law principles relating to settlement privilege are well known. However, we found this proposal problematic for a number of reasons.

It seems to lose sight of the fact that settlements of OSC proceedings are made in the public interest. They are not negotiated "in the best interests of OSC Staff."

Similarly, the proposal fails to recognize that resolutions of civil lawsuits remedying misconduct by market participants – especially class actions that have been certified by the courts – are also outcomes that serve the public interest. They are not mere private agreements.

If regulatory proceedings have been concluded on the basis of an admission that a market participant has harmed investors, the party making the admission should not be shielded from responsibility for rectifying their admitted wrongdoing. Certainly, from a public policy standpoint, there's an air of unreality to the suggestion that admissions of this sort can or should remain privileged and must be considered confidential even after they've been made publicly to bring the regulatory proceedings to an end.

Market participants who wish to resolve OSC proceedings without making admissions of wrongdoing have the option of entering into a no contest settlement – but that requires them to first pay appropriate compensation to harmed investors.

There is no public policy justification for letting any wrongdoer have their "admission" cake and eat it, too.

ELEMENTS OF OTHER KEY PROPOSALS

Proposal 2:
Separate regulatory and adjudicative functions at the OSC

We agree that it is time for the OSC to evolve beyond a structure in which the Commissioners perform both rule-making and adjudicative functions. Separating the two will foster greater public confidence in the fairness of our regulatory system.

However, adjudication of regulatory matters cannot be conducted adequately in the absence of a thorough grounding in the policy rationale and strategic considerations underlying all rules and regulations promulgated by the OSC. Accordingly, if a separate adjudicative branch or independent tribunal is established, it will be essential to create mechanisms to ensure they are kept abreast of the specific factors that generate and mold the development of those rules and regulations.

At the same time, it also will be important to ensure that the adjudicative branch or tribunal is not politicized or influenced by partisanship of any kind, including government influence. So, we urge the Task Force to recommend that an independent adjudicative tribunal report, not to the Minister of Finance, but to the Attorney General – as most other provincial tribunals do.

Also, in connection with this recommendation, we think it is important that the Task Force provide greater detail on the specific roles and relationship of the OSC's Chair and CEO under the proposed new governance structure.

In response to your specific questions relating to this Proposal 2, our comments are as follows:

- *Under this new structure, who should have authority to exercise rulemaking (i.e., the CEO or the Board of Directors)?* – We assume the Board of Directors would be responsible, collectively, for fulfilling the OSC's mandate; and it would be the Board who will be chosen to collectively embody the public interest. On that basis, rulemaking authority should rest with the Board.

- *Are there certain matters that should not be referred to a tribunal, but retained by the regulatory side of the OSC, such as mergers and acquisition hearings?* – The adjudicative branch or tribunal should deal with compliance-related matters and enforcement proceedings. Issues relating to issuer corporate structure and finance, and matters of an administrative nature, should remain on the regulatory side.

- *Should the OSC's mandate include a directive requiring it to pursue a policy imperative of rules-based or principles-based regulation?* – We do not favour an "either-or" approach to the development of regulatory policy, and would not support embedding such a concept in the OSC's mandate. The OSC must remain nimble and therefore should retain the ability to tailor its approach to each situation requiring a regulatory response.

Proposal 3:
Strengthening the SRO accountability framework through increased OSC oversight.

We agree with many of the Task Force's comments about SRO accountability. However, given the national mandate of the SROs and their pan-Canadian operations, we believe it is premature for Ontario to proceed unilaterally on this front in light of the SRO framework review currently being conducted by the CSA.

That said, our position on SRO governance is already a matter of public record and in most respects it aligns closely with your proposal to implant in the SROs' recognition orders a requirement to appoint directors with investor protection experience.

Also, given that modern SROs are not meant to be mechanisms for advancing industry self-interest, and that retail investors are key stakeholders in SROs, we support the Task Force in calling for "greater stakeholder input on SRO strategic and regulatory priorities to ensure that the SROs are spending resources on and undertaking a regulatory program that is aligned with the public interest.”

But investors should not be relegated to providing their input as supplicants. They should have voice as full partners with the investment industry in governance of their joint, intertwined *community* of interests, and, going forward into the future, that community should be considered the “self” in self-regulation of Canada’s investment business.

In response to your specific question relating to this proposal:

- *Should there be an Ombudsperson service to address any complaints that SRO member firms may have about services received from their respective SRO?* – We do not regard the creation of such a service as necessary or prudent. It could become a means of giving firms control over the SRO or a way for firms to evade robust oversight by the SRO.

Proposal 4:
Move to a single SRO that covers all advisory firms, including investment dealers, mutual fund dealers, portfolio managers, exempt market dealers and scholarship plan dealers

Again, we must preface our comments by stating that this proposal is premature in light of the CSA’s SRO framework review. We believe the Task Force should await the outcome of that review before making final recommendations to the Ontario government on this topic.

Nevertheless, at this time we can say that, in general terms, it makes sense from an investor perspective to place investment dealers and mutual fund dealers under a single regulatory regime. It also makes sense to include PMs, EMDs and SPDs – either immediately or soon thereafter. However, three additional key considerations apply in assessing this proposal from an investor perspective:

(a) The single regulatory regime need not necessarily be an SRO. It could be direct oversight by statutory regulators – either individually in each province and territory, or nationally through the CSA, or a hybrid of CMRA/non-CMRA jurisdictions if and when that system becomes operational. But in any case it should *not* be an SRO unless that SRO is designed to serve the interests of retail investors as well as its member firms.

(b) For the interests of retail investors to be adequately served by an SRO, those investors must have voice as full partners in the SRO’s governance and at the heart of its decision-making apparatus. In effect, as mentioned above, the

SRO should represent and govern the symbiotic interests of investors and member firms as an investment *community*. The self-regulatory organization therefore must be an entity that defines its "self" as that community. It must see its purpose as serving the communal interests of investors and the investment business, as well as the broader public interest.

(c) From a retail investor perspective, the rationale for including PMs, EMDs and SPDs under one unified regulatory regime also applies to all other investment and financial advisors. Accordingly, financial planners, mortgage brokers, pension plan advisors and those who sell insurance-based investment products should also be included. Investors and other financial consumers need to be able to expect that anyone providing investment or financial advice of any kind in Ontario:

(i) will be proficient;

(ii) will provide advice that's in the best interest of the person they're advising (either free of conflicts of interest or only after disclosing and resolving any conflict in their client's favour); and

(iii) will be subject to a consistent level of robust oversight and effective rule enforcement.

In response to your specific questions on this proposal, our comments are as follows:

- *Should SRO's regulatory oversight be commensurate with the market participant's size and sophistication?* – No. Size and sophistication do not correlate (positively or negatively) to risk of compliance failure or risk of resulting harm to investors.

- *Should SROs carry out registration functions for the OSC?* – No. This would create a conflict of interest. So long as SRO revenue is derived from member firm fees, the SRO will be incented to register as many firms and their individuals as possible. The public would have doubts whether proficiency requirements were being fully met, and whether evidence of poor character was being disregarded.

Proposal 6:
Streamlining the timing of disclosure (e.g., semi-annual reporting)

We understand the Task Force's concern that the cost of quarterly reporting can, in some instances, exceed its benefit – especially for small issuers whose financial position may not change much during a quarter.

However, quarterly earnings reports are the bread and butter of information for stockholders and analysts who want the most up-to-date information, and who regard those reports as a way to secure transparency from companies they invest in or analyze.

The importance that frequency plays in this information flow is highlighted in a study published by the Kelley School of Business Research in August 2019. The study found that, with information and transparency provided only by semi-annual earnings announcements, investors would tend to over-react to news from competitors or other information about the industry in the media. This indicates that even if companies choose to go to semi-annual reporting cadence, investors will invariably seek other sources of information to make their investment decisions.

We note also that, compared to a six-month cycle, quarterly reporting serves as a better safeguard against the development of gaps between insider and public information – thereby possibly decreasing the likelihood of insider trading.

The public financial reporting component typically represents a relatively small additional element of what the company would be generating anyway. So, while it could reduce the "last mile" of its financial reporting requirements, the incremental time and cost involved is only a fraction of the total cost. The real solution here is to address the underlying problem by employing technology to streamline the process for consolidating, closing and transmitting financial results.

Proposal 8:
Introduce greater flexibility to permit reporting issuers, and their registered advisors, to gauge interest from institutional investors for participation in a potential prospectus offering prior to filing a preliminary prospectus

We appreciate the intent of this proposal but cannot support its prioritization of institutional investors' interests over those of retail investors.

Allowing a preview for institutional investors will give them an unfair advantage in accessing investment opportunities. If the preview of an offering indicates strong institutional interest, there will be no incentive for dealers to engage in the labour-intensive task of marketing that offering at the retail level, so institutional players will acquire the bulk of the offering even if the dealer has a policy in place to fill orders equitably.

Perhaps some mechanism can be devised to avoid this outcome, but it's hard to imagine one that would actually be workable and also fair.

For example, reserving a set portion of each offering (say 25%) for retail investors is arbitrary, and it doesn't really solve the fairness problem if it leaves a significant amount of retail demand for the offering unfilled.

Nor would these problems be mitigated by giving retail orders priority, or by imposing a lottery system for fills. Those measures likely would prevent institutional investors from committing to buy. So again, just as noted above, if institutional previews are permitted, dealers will be dis-incented to seek retail orders wherever previews indicate strong institutional interest.

We "get it" that a previewing process could be quite valuable in fostering capital formation. For that reason, we encourage the Task Force to come up with a process that is fully equitable. But absent finding one, we urge the Task Force to abandon this proposal.

Proposal 18:
Introduce a retail investment fund structure to pursue investment objectives and strategies that involve investments in early stage businesses

It is not clear whether the Task Force intended this proposal to channel funding only toward early stage businesses or also toward established small enterprises. Support for both will be crucial to rebuilding Ontario's economy in the wake of COVID-19, especially since the majority of private sector jobs are provided by small business.

But that support cannot come indefinitely from government subsidies. Although they constitute lifelines right now, subsidies tend to breed dependency instead of vigour and resilience. Likewise, easier access to credit is not the answer, as it will just encumber our entrepreneurs with weighty debt burdens going forward.

Instead, these businesses will need a sustained equity infusion. And in these challenging times, that may well require mobilizing ordinary citizens to invest their savings in the country's small businesses and early-stage enterprises – something that will entail taking considerable risk.

In return, investors should be able to expect that their capital will be treated as a precious resource. They should be protected from having it squandered or placed unnecessarily at risk through incompetent advice, or diverted to inefficient use because of conflicts of interest, or eroded by high fees.

This will require the investment industry to step up. More than ever, dealers will need to upgrade the proficiency and professionalism of advice they provide. The industry also will need to ensure investment products such as those contemplated by this proposal are structured, marketed and distributed through sales channels aligned, as far as possible, with investors' best interests.

Regulators must play their part, too, by swiftly putting in place a full suite of clear and robust rules setting these standards for issuers, dealers and advisors, and by enforcing those rules.

We recommend that the Task Force integrate this framework into their proposal for the development of investment products aimed at facilitating capital formation for start-ups and small business. Those products are much needed to help rebuild Ontario's economy, but they require adoption of the other measures identified here in order to make them a fair and reasonable proposition.

In addition, these products should be subject to limitations, as noted in our answers to the following questions posed by the Task Force:

- *Do you think this type of fund would provide a meaningful new source of financing for small business in Ontario?* – Yes, especially if it can be structured in a way that allows retail investors to support "local" small business in their city or region.

- *Should the scope of the investments, or a portion of the investments, for this type of fund be specifically limited to small business or expanded to other types of businesses?* – Precluding development of hybrid funds seems unnecessarily restrictive; but investing successfully in small business ventures requires specialized expertise, so it probably would be prudent for the funds to focus on small business.

- *Since these funds would be available to retail investors, are there any specific conditions that should be prescribed to protect investors?* – These funds should bear the highest risk rating, plus clear risk disclosure in plain language. Also, given the liquidity issues and asset valuation issues that likely will be associated with these investments, regulators should consider implementing a requirement for pre-purchase advice from a registrant specifically certified for proficiency in this field. Consideration also should be given to a prohibition against leveraged purchases, and portfolio limits on purchases (say, 10% of portfolio assets).

Proposal 19:
Improve corporate board diversity

Board and executive diversity matters to investors, particularly in light of growing evidence that merit-based diversity contributes to superior corporate financial performance.

Our answers to the Task Force's questions on this topic are as follows:

- *What should be the appropriate target for women and BIPOCs? What timeline should be prescribed for these targets to be achieved?* – Although appropriate and achievable targets, no doubt, are context specific for each industry and perhaps for each company, the disappointing results from "comply-or-explain" suggest progress will remain elusive without prescribing at least minimum targets and timelines. We are not, ourselves, equipped to specify suitable minimums, but as a general comment we do suggest that consideration be given to combining aggressive targets with a mechanism for shareholders to grant some temporary latitude in achieving them.

- *What would be ways to increase compliance for companies who do not meet these targets?* – We believe the most appropriate and effective mechanism would be a prescribed, meaningful reduction of director and executive remuneration until the targets are met.

- *Should these requirements be extended to all reporting issuers?* – Yes. We see no reason why this initiative should be limited to TSX-listed issuers.

Proposal 20:
Introduce a regulatory framework for proxy advisory firms (PAFs) to: (a) provide issuers with a right to "rebut" PAF reports, and (b) restrict PAFs from providing consulting services to issuers in respect of which PAFs also provide clients with voting recommendations

We agree that issuers should be able to reply to these reports, so long as opportunity is provided for PAFs to respond. The issuer should not have the last word.

With regard to PAFs carrying out dual roles, we think mandatory disclosure would be a sufficient safeguard if it were coupled with a requirement to resolve all conflicts of interest in the client's favour. A blanket prohibition seems unnecessary.

Proposal 32:
Requirement for market participants to provide open data

We caution that mandating open data will not benefit investors and will do little to facilitate competition in the absence of regulation also ensuring that:

- Investors are the owners of their data,

- Only they can place their data into the open data stream and determine how it will be used in that system and with whom it will be shared,

- Robust measures are in place to protect their data and their privacy, and

- Effective regulatory enforcement measures reinforce these directives.

Proposal 36:
Create a prohibition to effectively deter and prosecute misleading or untrue statements about public companies and attempts to make such statements

More detail is needed on this proposal. In particular, the Task Force should indicate whether it recommends prohibiting only untrue statements made knowing they are false or baseless, and made for the purpose of manipulating the market. As presently articulated, the proposal's chilling effect cannot be fully evaluated.

<u>ADDITIONAL COMMENTS</u>

As we stated at the outset of this letter, we acknowledge the depth and breadth of the 47 proposals presented by the Task Force. However, the proposals leave unexplored a few issues that we urge the Task Force to address in its final report.

(a) Independence of the OSC

We agree with the Task Force that Ontario's prosperity depends on the province's capital markets being dynamic and competitive. But our markets also must be stable and enduring, and they must remain attuned to our economic circumstances – even as Ontario's economic goals and priorities evolve and as governments, inevitably, come and go.

A prescription for modernizing our capital markets, therefore, must articulate a clear vision for their independent regulation. To that end, the Task Force should consider proposing:

- A non-partisan process for selection of the OSC Chair and Vice-Chairs, its CEO and its commissioners/board members, based on criteria that align with all elements of the OSC's mandate, including investor protection skills and knowledge; and

- Governmental and ministerial oversight principles that establish tenets of non-interference in the OSC's policy development and rule-making processes – particularly in the OSC's delineation of the public interest for purposes of administering the Securities Act and its regulations.

(b) Criteria for accredited investor status

Several of the Task Force's proposals involve expanding the exempt market to offer new financial products and investment opportunities to accredited investors. But, as noted in a few of our comments on Problematic Proposals, Ontario lacks a meaningful test for determining whether an individual should be considered an accredited investor.

It would be very helpful if the Task Force could formulate a recommendation addressing this problem. Specifically, a workable test is needed to gauge whether an individual possesses the investment knowledge or financial sophistication required to assess and understand the risks involved in an investment on offer.

(c) Harmonizing regulation

It is unclear from the Task Force report how making securities regulation a competitive advantage for Ontario fits with harmonizing regulations across the country. Certain proposals appear to be inconsistent with elements of the CMRA project (e.g., an adjudicative branch potentially structured in a manner that differs from that articulated for the CMRA; a proposed veto for Ontario over SRO policies and appointments) despite the report noting that Ontario remains committed to joining the CMRA. We hope the Task Force's final report will clarify this.

Also, there has been no indication whether the Task Force considered the relative merits of combining the OSC with FSRA, nor whether the cost/benefit of combining the province's two largest financial regulators was analyzed relative to the cost/benefit of participating in the CMRA.

(d) Statutory recognition of the Investor Advisory Panel

For the past 10 years, the OSC has found it useful to have a standing advisory committee devoted to providing the Commission with input on policy issues based on the perspectives of investors and investor advocates. Unlike the OSC's other advisory groups, the Investor Advisory Panel (IAP) is expressly mandated to operate in an independent self-directed manner, with its own budget and research capability. It is the only advisory committee that is not chaired by an OSC director or senior staff member.

Despite its autonomous status, the IAP is not a statutory body and therefore its mandate is at all times subject to revision or termination by the Commission. But because the OSC's own mandate gives a measure of prominence to investor protection, the IAP could conceivably be regarded as an integral and essential component of the OSC's regulatory framework – which raises the question of whether the IAP's existence and mission should be acknowledged and given some degree of permanence by the Securities Act.

We would welcome the Task Force taking the opportunity to explore this question, as part of its modernization of the Act and its effort to secure the OSC's place as an innovative and forward-thinking regulatory agency.

* * *

We wish to thank you and your colleagues for this opportunity to comment on the Task Force report. Please contact us if you require any additional information or wish to hold further discussions about these matters.

Sincerely,

Neil Gross
Chair, Investor Advisory Panel