ONTARIO TEACHERS' PENSION PLAN BOARD
RESPONSES TO
SECURITIES REVIEW ADVISORY COMMITTEE
ISSUES LIST
MAY, 2000

INTRODUCTION

As an active institutional investor in Canada's capital markets, the Board has strong views on aspects of Canadian corporate and securities laws, and the administration of those laws, particularly as they impact on shareholders' rights.

While we will comment on many, but not all of the issues raised, and a final issue that was not raised at all, of paramount concern to the Board are the need for improved continuous disclosure by Canadian issuers, and the requirement for a more robust enforcement by the regulators of the laws that exist. We also consider the plethora of regulation at the federal and provincial levels damaging to the efficiency of the capital markets in Canada and hence a matter that should be addressed.

While we have views and concerns on the operation of securities laws and regulations from an institutional buyer's perspective, we do not always have answers to the problems that we see. To the extent that any of the following comments raise questions with the Committee, we would be pleased to elaborate.

ISSUES LIST

3. We observe that there are many types of registration required under the Ontario Securities Act (the "Act") for what amounts to much the same type of activity. Whether a person or company is giving advice or executing a trade, the same standards of disclosure of conflicts of interest should apply.

4. The internet is growing rapidly, and regulation that recognizes this new "open system" needs to be in place to allow for all investors to expect fair dealing, no matter the transaction/information vehicle. Recourse to the appropriate jurisdiction should be available should investors be "mistreated".

6. We believe that, to the extent that control block restrictions are desirable from a policy perspective and hence in the Act, they should prevent the structuring of transactions around them. It is troublesome to us that insiders of companies can appear to hold large positions in the companies they founded or manage, and yet have disposed of their economic interests in lending or derivative arrangements that do not engage the insider reporting requirement. Investors rely on insider reports because they confirm or deny an alignment of the interests of founders and management with those of shareholders. To the extent that they do not reflect reality, the Board has an issue. See our response to item 30 for more particulars on our views around enforcement on insider trading violations.

7. Legending of securities certificates needs to be changed to reflect the book-based system in which we operate, at the very least. We might suggest full disclosure of securities which have hold periods in certain investors, hands, as this may be information that other investors consider material.

8. What we term “balkanization” in securities regulation is problematic. The activity itself, rather than the provider of that service, should be the focus of regulation. Coordination among financial services regulators would be beneficial.

9. Capital market participants who have a problem with a service provider in the industry should have recourse to an ombudsman or arbitration scheme, provided that there remains the right for the injured party to escalate a complaint beyond the ombudsman or arbitrator to the securities regulator or the courts.

10. We believe that the Act should not be extended to regulate derivatives. For the most part, trading in derivatives occurs between sophisticated parties that do not require the protection of the Act. The derivatives participants are under the regulation of other bodies, and to make laws around trading in derivatives would further duplicate regulation of participants in these markets. Finally, participants would structure around constraints imposed upon these activities in Ontario by going elsewhere. Such activity would not encourage Canadian capital market development. As long as individuals who may be informed, though perhaps not sophisticated, are protected in their derivative activities, it is not relevant to us where the protection may be.

11. The argument to require registration for all market participants who exert influence over decision-making in respect of securities transactions is compelling.

12. Many investors, both retail and institutional, make investment decisions without the help of any registrant. "Know-your-client" rules, and perhaps even the need for intermediaries themselves, are irrelevant in circumstances where execution of trades is all that is required. Clients should be required to sign clearly worded, comprehensive acknowledgements that they are responsible for undertaking transactions without advice.

14. We believe that, as their name suggests, SRO's should enforce their own rules. We do not believe, however, that the OSC should delegate its enforcement powers to an SRO. We do believe, though, that the OSC could have some role in ensuring that the SRO's rules are followed through the exercise of the OSC's enforcement powers.

15. We believe that investors should be permitted to go where liquidity exists, and that trading is borderless. We favour competition among exchanges. To the extent that the OSC exercises competent oversight over exchanges, it should recognize exchanges to provide competition and hence liquidity. The OSC would have to mandate a "virtual" order book in which all exchanges would participate, otherwise liquidity and supervision would be fractured.

16. We would agree that the Act needs to recognize the role the OSC plays in ensuring all regulations, whether through the Act or an SRO are adhered to, and that enforcement is included with this role.

17. "It is our understanding that the provision of custody services in Canada is regulated through the federal Bank Act (?) and the relevant provincial Trust Company Act (?). The extent to which the capital adequacy rules regulate the institution providing custody services is determined by the assets under custody in the jurisdiction and appropriate segregation of assets are the critical investor concerns. What may warrant increased scrutiny by the Act or other regulators is the extent to which assets under indirect custody (i.e. international assets in foreign jurisdictions) are considered in the calculation of capital requirements and monitoring of sub-custodian activity.

18. We would support the modernization of laws that govern the holding, transferring and pledging of securities held through the indirect holding system. The vast majority of securities would be registered in CDS and a clear and certain legal foundation for the indirect holding system would advance securities law into the modern age.

19. The Board was represented, through the participation of its executive vice president of investments, on the Allen Committee. We wholeheartedly endorse the recommendations of the Committee and encourage their implementation into law, quickly. Information is the lifeblood of trading on securities markets, and misinformation, with no consequences to the purveyors of it, will continue to have very high costs to Canada's capital markets. A more effective system of continuous disclosure will still not meet the appropriate standards unless directors and officers are liable for continuous disclosure statements.

20. We observe that corporate Canada has a surprisingly high test for the nee to disclose matters of "materiality", whether of "material facts" or "material changes". A focus on "material information" may be beneficial, but the importance of the requirement for disclosure once a threshold is met, whatever the threshold, cannot be over-emphasized. The owners of a franchise, the shareholders, have a right to know about things that are significant to their property, whether that be material contracts with major shareholders or test results. Enforcement of laws for failure to meet disclosure obligations is key. Boards and management must take their disclosure obligations more seriously in Canada, and consequences for a failure to do so must attach. There is now little disclosure liability outside of a prospectus document. The vast majority of securities transactions occur in the secondary market, so a system that regulates only securities offerings does not properly support the integrity of the capital markets.

21. If the standards of the CICA Handbook are not high enough to protect investors in Canadian issuers adequately (which arguably, in light of several recent and high profile failures, they are not), they must be raised by the OSC. We read and support the Report of the NACD Blue Ribbon Commission on Audit Committees and encourage common accounting standards across jurisdictional boundaries. The more Canadian issuers are obliged to present information in a way that is understood by non-Canadian investors, the more attractive Canada becomes as a place to invest. We observe that many Canadian issuers list on the NASDAQ so that they comply with US financial statement disclosure standards and are hence eligible for US fund investment. Canadian regulators should definitely "raise the bar". We would go on to say that it may be less a question of the standards and more a question of enforcement of the existing standards and the use or misuse of "professional judgment" that appears to be lacking. Rigorous application and enforcement of the GAAP and GAAS standards for financial statements is critical to the long-term success of the Canadian capital market and Canadian issuers. Any pressure that could be brought to bear on the harmonization of International Accounting Standards would be useful. It is our understanding that this is currently being pursued through a recently restructured Board of International Accounting Standards Committee (ISAC).

22. Selective disclosure is a problem for issuers and for investors. It should be addressed in legislation and attach significant consequences for improper conduct by both issuers and investors who make use of information that has been disclosed on a selective basis. The SEC's proposed rules address the problem and would be a good model for the OSC. Selective disclosure is tied to continuous disclosure and there should be consequences for improper disclosure.

24.-27. We would make two comments on mutual funds. The first goes to our view that their holdings, irrespective of beneficial ownership, should be consolidated for reporting purposes. To the extent that mutual fund managers do not consolidate their portfolios under management, they are at a competitive advantage over institutional competitors in the marketplace, who have to discuss their holdings. We also believe that the role of the board of a mutual fund should be clarified.

28. The Board's position on shareholder communication is that there should be no restriction on shareholders communicating among themselves in respect of property that they hold in common with others. We have participated in the modernization of the CBCA in making submissions to Industry Canada and testifying, both in 1996 and 2000 before the Senate Banking Committee. If it would assist this committee, we would be pleased to provide copies of our submissions.

29. The Board made a submission entitled “Re: Take-over Bid Rules and Shareholder Rights Plans – A Matter of Time” dated September 21, 1995 in which we recommended that the OSC use its rule making power to make shareholder rights plans a prohibited defensive tactic upon the OSA being amended to extend the minimum bid period from 21 to 35 days. We support the extension of the minimum bid period to 35 days, as expressed in the *More Tax Cuts for Jobs, Growth and Prosperity Act, 1999*; however, if shareholder rights plans continue to be a permitted defensive tactic (which seems to be the prevailing view), we would like to see an even longer minimum bid period, perhaps 35 business days. This is an area of considerable interest to the Board, and we would be pleased to discuss it further with the committee.

30. We are highly skeptical of the OSC’s detection capabilities with respect to insider trading and would encourage heightened attention to investigation of trading situations that attract media coverage. We laud the OSC’s increased allocation to enforcement. See item 6 for our views on structured transactions that avoid insider reporting obligations.

31. The Board encourages the express inclusion of offences in either the Act or the regulations, so that “bad actors” can be pursued and dealt with quickly and decisively. We would very much like to see the OSC as a “force to be reckoned with”, much like the SEC, rather than a regulator with no offences to pursue and no resources to do it. Putting offensives in the regulations or the rules, rather than in the Act, might make the OSC more able to respond to “flavour of the month” offences.

32.- 33. We come at the problem of regulatory harmonization in the securities area from a deliberately naï ve perspective, and prefer to put political and constitutional issues aside in articulating our position. We recognize that, in fact, coming to the “sensible” conclusion for Canada is not straightforward. A national system of securities regulation is the desirable end result. No matter how good Ontario gets, if the system is based on harmonization and co-operation, and other jurisdictions have less good standards and enforcement capabilities, there will be a “race to the bottom”. Issuers will earn the right to raise money in the capital markets in less rigorous regulatory environments, get listings in the premium markets, and tarnish the reputation of the entire country. The provinces need to recognize that Canada is suffering as a destination for business and capital because they refuse to give up jurisdiction to a first class regulatory regime that is administered and enforced by a first class regulator. Canada needs to get on one page in securities administration if it hopes to compete globally.

34.- 38. Securities laws should be updated to bring them into the technological age, and our view is that liability must attach to information that issuers place in the public domain, whether over the internet or otherwise. Companies will communicate with their customers and their investors in ways that are consistent with their corporate culture, and it is incumbent on legislators and regulators to keep pace with the people they are trying to regulate. While regulation may not be necessary to permit shareholders to vote on-line, issuers should be required, by legislation, to disclose the results of the vote on any special resolution

39. We are supportive of the OSC's rule-making authority. It permits flexibility in the administration and enforcement of standards in a dynamic area. Information is available at a speed that may not have been fully appreciated only a few years ago, and opportunities to make use of that information 24 hours a day requires agility in regulating and enforcing regulation.

40. We believe strongly that the OSC should have whatever enforcement powers are permissible in a democratic society to do the job it has of protecting investors in the Canadian capital markets. They look very weak at the moment. Canadians depend on the capital markets for their retirement security, and the OSC has a significant responsibility to safeguard that security.

Other One is that does not appear to be addressed is the role of the Issuer's Trustee as an intermediary in the efficient transfer of capital from investor to investor, particularly with respect to the processing of take-over bids. There do not appear to be any standards or requirements to act within the best interests of the shareholder. Timely exchange of shares and cash in a manner consistent with standard settlement time frames is important to assure all investors are on a level playing field.

CONCLUSION

Having completed the review and comment process by interested persons at the Board, we have taken a step back and would put a few of our own issues on the Committee's list:

1. What does the Committee see itself trying to regulate?

2. What is the difference between corporate law and securities law and how could the integrated whole be better regulated?