

GLORIANNE STROMBERG

50 Keewatin Avenue
Toronto ON M4P 1Z8

Telephone: (416) 481-8941
Telecopier: (416) 481-3944

E-Mail: gstromberg@sympatico.ca

June 9, 2000

Purdy Crawford
Osler, Hoskin & Harcourt LLP
Barristers & Solicitors
Box 50, 1 First Canadian Place
Toronto ON M5X 1B8

Dear Purdy:

Re: Five Year Review of Securities Legislation in Ontario

Thank you for your letter of April 28, 2000 inviting me to comment on the Request for Comments, Issues List, and Commentary and Additional Questions of the Securities Review Advisory Committee which was published in the *OSC Bulletin* dated April 28, 2000.

The Securities Review Advisory Committee has been established at a time when the effectiveness, appropriateness and relevance of current regulatory and supervisory structures and systems are increasingly being questioned. The Committee accordingly has a unique opportunity to make recommendations for changes that will better match regulation and oversight with marketplace realities.

As you know, I have made extensive recommendations on this subject. The recommendations provide an integrated framework for addressing the matters dealt with in the Issues List. The recommendations are primarily strategic and are contained in the documents listed in the first footnote below¹. They should be helpful to the Committee in placing in context the many matters dealt with in the Issues List while avoiding the risk of becoming immersed in minutiae. The 1998

¹ *Regulatory Strategies for the Mid-90s - Recommendations for Regulating Investment Funds in Canada*, prepared for the Canadian Securities Administrators, January 1995. (Available in printed form from the Ontario Securities Commission and in electronic form at <<http://www.osc.gov.on.ca>>) This Report is sometimes referred to as the "1995 Report".

Regulation and Supervision of Investment Funds in the New Financial Landscape - A Canadian Perspective presented by Glorianne Stromberg as part of the background material for the third session of the Expert Meeting on Institutional Investors organized by the OECD Committee on Financial Markets in July of 1997. (1998 OECD Publications, *Institutional Investors In The New Financial Landscape*, Page 449) This paper is sometimes referred to as the "1997 OECD Background Paper".

Investment Funds in Canada and Consumer Protection - Strategies for the Millennium, a Review by Glorianne Stromberg prepared for the Office of Consumer Affairs, Industry Canada, October 1998. (Available in printed form from Industry Canada's Information Distribution Centre and in electronic form at <<http://www.strategis.ic.gc.ca/oca>>) This Review is sometimes referred to as the "1998 Report".

Globalizing Securities Regulatory Strategies, Remarks by Glorianne Stromberg prepared for the Panel Discussion on Developing Uniform Standards to Allow a Global Passport for Mutual Funds at the 1999 Conference of the International Bar Association Section on Business Law Barcelona, Spain - September 26 - October 1, 1999, published May 2000 in *Business Law International*.

Report, the 1997 OECD Background Paper and the paper on *Globalizing Securities Regulatory Strategies* provide an overall strategic framework while the 1995 Report focuses on the application of the strategies to investment funds.

I hope that in developing a framework for remedial recommendations, the Committee will give serious consideration to all of my recommendations including:

- adopting an integrated regulatory structure as outlined in Sections 10 and 12 of the 1998 Report;
- implementing a common regime for money management as outlined in Section 12 of the 1998 Report;
- reviewing the effectiveness of the self-regulatory component of the securities regulatory regime as outlined in Section 12 of the 1998 Report;
- making systemic changes in the securities regulatory system aimed at putting all investors on an equal footing and improving the quality and timeliness of the information that is in the marketplace as outlined in Section 13 of the 1998 Report; two fundamental changes include replacing the closed system of securities regulation with a simple issuer-based, integrated disclosure model and leveling the playing field with respect to the dissemination of information;
- adapting regulation to recognize the increased role of advice-giving with particular emphasis on enhancing competence and proficiency standards and simplifying the registration system as outlined in Sections 15 and 16 of the 1998 Report;
- creating an effective disclosure system as outlined in Sections 14, 17 and 18 of the 1998 Report;
- establishing an effective governance regime including prudential oversight and operating standards for investment funds as outlined in Sections 19, 20, and 25 of the 1998 Report; and
- enhancing consumer redress mechanisms as outlined in Section 24 of the 1998 Report.

I am including (as Appendix 1 to this letter) a copy of my letter to David Brown, the Chair of the Ontario Securities Commission, dated May 29, 2000 responding to his request for my comments on the draft 2000/2001 Statement of Priorities of the Ontario Securities Commission. Some of the comments in this letter may be helpful to the Committee's deliberations. I refer in particular to those respecting building an integrated financial services agency (including the desirability of integrating corporate and securities regulation and possibly bankruptcy and insolvency regulation), the need for timeliness, the need for simplification of regulation, and the need to enhance responsibility and accountability.

One of the matters that the Committee will be looking at is the current rule-making process. My observation is that it is not working. It has become a costly, cumbersome, legalistic and complex process. For a variety of reasons, it is not meeting one of the core needs for which it was designed - that of making timely changes to securities regulation. It is also not meeting the core needs for clarity and certainty. Instead, the resulting rules have contributed to greater complexity and confusion.

With respect to the comments on the need for the simplification of regulation that I made in conjunction with the draft 2000/20001 Statement of Priorities of the Ontario Securities Commission, I would add that as a minimum, there is a need to re-write the Securities Act, the Regulation under the Act and the Rules made under the Act to eliminate their often overlapping and conflicting provisions.

* * *

I hope that the foregoing is of assistance to you. I would be glad to discuss any aspect with you if you should wish. In the meantime, I send my best regards.

Yours very truly,

Glorianne Stromberg

GLORIANNE STROMBERG

50 Keewatin Avenue
Toronto ON M4P 1Z8

Telephone: (416) 481-8941
Telecopier: (416) 481-3944

E-Mail: gstromberg@sympatico.ca

May 29, 2000

David A. Brown, Chair
Ontario Securities Commission
Suite 1800 Box 55
20 Queen Street West
Toronto, ON M5H 3S8
Canada

Dear David:

Thank you for your letter of April 4, 2000 requesting my comments on the draft 2000/2001 Statement of Priorities of the Ontario Securities Commission (OSC) which you enclosed.

Having spent so many years working with the OSC both before and while I was a Commissioner, I am well aware of the challenges that the OSC faces and the dedication of its staff in working to address them. I therefore offer the following observations and comments in the hope that they will be of constructive assistance to the OSC in developing and implementing its business strategies and priorities.

1. **Strategic Considerations and Key Challenges** - The announcement by the Province of Ontario (which was made following the publication of the Statement of Priorities) of its intention to merge the OSC and the Financial Services Commission of Ontario (FSCO) presents the OSC with what is probably its most significant strategic consideration and key challenge.

The merger proposal is a unique opportunity to make substantial progress on the road to building an integrated financial services agency. This is so despite the fact that at present the banking pillar, with the exception of certain functions, will not be part of such agency.

Hopefully Ontario's integrated financial services agency will be a prototype for a similar approach in other Provinces and Territories and will ultimately form the basis for agreement on an integrated financial services agency that will operate throughout Canada.

I therefore think it is important that the OSC recognize the immediacy of the strategic challenge with which it is presented and that it focus a large part of its efforts on working with FSCO and others to implement the OSC/FSCO merger effectively and efficiently. In doing so, it will be important to not just build a "container" around separate pillars or silos but to focus on creating a structure that matches regulatory supervision and oversight with integrated functional processes so that from the regulatory perspective at least, it will make no difference which type of institution is carrying out the function. It will also be important to incorporate sufficient and appropriate prudential regulation into this functional regulation.

As you know, I have written and spoken extensively on this subject and on the need for the regulatory and supervisory structure and system to match marketplace reality.

Another aspect of the OSC/FSCO integration initiative that should be focused on is the desirability of integrating corporate and securities regulation. The difference between what is a matter of corporate law regulation and what is a matter of securities law regulation is increasingly difficult to distinguish. In at least one jurisdiction (Australia) that has integrated corporate and securities regulation, bankruptcy and insolvency regulation has also been included with corporate and securities regulation. Some thought should be given to whether this would be desirable to do here as well.

2. **Increasing Knowledge and Awareness** - The OSC's increasing recognition of the need to enhance peoples' knowledge and awareness which is reflected in the Statement of Priorities is encouraging.

It is important to recognize that this need to enhance knowledge and awareness applies not just to investors but to industry participants and regulators as well.

I note that throughout the Statement of Priorities the term "investor education" is used but I sense that the term is being used primarily in the context of "pushing" information at people without recognizing that this didactic teaching approach is falling short of achieving the OSC's goal of investor protection.

It is also important to recognize that it is not just information that people need. They also need the means to understand and apply such information and to comprehend its impact on their decision-making.

3. **OSC Mandate** - The OSC has made references in various places (including speeches) to the need to amend its constating legislation to extend its mandate to include "investor education".

With respect, I do not think that there is a need to do this. I view "investor education" as being a "tool" or strategy rather than a "mandate". In other words, investor education is simply one of the tools and strategies that is available to the OSC to use to "protect investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets in Ontario and confidence in their integrity". I do not believe that there is any need to extend the mandate of the OSC in order to permit the OSC to use investor education as one of its tools or to work with others in this respect.

4. **Timeliness** - There is a need to "pick up the pace". It is taking the OSC far too long both to recognize the need for change and, having recognized the need, to implement the changes. This is one of the problems which results when decisions are taken and implemented only if a consensus on both the action to be taken and the means to implement the action can be reached. In many cases, the actions that result are in the category of "too little; too late". I think the OSC could substantially improve its effectiveness in carrying out its mandate if it were to aim a little higher than the minimum level at which it can obtain consensus for change.

Enhancing the knowledge and awareness of regulators (which is needed with the ever-changing and increasing complexity of today's financial markets) should serve to reduce the information gap between regulators and the regulated. It should, as regulators gain industry knowledge and experience and confidence in their knowledge and experience, speed up both the recognition of the problems and the recognition of the appropriate means to deal with them.

5. **Simplification** - There is a need to simplify regulation. The overlap of the Securities Act, the Regulation made under the Securities Act and the Rules made under the Securities Act is mind-boggling.

The increasing use of delegated legislative authority to change the provisions of the Act has resulted in a complexity that leaves most people uncertain of what the requirements are or even where to find them. This is counter-productive to the OSC's goal of "providing clearer rules". This needless complexity also encourages those who are able to afford the costly fees of lawyers, accountants and other experts to weave their way through the labyrinth to come up with schemes that defy the spirit of the regulatory requirements. This in turn spawns yet another set of virtually incomprehensible amendments as well as enforcement actions to deal with contraventions. This is not a productive use of resources for either industry or the OSC and does not foster fair and efficient capital markets or confidence in the integrity of such markets.

Apart from the need to address the complexity caused by the overlap of the Securities Act, the Regulation and the Rules, there is a need to simplify the substance and the form of regulatory requirements.

While I strongly support the need for clear rules, it is important not to fall into what I call the "clarity trap". Most of the new Rules are extremely complex and difficult to comprehend even for those of us who have had a "head start". This is counter-productive to the OSC's goal of "providing clearer rules".

I think it would help the OSC achieve its mandate if it were to subject all its rules to a "plain meaning" test. The goal should be to ensure that reasonably intelligent people should be able to understand what the requirements are to carry on their business without having to rely on obtaining experts' advice to gain this basic understanding. This ability is important to the OSC's goal of fostering the integrity of the capital markets.

6. **Guidelines and Standards** - I am in full agreement with you that identifying "best practices" and articulating guidelines and standards are complementary strategies for achieving effective regulation. However, unless these strategies are accompanied by incentives to adhere to them and consequences for non-adherence they usually fall short of what is needed for effective regulation and often result in the credibility and effectiveness of the Regulator in fulfilling its mandate being questioned.

There is also a need when adopting best practices, guidelines and standards, to build in a third-party process for adopting an equally effective alternative standard or practice that will constitute "compliance" with the best practices, guidelines and standards. Self-identification of an alternative standard without it being subjected to an objective evaluation of its effectiveness for the purpose, is often problematic.

7. **Enhancing Expertise** - One of the areas where there is a need for the OSC to enhance its understanding relates to indexing and its various applications. It is all too easy for staff to become mesmerized by what they are selectively told and to lose sight of some very basic and fundamental issues.

8. **Responsibility** - It is important to review the effectiveness of some of the strategies that the OSC has used and proposes to use - particularly those that relate to the delegation or assignment of regulatory functions to self-regulatory or other organizations. Oversight of these delegated or assigned functions needs to be strengthened and accountability heightened. Now that the OSC is a self-funded agency, it is timely to re-examine the appropriateness of off-loading some of the Commission's core functions. However, whether the work is done directly or is "outsourced", the Commission needs to take responsibility and be accountable for what happens or does not happen.

9. **Consumer Redress Mechanisms** - One of the core needs that has not been addressed in the Statement of Priorities (and needs to be) is the need to foster more effective, timely and affordable consumer redress mechanisms.

10. **Enhancing the Quality of Continuous Disclosure** - There are two key initiatives that would enhance the quality of continuous disclosure that have not been included in the Statement of Priorities. The first relates to implementing the recommendations contained in the CICA Research Reports on Financial Reporting and on Audit Standards for investment funds which were issued respectively in the spring of 1997 and in the spring of 2000.

The second relates to speeding up the disclosure of the portfolio holdings of investment funds. This has become an issue of timely disclosure. The lack of timely disclosure of portfolio holdings is hindering effective decision-making by many investors and giving unfair advantage to some people who are able to gain access to information that is not readily available in the marketplace to all investors.

As a minimum, funds should be required to update their 10 top holdings and their sector allocation information on a monthly basis and to disseminate this information so that it is publicly available and accessible.

* * *

I hope that the foregoing is of assistance to you. I would be glad to discuss any aspect with you if you should wish. In the meantime, I send my best regards.

Yours very truly,

Glorianne Stromberg