Dear Mr. Crawford,

Attached, please find an interim submission by Howard Hampton, Ontario NDP leader, in response to your 5 year review draft report. In our role as an opposition party, we will release a more detailed set of proposals once the final report is completed and the government has given at least some indication as to how it wants to respond to your final report.

Wtih this next stage in mind, it would be very useful for us to know the approximate release date of your final report. A quick email to me on this subject at ethanp@ndp.on.ca would therefore be very much appreciated.

Sincerely,

Ethan Phillips
Financial Issues Researcher
Ontario New Democratic Party
(416) 325-7113

No Enrons in Ontario

A Brighter Idea to Protect Investors:

An NDP Vision for 21st Century Securities Regulation

A brighter idea for Ontario

Ontario

Dear Friends,

As Leader of the Ontario New Democratic Party, I am pleased to release this policy paper "No Enrons in Ontario - A Brighter Idea to Protect Investors: An NDP Vision for 21st Century Securities Regulation".

I believe the proposals and analysis in this paper are a serious response to the questions and challenges facing individual and institutional investors today. In my view, only Social Democrats will be willing to pursue the kinds of reforms needed to provide the transparency, fairness and confidence investors seek.

Invariably, with such a broad topic, some issues will have been left out while others will spur heated debate.

I invite both New Democrats and members of the broader community to read this paper and let me know what you think.

Yours sincerely,

Howard Hampton, MPP
Leader, Ontario NDP

Please direct comments and questions to:

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“The salary of a chief executive of a large corporation is not a market award for achievement. It is frequently in the nature of a warm personal gesture by the individual to himself.”

- John Kenneth Galbraith

No Enrons in Ontario

Introduction

Corporate Ontario needs to clean up its act. The Ontario government must move immediately to protect ordinary people who invest their hard-earned money in a mutual fund or company shares. If it doesn't, not only will the savings of those people be at risk, but the economy and people's jobs will be too. Eventually, if investor confidence continues to erode, even pension funds may be at risk.

The NDP has a detailed, practical package to clean up corporate Ontario. The NDP's "no more Enrons" package includes:

1. Toughening up the rules and regulations governing public auditors to ensure that investors are protected and that arms-length audits tell the truth about how a company's doing.

2. Giving the Ontario Securities Commission more power to clamp down on securities fraud.

3. Increasing corporate board members' legal liability for misleading statements.

4. Forcing mutual fund holding companies to have independent boards for each fund.

Part 1: Public Auditing /Accounting Issues

To many close observers of the Enron and WorldCom scandals, the self-regulatory approach to overseeing the accounting industry was the single biggest underlying factor contributing to the fiascos. In addition, various other auditing/accounting issues have been identified as contributing to these and other scandals that are now seriously undermining investor confidence and stock markets.

Recommendation 1: A true Public Oversight Board for accounting

1. The NDP would revoke the mandate of the accounting profession for standard setting, investigation and discipline, (including amending the regulation of the Ontario Business Corporations Act which grants standard setting duties to the national accounting body run by the accounting profession, the CICA). An independent "public accounting board" roughly along the lines of the United Kingdom's and as proposed by the U.S. Senate Banking Committee, would be established. The new Board would be responsible for licensing, investigations, and disciplinary activity in the public accounting profession and would create a new standard setting body that would not be associated with existing organizations representing the accounting profession.

A Brighter Idea to Protect Investors:

The Board would:

- Be an arms-length organization with its own enabling legislation fully funded by the provincial government, not the accounting profession;
- Consist of five members appointed by the Ontario Government and would have a majority of non-accountant members;
- License public accountants;
- Establish and enforce compliance with quality control and auditing standards;
- Administer an ongoing program to review accounting and auditing practices;
- Investigate and discipline individuals and firms who violate laws and professional standards;
- Recognize Generally Accepted Accounting Principles established by a separate independent body.

Recommendation 2: Forbid public accounting firms from providing auditing and non-auditing services

Specifically, the following non-auditing services could not be offered to clients in conjunction with auditing services:

- Bookkeeping or other services related to a client's accounting records or financial statements
- Financial systems design
- Appraisal or valuation services
- Actuarial services
- Internal audit services
- Any management or human resources function
- Tax services, except with the approval of the audit committee of the client

Recommendation 3: Truly Independent Audit Committees

- Ban "inside" Directors from serving on Audit Committees (i.e. ban management directors as well as lawyer, banker, etc. directors that have a business relationship with the company).

Recommendation 4: Stop the "old boys" network

- Establish a two-year cooling off period before an employee of an audit firm can join a client firm.

Recommendation 5: Greater Accountability Through Rotating Audit Firms

- Require firms to "rotate" (or change) their auditing firms every five years in order to ensure greater accountability.

Recommendation 6: Reform accounting standards starting with the expensing of executive stock options

- There should be a comprehensive review of accounting standards performed by the new accounting body, but immediate action should be taken by the existing standard setting body to force companies to count stock options given to their executives as an expense.

Part 2: Securities and Corporate Governance Issues

Over the years, there has been a flurry of provincial reports calling for reform of the regulatory framework governing securities and corporate governance, but very little action has been taken by the Ontario Government. Many observers in the financial community believe that Ontario is well behind the U.S. in these areas and that the relative lack of "transparency" here has hurt the competitiveness of the TSX and Bay Street more generally.

In late May, the blue chip Five Year Review Committee, chaired by Purdy Crawford, strongly urged the Ontario government to overhaul its securities regime to protect individual investors.

Ontario must act now to protect the savings and investments of ordinary Ontarians. The NDP would:

Give the Ontario Securities Commission (OSC) the powers it needs to clamp down on securities violations

While the OSC may prosecute an offence by initiating quasi-criminal proceedings in the Ontario Court of Justice under section 122 (which could result in jail or fines), it lacks the ability to impose its own "administrative" fines.

Apparently, the OSC is the only major securities regulator in North America that lacks this power, which is viewed as the appropriate sanction in many, if not most, securities violations. The OSC also lacks the power to order the "disgorgement" of ill-gotten gains (ordering the offending party to give the money up).

Recommendation 1: Increased sanction powers for the OSC

- Under s. 127 of the Act, the OSC should be granted the power to levy "administrative fines" of up to $2 million and should also be granted the power to order the "dis-gorgement" of "ill-gotten" gains with the option of allocating at least some of the dis-gorged funds to third parties hurt by the securities violation.

- Under the quasi-criminal s.122 of the Act, the maximum penalties should be increased to $5 million and five years in jail from $1 million and two years in jail. Also under s. 122 of the Act, the Ontario Court of Justice should be able to order the guilty party (or parties) to compensate the victims of the securities violation.

A Brighter Idea to Protect Investors:

Board member liability in misrepresentation of "continuous" financial disclosure obligations

There is currently a discrepancy in Ontario securities law between requirements to disclose information in the prospectus, the document that must be given to all individuals to whom securities are delivered, and ongoing information about how the company is doing (continuous disclosure). In the case of the prospectus, the Securities Act provides that if a prospectus contains a misrepresentation, the purchaser may sue the issuer (the company, or more specifically the individual members of the Board). In the case of continuous disclosure obligations, there is no such individual (or civil) liability. This is a serious issue in that only six per cent of all capital market trading falls under the auspices of a prospectus while secondary trading accounts for the remaining 94 per cent.

There is currently draft legislation to remedy this situation that has been proposed to the Ministry of Finance (MOF) by the Ontario Securities Commission (the OSC, of course, can only make recommendations). This draft legislation was formally submitted to the MOF on Nov. 2, 2000 and reflects the thinking of the Allen Commission (a previous study), which called for a "statutory civil remedy" in the case of misrepresentation in continuous financial disclosure situations.

A variation on these recommendations is also contained in the Crawford Report and in various other reports. Up until recently, the issuer community (i.e. big business) has been vehemently opposed to such provisions and there has been no response from the Conservative Government to the OSC draft legislation. However, in the post-Enron era, this is clearly an idea whose time has come.

Recommendation 2: End misrepresentation in "continuous disclosure" situations

- Immediately adopt the changes recommended by the OSC regarding Board member liability in misrepresentations in "continuous {financial} disclosure" situations. This change would make Directors personally legally responsible for the failure of the corporation to comply with continuous disclosure requirements and would essentially replicate the Board member liability with regard to the accuracy of the financial information contained in prospectuses.

- Currently, there is no requirement that the external auditor examine and "sign–off" on quarterly financial statements, only on fiscal year-end financial statements. The Act should be amended to require external auditors (and therefore the Audit Committee) to approve quarterly financial statements as well as year-end statements.

Mutual Fund Governance

Most major jurisdictions other than Canada have some form of mutual fund governance requirement. No jurisdiction in Canada has such requirements. According to the Crawford Committee "the fundamental reason for requiring mutual fund governance in Canada is that the structure of the fund industry is by definition conflicted and there is no one whose sole responsibility is to protect the interests of the unit holders".

The key issue here is to ensure there is an oversight mechanism for individual mutual funds that is independent of the management company and focused exclusively on the best interests of the unit holders. Currently, there is no mechanism to do that as there are no requirements for a governance structure of any kind.

The Crawford Committee also recommends that any enabled governance body for mutual funds have the power to fire the fund manager in cases of poor performance or conflict of interest.

Recommendation 3: Protect mutual fund unit holders through independent governance body

- The OSC should introduce rules requiring that all publicly offered mutual funds establish and maintain an independent governance body (or board). This body would also have the right to fire the fund manager in cases of poor performance, conflict of interest, etc.

Summary of Recommendations

1. Create a true Public Oversight Board for Accounting responsible for licensing, investigations, and disciplinary activity in the public accounting profession and would create a new standard setting body that would not be associated with existing organizations representing the accounting profession.

2. Forbid public accounting firms from providing non-auditing services in conjunction with auditing services.

3. Ban "inside" Directors from serving on Audit Committees.

4. Establish a two-year cooling off period before an employee of an audit firm can join a client firm.

5. Require firms to "rotate" (or change) their auditing firms every five years in order to ensure greater accountability.

6. Reform accounting standards starting with the immediate expensing of executive stock options.

7. Increase sanction powers for the OSC, including the power to levy "administrative fines" of up to $2 million and the power to order the "disgorgement" of "ill-gotten" gains by amending s.127 of the Act.

8. End misrepresentation in "continuous disclosure" situations.

9. Protect mutual fund unit holders through independent governance body.

10. Amend s. 122 to enable the Ontario Court of Justice to levy penalties of up to $5 million in fines and 5 years in jail and to order the guilty party to compensate the victims of the securities violation.

NDP NPD

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