

**DEALING WITH CHANGE: SHAPING FINANCIAL
REGULATION FOR THE FUTURE**

**REMARKS BY
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As you may know, the Ontario government announced in last May's budget that it is proposing to merge the OSC and the Financial Services Commission of Ontario. Since then, the Government has published a discussion paper on the merger, conducted consultations and is currently drafting the relevant legislation. I'll be discussing how a merger is in sync with global trends in financial regulation aimed at ensuring fair, consistent and efficient regulation.

But first, I'd like to describe the context in which this merger would take place.

Regulators – like all market participants – see fresh evidence every day of what the Greek philosopher Heraclitus said a little over two-and-a-half millennia ago: “There is nothing permanent except change.”

There is almost no aspect of the capital markets today that is not undergoing rapid change.

Consider some of the trends:

Investment is more ubiquitous. Last year, a TSE survey found that about half of Canadians are invested in the markets – twice as many as 11 years earlier. The growth in retail investment has spawned a huge secondary market, which is now responsible for 90 per cent of securities transactions. A nation of savers has become a nation of investors.

Investment is more mobile. It was a Canadian who first observed that the world was becoming a global village. Now, Canadian investors and companies are becoming increasingly active in the global village marketplace. The Internet is driving that trend at cyberspeed. Increasingly, there is one market: the world.

Investment is more democratic. The most important distinction between a broker and a client used to be that one had information and the other didn't. That distinction is fading rapidly. Almost half of Canadians with access to the Internet use it to do their own research, without relying on their broker.

Investment is more self-directed. It used to be that the way you made a trade was to call your broker. Last year, according to the Investment Dealers Association of Canada, online trading accounted for about 40 per cent of all retail stock transactions in Canada.

Changes in Canadian markets mirror changes around the world. As Chairman of the policy-making committee of the International Organization of Securities Commissions, I hear the same issues raised, in several different languages, from all parts of the globe. In a borderless world, all market institutions are grappling with the same underlying issues.

Regulators are examining their policies and operations, and applying similar tests: Are we creating a viable market that is attractive to domestic and foreign investors? Are we helping our market participants compete globally? Are we achieving these goals while maintaining high levels of investor protection?

As a small country representing less than 2 per cent of global capital markets, Canada faces the challenge of being in the forefront of change.

It's a challenge we can meet.

Canadian stakeholder groups – including exchanges, professional associations, and government as well as regulators – have been energetically examining the issues emerging from change in the nature of investment.

Over the next few weeks alone, eight discussion papers will be released by various organizations and task forces for public comment across Canada. I can't recall the last time that so much diverse expertise and so many resources were devoted to raising national debate about our financial institutions.

These studies address a wide range of issues. But all have the same catalyst – the need to deal with change. For example:

- Dealing with change includes re-evaluating standards of corporate governance.

Next week, a Joint Committee sponsored by the TSE, CDNX and The Canadian Institute of Chartered Accountants will release a discussion paper outlining what Canadian public companies, exchanges and regulators need to do to keep up with international standards in such areas as financial reporting, the role of audit committees, and the need for financial literacy among corporate directors.

- Dealing with change includes recognizing that in a globalized information age, financial information must be readily understandable, comparable and transparent – across borders.

Last year, half of all debt and equity financing by Canadian issuers was raised in foreign markets. If you're going to raise capital, you have to be able to explain your financial statements in a way that investors will understand – regardless of what country they happen to be in.

Next week, the umbrella organization of Canada's provincial and territorial securities regulators – the Canadian Securities Administrators – will release a concept paper seeking comment on whether to revise current financial reporting rules. The concept paper will ask a number of questions about the use by Canadian companies of foreign accounting standards. But perhaps the most important question for Canadians will be: should we permit Canadian companies to use U.S. accounting standards without being required to re-crunch the numbers according to Canadian GAAP rules?

- Dealing with change includes addressing the potential for conflict of interest among analysts.

This spring, the TSE Committee on Analyst Standards – which includes representatives of the buy-side, investment dealers, and analysts – will release a paper on managing potential conflicts of interest, including proposed disclosure requirements and possible prohibitions on investment activity by analysts.

- Dealing with change includes ensuring a level playing field where all investors have access to the same information at the same time.

A corporate survey we released in August found there were too many bumps on that playing field. For example, more than 80 per cent of companies did not invite retail investors to the quarterly conference call with analysts. And only 29 percent had a formal policy governing the public release of important information.

The Canadian Securities Administrators will be releasing a draft policy for comment this spring which will provide guidelines for dealing with selective disclosure. It will include proposals for ways to use advanced communications technologies to achieve better information dissemination – and include all investors in the circle of disclosure.

- What else does dealing with change include? An increasing number of Canadian employers are shifting from traditional defined-benefit pension plans to retirement regimes under which employees make investment choices for their retirement. Dealing with change includes ensuring uniform regulatory protection and information.

This shift to defined contribution plans and group RRSPs involves a huge transfer of risk from employers to employees. In Ontario, over the past five years, enrollment in defined benefit retirement plans has declined by a third. But in defined contribution plans it has increased by about 50 per cent. About two-and-a-half million Canadians hold over \$39 billion in assets under defined contribution plans and Group RRSPs.

Next month, the Joint Forum of Financial Regulators in Canada will publish a paper seeking comment on specific proposals to ensure that these plans provide adequate investor protection and disclosure – such as a prospectus, statement of investment objectives, and historical investment performance.

- Dealing with change includes examining the unique disclosure needs of specific resource industries, like oil and gas, in which investment decisions depend on detailed technical information and analysis at the physical source.

This spring, the Alberta Securities Commission, on behalf of the CSA, will publish for comment proposals to update uniform oil and gas disclosure and reporting requirements, comparable to the work done in Ontario two years ago by the Mining Standards Task Force.

- Dealing with change includes developing governance standards to ensure independent oversight of the investment decisions of mutual funds.

Last month, during the height of RRSP season, you couldn't watch a hockey game without seeing an ad for a mutual fund. Canadians have more than \$400 billion invested in over 1700 mutual funds.

But mutual funds are more than massive selling machines. They are also responsible for investing the money entrusted to them. I believe there should be a clear delineation between these two functions. The Canadian Securities Administrators will soon be releasing a concept paper exploring the need for mutual fund governance, independent of mutual fund managers.

And that will pave the way for easing or eliminating many regulatory restrictions governing investments by mutual funds. With a proper measure of independence, mutual fund portfolio managers can be treated the same as pension fund managers who are required to act prudently. – but are not burdened by specific investment restrictions.

- Dealing with change also includes regularly reviewing securities laws in a constantly evolving investment environment.

As part of a legislatively review mandated every five years, an advisory committee to Ontario's Minister of Finance has been assessing how effectively Ontario's securities laws enable market regulation to keep up with changing needs. The committee has gathered input from a wide range of market participants, and is completing what I expect will be a detailed and comprehensive set of recommendations, to be released for comment in the next few weeks.

These concept papers and position papers deal with some of the central concerns of investors, listed companies, and other market participants. They address the quality of market information, the nature of governance, and the method of regulation.

There is one other area in which it is vital to deal with change: increased integration among financial service providers. In my view the proposed merger of the OSC and FSCO is a necessary step in the evolution of financial services regulation.

The traditional four pillars – banks, insurance companies, securities firms and trust companies – have melded together. Deregulation opened them up. Innovation, new technologies, and customer demand for new products drove them onto each other's turf – along with new participants. More and more financial services are being delivered by huge conglomerates integrated across the sectors.

In fact, for most financial players, the left-hand sides of their balance sheets – the revenue generating side – are now almost identical.

The industry has been remodeling itself. Shouldn't the regulatory system be doing the same?

That identical question is being raised in virtually every jurisdiction in the industrialized world.

On four continents, we're seeing regulatory reforms to ensure consistent regulation of similar activities – regardless of the sector in which the financial institution was traditionally grouped.

As the Wall Street Journal put it last week – “the idea is catching on.”

In many parts of the world, harmonization is being pursued through horizontal integration. In Australia, a single regulator now regulates the market conduct of all financial institutions. In the U.K., nine separate agencies have been combined into one, regulating all aspects of securities, insurance, pensions and banking. A similar integrated concept is being followed by Germany, Japan, and the Republic of Ireland. To date, at least 15 countries have moved to consolidate regulators.

Governments all over the world are coming to terms with the need to regulate on the basis of a financial institution's current activity, rather than its historic nature. The only difference is in the precise regulatory formula, based on distinct political traditions and culture.

Ontario's proposal is in keeping with the latest global thinking.

As a single agency, the proposed Ontario Financial Services Commission will be better positioned to ensure consumer and investor protection from unfair, improper or fraudulent practices, and to vigorously enforce clear and unambiguous rules. It will simplify financial service regulation by providing investors, consumers and financial service industry participants with one window to turn to.

Consumers will be able to enjoy the same comfort level in dealing with any entry point to the financial system. Consistent purchase disclosure documents will make it easier to compare products across sectors. Consistent proficiency standards will apply to your insurance agent, pension consultant, financial planner, securities salesperson and mutual fund salesperson.

Decision-making will be streamlined, and duplication eliminated. All financial institutions will be provided with a level playing field; similar financial products will be subject to similar regulation.

Consider some of the anomalies in the current regulatory approach. There are the differences in the way defined-benefit and defined-contribution retirement plans are treated. There are different standards of education and expertise for your portfolio manager, depending on whether she works for a securities firm or a pension

administrator. There are different rules designed to protect clients from conflicts of interest.

More than two out of every three life insurance agents in Ontario are also registered to sell securities. Whom your agent is regulated by depends on which product you are discussing. Regulatory responsibility can change over the course of a half-hour conversation across your coffee table.

Look at it this way: What would you think if the Board of Health sent out different inspectors to the same restaurant -- one to examine how the chicken is being prepared, another to check the seafood? Even worse -- what if those two inspectors enforced different regulations?

Obviously there are still some distinctions between the financial sectors. The proposal recognizes them. Within the new Commission there would continue to be a Superintendent of Pensions and a Superintendent of Insurance to carry out regulatory responsibilities for those sectors. Hearings under the Pension Benefits Act will be held before a separately constituted Pensions Tribunal.

But the legislation also recognizes that insurance, pensions and securities have far more in common with each other.

Consider the issue of rule-making authority. Five years ago, the Ontario Government granted rule-making authority to the OSC, which effectively allows it to make rules that have the force of law -- a practice that is consistent with securities regulation in most jurisdictions. The merger would extend that authority into some aspects of pensions and insurance.

Some expected fierce resistance to this. In fact, most of the insurance and pension industry representatives we talked to have expressed a desire to contribute to policy-making for their industry in a transparent way, and to be involved in the early stages of rule and regulation making.

Securities have always been an investment product. Many forms of insurance have become investment products. For many people, pensions are the most important investment product they possess. It's time to treat them as such. It's time to eliminate regulatory gaps and overlaps. It's time to end confusion over who regulates what.

And it's time for all Canadians to involve themselves in shaping a framework of financial regulation for the future. You're all busy people. But we need your help -- we need your feedback -- to make sure that the thinking that is being put forward over the next few months about the future course of financial regulation in Canada addresses your concerns and encompasses your view of the world.

Ladies and gentlemen, at one time it may have seemed that the more things change, the more they stay the same. But in financial services, at the dawn of the 21st century, change is apparent, continuous and revolutionary.

Canada is very much a part of this global whirlwind. Not only must we keep up with it – we can be in the forefront of managing it. We can make Canada a model of modern regulation, and secure our place at the cutting edge. We can advance our ability to promote investment, generate wealth, and create an era of opportunity for all Canadians.

Thank you.