Office of the Auditor General of Ontario

Value-for-Money Audit:

Ontario Securities Commission

December 2021

Ministry of Finance

Ontario Securities Commission

1.0 Summary

An effective, efficient and fair capital markets system is a critical component of a thriving modern economy. With access to well-regulated capital markets, business owners can more easily and confidently raise money to invest in business ventures, which helps create jobs and boost economic growth.

Well-regulated capital markets also benefit investors by providing opportunities for creating wealth and funding their retirement. If Canadian investors are not well served with clear, reliable, timely and appropriate information about the investments they make, their financial goals may be compromised.

Canada is the only G20 country that does not have a securities regulatory authority at the national level, partly because of a 2011 Supreme Court of Canada ruling that determined the regulation of capital markets was mostly a provincial responsibility, and partly because there has been insufficient political support among the provinces for a single "cooperative" regulator.

Canada's capital markets are regulated through laws established by each of Canada's 13 provincial and territorial governments, and are administered by a securities commission or equivalent authority each has established. The Ontario Securities Commission (OSC) and its fellow provincial and territorial securities regulators have formed what is known as the Canadian Securities Administrators (CSA), which acts to co-ordinate certain activities among the jurisdictions and seeks to promote a harmonized approach to securities regulation across Canada.

The OSC is a Crown corporation accountable to the provincial Legislature through the Minister of Finance under provincial securities legislation and a Memorandum of Understanding. It administers and enforces the provisions of Ontario's *Securities Act* (Act) and *Commodity Futures Act* and administers certain provisions of Ontario's *Business Corporations Act*. The OSC's mandate is to provide protection to investors from unfair, improper or fraudulent practices; foster fair, efficient and competitive capital markets, and confidence in the capital markets; foster capital formation; and contribute to the stability of the Canadian financial system and the reduction of systemic risk.

The OSC is the largest regulator in Canada due to the size and nature of the capital markets and participants that it regulates. In 2020/21, the OSC employed 629 employees and had about $138 million in revenue and $128 million in expenses. Its Whistleblower Program—the first of its kind in Canada—awards tipsters if their information leads to a successful hearing before the OSC's Tribunal.

The OSC's mandate involves making rules, monitoring compliance to rules and legislation, and enforcement. Our audit concluded that the OSC's rule-making processes are lengthy and are not always timely, especially when rules have to be drafted in co-ordination with other securities regulators that are part of the CSA. The OSC takes, on average, 2.9 years to develop a new CSA rule, policy or amendment, more than a year longer than for Ontario-only rules (1.7 years). Delays have also been attributed to the complexity of the sector and strong industry opposition to change. Two changes to increase investor protection (that is, proposed bans on deferred sales charges and trailing commissions), took more than a decade to implement, and the trailing commission ban is only partial.

Our audit also found the OSC is vulnerable to political interference, which risks undermining its operational independence and impartiality. For example, on deferred sales charges, the Ministry surprised the OSC by initially publicly opposing the OSC-led CSA's consensus on needed reform in September 2018. The Ministry later reversed its position in May 2021. This incident demonstrated the government's ability to override the OSC's judgment and supportive evidence on a proposed reform.

We also confirmed that the OSC has limited enforcement tools. For example, it does not have the power to issue "tickets" to individuals and companies, for violations that do not warrant a full-blown investigation by OSC's Enforcement Branch. The OSC also does not have the power to make orders to seize assets or direct the refusal of driver's licence renewals to collect unpaid monetary sanctions from individuals and companies who violated securities laws. These powers have been provided to the British Columbia securities regulator. Between fiscal years 2011/12 and 2020/21, the OSC collected only 28% of $525 million in monetary sanctions it imposed. Most of the uncollected balance is owed by unregulated individuals and entities, such as those that trade or advise in securities without being registered with the OSC. The lack of effective enforcement tools has hindered the OSC in deterring wrongful conduct and collecting monetary sanctions when imposed.

The OSC deposits money collected from administrative penalties and other enforcement orders in a special fund, called the Designated Fund. The *Securities Act* allows this fund to be used for certain purposes including those related to the benefit of the investor community. Of the amount collected and accumulated in the OSC's Designated Fund, it only paid out between 6% and 11%, for the benefit of the investor community as well as for other purposes allowed under the Act, each year between 2016/17 and 2020/21. About $208 million in sanctions was also directly paid by violators to investors in that period. As at 2020/21, the Designated Fund held $117 million.

We noted during our audit that some of the OSC's information systems are significantly outdated and are not interconnected, which has hindered its ability to effectively utilize data gathered in order to operate more efficiently.

See **Appendix 1** for a glossary of terms.

The following are some of our other significant findings:

- **The OSC could better ensure that firms act in the best interests of their clients.** In Ontario and the rest of Canada, there is no single rule that requires advisors, dealers and their representatives (dealers) to act in the best interest of their clients. Studies have shown that most investors mistakenly believe that dealers have a legal obligation to act in their clients' best interest. To improve the quality and impartiality of advice that investors receive, the CSA, with the OSC as lead, began studying the area and proposing possible reforms. The reforms originally studied included a fiduciary duty or similar overarching client best interest standard, similar to what is required in the United Kingdom, Australia and the European Union. This would require dealers to act in their clients' best interest. However, the eventual changes, called the "client-focused reforms," were narrower, more complicated and would allow systemic conflicts of interest to continue.
- **Deferred sales charges and trailing commissions have taken over a decade to be banned, and the ban on trailing commissions only applies to discount brokers and not to other dealers**. The OSC, along with the CSA, took almost a decade to decide to ban deferred sales charges (the fees an investor must pay if they sell a fund within a specified time) and trailing commissions (the payments that a mutual fund company

makes to dealers for as long as the dealer's client holds on to the company's fund). Regulators found that many investors do not know how much they pay in these hidden fees or that they pay them at all. Although trailing commissions will be prohibited for discount brokers/dealers (that is, dealers who are not permitted, under existing regulations, to provide advice to investors) effective June 1, 2022, under the proposed rules they will still be permitted for full-service dealers. The potential conflict of interest that arises from this arrangement is that a dealer will seek to maximize its own revenue by recommending funds that pay it higher commissions whether or not those funds are best for the investor. The new rules continue to allow trailing commissions so long as dealers have implemented complicated controls to identify, document, disclose, and address conflicts. Certain similar existing controls in the investment industry in Canada have proven ineffective in deterring such conflicts of interest. By contrast, securities regulators in the United Kingdom and Australia have banned these types of embedded commissions since 2012.

- **The OSC conducts limited reviews to vet the entry of special purpose acquisition companies (SPACs), capital pool companies (CPCs) and reverse takeovers (RTOs) in the capital markets, thereby not adequately protecting Ontario's investors from potential losses in these types of companies.** For instance, from 2016/17 to 2020/21, the OSC reviewed only seven CPCs out of a total of 77 CPCs at the time of entry to the market, after identifying issues with their promoters. The OSC also does not always alert investors to the specific risks posed by these kinds of transactions. In two examples we looked at, private companies that entered the markets by taking over a public company faced many allegations and complaints regarding conflicts of interest and illegal insider trading. One of the companies was eventually delisted from the stock exchange—that is, the company's shares were no longer allowed to be publicly traded. The other company was ordered by Ontario's Superior Court of Justice to compensate investors for omitting material facts that resulted in an artificial inflation of the company's share price. Because issuing securities in the public markets through the traditional IPO method tends to be more expensive for companies due to related legal costs, regulatory scrutiny and the volume of documentation required, the alternative methods of entering the public markets are becoming more popular.
- **The Corporate Finance Director lacks statutory authority to require companies using regulatory exemptions from issuing prospectuses to make adequate disclosures to the investing public following non-compliance.** We found that the OSC's Corporate Finance Branch does not have adequate regulatory authority to respond effectively and on a timely basis when it identifies a lack of sufficient disclosure by companies that have distributed securities using a regulatory exemption. Existing rules allow a company or fund to quickly raise money without the expense of preparing a prospectus and filing it with the OSC. However, the company or fund is still required to make regulatory disclosures to the investing public. Between 2016/17 and 2019/20, we noted that the Corporate Finance Branch identified non-compliance concerns relating to the lack of adequate disclosure to the investing public in 36 reviews (or 35%) of the 104 reviews of disclosure filings that the branch conducted. The Corporate Finance Branch does not have the power to issue a cease-trade order to a company, that is not a reporting issuer, for non-compliance and can only request that the company voluntarily cease distributing securities until it has complied with the disclosure requirement. We examined 10 of the 36 reviews conducted by the branch in detail, and in two of the 10 reviews we determined that potential investors could have been better protected if the Director of the Corporate Finance Branch had the legislative authority to issue a cease-trade order to the company for insufficient disclosures. In another two

cases, branch staff had to **request** the companies to provide the necessary disclosure to the investors—which the companies complied with—but the Director of the Corporate Finance Branch did not have the legislative authority to **require** them to comply with securities laws.

- **The OSC has limited power to require communication of information to it by the Canadian Public Accountability Board.** The CPAB is the national and independent body responsible for the regulation and oversight of public accounting firms responsible for the audits of Canadian reporting issuers. In contrast, the Securities and Exchange Commission (SEC) in the United States has greater oversight authority over the CPAB's US counterpart, the Public Company Accounting Oversight Board (PCAOB), even though both auditor oversight bodies were created around the same time, in response to the same concerns after the accounting scandals in the late 1990s such as Enron and WorldCom. The SEC has access to inspection reports of audit firms and names of market participants inspected with deficiencies identified by the PCAOB. The OSC does not have the same access to documented information held by the CPAB. Regular communication of information from the CPAB is important so that OSC staff can determine if they need to review disclosures by specific market participants and then conclude if there has been a violation of securities law. This is especially important in cases where the CPAB inspections identify material deficiencies in the audits of reporting issuers as such deficiencies may create a heightened risk to the investing public.
- **The OSC lacks the necessary technology and analytical tools to conduct efficient oversight of market participants.** OSC staff face challenges in integrating information from various databases that is collected in differing formats. Better IT system integration is needed to identify potential securities law breaches by issuers across the public and private or exempt capital markets (where companies qualify for exemptions from legislative requirements) areas. We found that the OSC's Enforcement Branch lacked critical data analytics, tools and reporting capability to assess the effectiveness of its performance. For example, it is unable to track the average time between the receipt and closure of an enforcement case, or to flag cases that are taking exceptionally long. Currently, these activities are conducted manually by OSC staff.

This report contains 26 recommendations, with 57 action items, to address our audit findings.

Overall Conclusion

The Ontario Securities Commission (OSC) plays a key role in regulating the largest capital markets sector in Canada. However, the OSC has been impacted in certain of its regulatory activities to protect investors because of complexity of the sector and industry opposition to change. The regulatory framework and structure in Canada require the OSC to dedicate time and resources to work with other provinces and territories in the Canadian Securities Administrators (CSA) to promote harmonization while making rules, which has caused significant delays in addressing current and emerging market issues.

We noted that certain rules proposed by the OSC that could better protect investors were limited and less rigorous than similar rules in other countries, such as the United Kingdom and Australia.

The OSC needs to guard against perceptions that its rule-making is influenced by industry interests or swayed by political interference. It therefore needs to ensure it transparently and effectively carries out its mandate to protect investors as it weighs the views of stakeholders, many of whom have vested interests.

The government, for its part, needs to ensure that any disagreements with the OSC on proposed rules are based on evidence and are communicated transparently.

The OSC requires more legislative authority and tools to better enforce securities laws and to collect monetary sanctions imposed on unregulated companies and individuals.

In addition, the OSC has not effectively used its accumulated Designated Fund—collected from sanctions imposed through its enforcement activities—for the benefit of the investor community as much as permitted within the existing securities laws in Ontario.

Similar to the relationship between the Securities and Exchange Commission and the Public Company Accounting Oversight Board in the United States, the OSC should have more access to information from the Canadian Public Accountability Board to strengthen its regulatory work.

We noted that the OSC's information systems are outdated and/or operate in silos within the organization, which hinders its ability to use data more effectively and efficiently to monitor and regulate market participants. The OSC can become a more effective regulator by adopting new technologies and by building its capabilities to quickly respond to emerging issues in the sector.

The OSC has implemented a paid Whistleblower Program to protect investors and has taken numerous initiatives to promote investor awareness. The OSC also publicly reported on its performance in relation to its stated goals.

OVERALL OSC RESPONSE

The Ontario Securities Commission (OSC) acknowledges the findings of the Auditor General (AG), which will enhance our ability to regulate Ontario's capital markets.

The *Securities Act* requires the OSC to balance multiple mandates: providing protection to investors from unfair, improper or fraudulent practices, fostering fair, efficient and competitive capital markets and confidence in the capital markets, fostering capital formation, and contributing to the stability of the financial system and the reduction of systemic risk.

We acknowledge that key investor protection reforms – including the Client Focused Reforms and bans on deferred sales charges and trailing commissions charged by discount brokers – have taken considerable time to develop and implement through multiple public consultations and implementation periods. We also agree that additional and timely action should be considered if these reforms do not serve the best interests of investors. We are closely scrutinizing how these reforms are implemented. For example, we have expressed concerns with several bank-affiliated dealers' decisions to restrict sales of third-party investment products in certain channels.

We appreciate the AG's recognition that the OSC's Whistleblower Program remains the only paid program by a Canadian securities regulator. We also acknowledge the favourable comments regarding our Investor Office.

We recognize the need for greater access to data analytics tools, which would allow us to evaluate potential misconduct more efficiently, and we will continue to prioritize this area.

Our new Digital Solutions Branch is working, as a top priority, to replace separate legacy systems with a single enterprise platform. We will also continue to strengthen processes and controls for our IT systems.

2.0 Background

2.1 The Regulatory Framework in Canada and Ontario

Canadian securities regulation is provided through laws and regulations established by each of the nation's provincial and territorial governments; and by the rules and policies established by their securities commissions, including the Ontario Securities Commission (OSC). The Canadian Securities Administrators (CSA) is a collective arrangement that brings the 13 securities regulators together with the aim of co-ordinating and harmonizing investor and market rules and policies across the country. The CSA has no independent jurisdiction and describes itself as only an informal body; the CSA established a governance structure in 2003 and a permanent staffed office in 2004. Among the G20, Canada is the only country that does not have a single regulatory authority for securities at the national level. There have been unsuccessful attempts to create a national securities commission; **Appendix 2** lists recent events in the unsuccessful attempts to establish a national securities commission. **Appendix 3** shows how, absent a national regulator, the OSC works with the other provincial and territorial securities regulators to attempt to harmonize rules and regulations, to promote a co-ordinated approach for regulatory oversight within the country.

The OSC and its CSA counterparts also work with key partners to regulate market participants and stakeholders. These partners, which include the Investment Industry Regulatory Organization of Canada (IIROC), Mutual Fund Dealers Association (MFDA) and Canadian Public Accountability Board (CPAB), are detailed in **Appendix 4.**

The OSC also regulates stock exchanges (such as Toronto Stock Exchange, Canadian Securities Exchange and Neo Exchange) that list new companies that seek entry into the capital markets.

2.2 Ontario Securities Commission (OSC)

The OSC is a Crown corporation accountable to the Ontario Legislature through the Minister of Finance under the *Securities Act* and the *Commodity Futures Act*, and a Memorandum of Understanding dated December 31, 2019, that outlines the relationship between the OSC and the Minister.

As of March 2021, the OSC employed 629 full-time-equivalent staff. **Appendix 5** shows the OSC's organizational chart. In 2020/21, it recorded about $138 million in revenue generated from fees charged to capital market participants. Its expenses were about $128 million in the same year with a $89 million accumulated surplus balance as of March 31, 2021. (The OSC's Board approved a six-month operating reserve amount to be accumulated in the surplus balance; these funds are reserved for strategic, multiyear capital programs including technology initiatives.)

2.2.1 Board of Directors

The OSC's Board of Directors provides governance to the organization and oversees the management of its financial and other affairs. Each member has three specific responsibilities: 1) board governance; 2) rule-making; and 3) adjudication (except for the Chair and Chief Executive Officer), as shown in **Figure 1.** As of June 30, 2021, the role of Chair of the Board and the CEO was held by one person. As well, there were nine other board members with varied experience in capital markets, securities laws, corporate governance and finance.

2.2.2 OSC's Key Roles and Regulatory Activities

The OSC has three primary roles: 1) making rules, 2) monitoring compliance and 3) enforcing rules. **Appendix 6** lists the OSC's branches that perform these regulatory activities. **Appendix 7** lists the types and number of market participants active in Ontario that the OSC and other CSA commissions regulate.

Making Rules

The Ministry is responsible for setting the policy direction for the regulation of capital markets in Ontario and for the legislative framework for implementing such policy; the OSC is responsible for the development and implementation of rules consistent with that policy direction.

The OSC received rule-making authority in 1994. It makes rules, as set out in the *Securities Act* and the *Commodity Futures Act,* that apply to individuals and companies that sell securities and provide related advice; public companies; investment funds; and marketplaces (such as exchanges). In addition to rules, the OSC also makes policies, often "companion policies" that guide the application and interpretation of rules, and provides other types of information and guidance (for example, staff notices, consultation papers).

Figure 1: Key Functions of the Ontario Securities Commission's Members

Prepared by the Office of the Auditor General of Ontario

Function	Description
Board of Directors	The 10 members are appointed by the provincial government. They provide overall governance and direction including strategic planning and annual budgets, financial review, reporting and disclosure, risk assessment and internal controls governance through the full Board and four standing committees: Audit and Finance, Governance and Nominating, Human Resources and Compensation, and Risk.
Rule and policy making	Members attend regular meetings with staff to review and approve regulatory initiatives, priorities, policies and rules and to discuss general oversight of the capital markets. In addition, meetings of two members (excluding the Chair and CEO) are held twice weekly to consider companies' and individuals' applications for exemptive relief from Ontario securities law. Typical exemptions include relief from the prospectus and registration requirements or from requirements relating to preparing and filing of continuous disclosure documents.
Adjudication	Members other than the Chair and CEO act independently of their other Board roles and preside over enforcement proceedings brought before the tribunal.

There are many inputs into the OSC's regulatory branches' rule-making processes. These include the government's policy direction, responses to developments in the markets, global trends and emerging risks, contacts with other regulators (including regulators outside of Canada), areas of concern highlighted through complaints and whistleblower tips, and consultations with investors and industry representatives (often through one of 10 OSC advisory committees).

Rule and policy development, as distinct from the government's overall policy direction, is a public process. The OSC publishes proposed rules and policies for public comment on its website and in a printed form of its Bulletin. See **Figure 2** for a flowchart depicting the process, with timelines, for making rules and policies.

Monitoring Compliance

The OSC monitors market participants (detailed in **Appendix 7**) for compliance with securities legislation. In **Appendix 6**, among other roles and responsibilities, we note each of the following three activities:

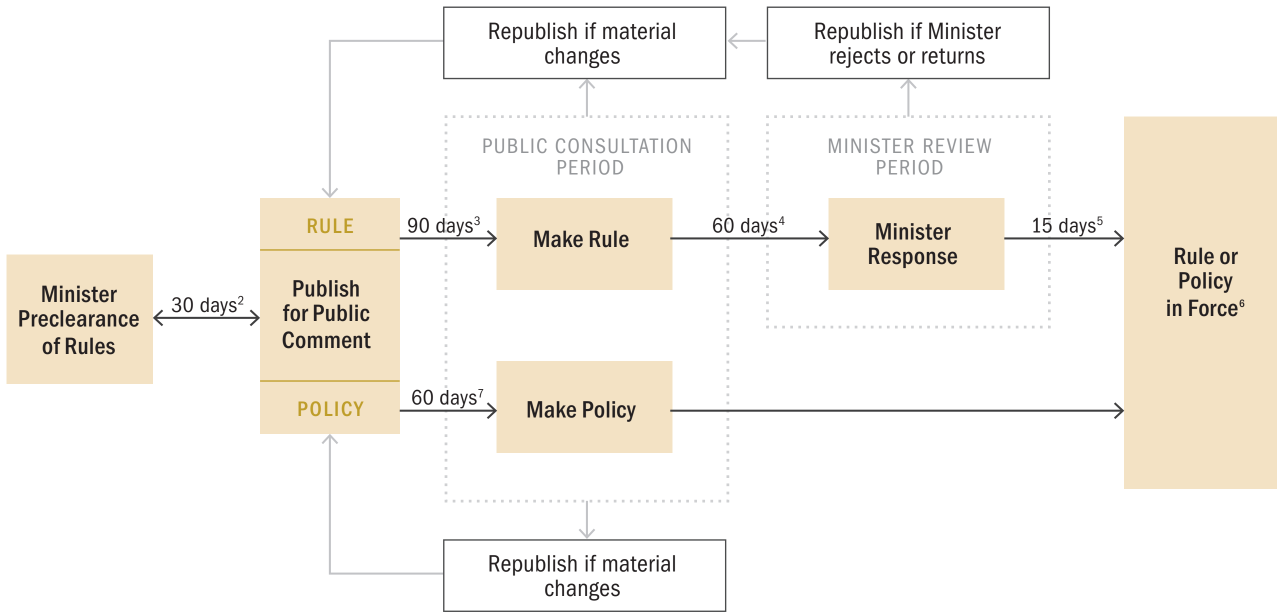
- reviewing and approving various filings from companies, such as prospectuses as well as registration applications for individuals and firms that sell securities and provide advice to investors;
- reviewing and granting exemptive relief to companies from legislative requirements; and
- conducting regulatory and compliance reviews on market participants.

The CSA, including the OSC, supervises IIROC, which monitors market activity in Canadian marketplaces, including stock exchanges and alternative trading systems.

In 2004, the OSC entered into an agreement with the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC) to provide Canada's financial intelligence unit with information semi-annually, about registrants that appear to have inadequate or no anti-money laundering/anti-terrorist financing policies and procedures. This information to be provided is on deficiencies, related to policies and procedures, identified by the OSC's Compliance and Registrant Regulation Branch. FINTRAC is a federal regulatory organization with a mandate to facilitate the detection, prevention and deterrence of money laundering and the financing of terrorist activities. Pursuant to a recent Memorandum of Understanding signed between them in January 2021, the OSC exchanges agreed-upon information with FINTRAC.

Figure 2: Rule- and Policy-Making Process[1]

Prepared by the Office of the Auditor General of Ontario



1. The Ontario Securities Commission (OSC) sets rules to govern capital markets and market participants. It also sets policies where necessary, for example, to guide the interpretation and application of rules ("policies" here refers to policies set by the OSC and not to the government's overall policy direction). The *Securities Act* requires the OSC to publish draft rules and policies for public consultation. The Act also requires the OSC to provide rules (but not policies) to the Minister of Finance for approval. If there are significant changes after public consultation or after being provided to the Minister, the Act requires that the OSC republish the draft rule or policy for further public comment.
2. Under the OSC's Memorandum of Understanding with the Minister of Finance, the OSC must provide proposed rules to the Minister of Finance at least 30 days prior to the proposed date of publication for public comment, unless the rule is urgent. The Ministry of Finance shall provide its questions, comments and suggested revisions to the Commission within 30 days of receiving the proposed rule, unless it requires additional time.
3. The Act requires the OSC to provide at least 90 days for interested persons and companies to provide written comments on the proposed rule.
4. The Act provides the Minister with 60 days after receiving a draft rule to approve it, reject it, or return it to the OSC for further consideration. While it is not set out in the Act or the Memorandum of Understanding, the Ministry also added a requirement in September 2018 that the OSC provide the Ministry with final rules for pre-clearance prior to the statutory approval period. See **Section 4.2.**
5. If the Minister does not approve, return or reject the proposed rule, it becomes effective 15 days after the 60-day period (unless there is a later specified day for it to come into force).
6. Once approved and in force, rules and policies may have subsequent implementation dates.
7. The Act requires the OSC to provide at least 60 days for interested persons and companies to provide written comments on the proposed policy.

Enforcing Rules

The Enforcement Branch of the OSC is responsible for enforcing rules and standards of conduct that apply to individuals and firms that sell securities and provide advice to investors, public companies, investment funds and marketplaces. The Enforcement Branch investigates alleged breaches of Ontario securities law such as misleading disclosures, abusive trading practices, and illegal insider trading.

Generally, a formal "case" is opened for each enforcement activity by the Enforcement Branch. See **Appendix 8** for a flowchart depicting the Enforcement Branch's case management process.

The Enforcement Branch selects cases for investigation based on a risk assessment methodology. It can bring proceedings before the OSC's Tribunal or before the courts seeking to establish misconduct by individuals or entities, and impose sanctions and penalties. The OSC Tribunal consists of board members of the OSC, except for the Chair and CEO. In the five fiscal years from 2016/17 to 2020/21, the OSC concluded a total of 77 proceedings it brought before its Tribunal and 29 proceedings it brought before the courts. **Appendix 9** shows more detail about proceedings concluded before the Tribunal and the courts as well as the sanctions, penalties and sentences the OSC issued as a result of these proceedings.

OSC orders are routinely filed in the Superior Court of Justice of Ontario. Under securities law, these orders become enforceable after they are filed. This allows the OSC to use a range of creditor remedies to collect amounts owing, wherever possible, which can include garnishment, seizure and sale of property, and registering liens, as shown in **Appendix 10**.

2.2.3 Whistleblower Program

In July 2016, the OSC established the Whistleblower Program, the first paid program by a securities regulator in Canada. Alberta, British Columbia and Quebec each have a whistleblower program in place, but no financial awards or incentives are given to tippers. Internationally, the United States' Securities and Exchange Commission (SEC) and the UK securities regulator, the Financial Conduct Authority (FCA), have also implemented whistleblower programs. Like the OSC, the SEC's program offers financial awards but the FCA does not.

Under Ontario's program, whistleblowers may be eligible for discretionary awards of 5% to 15% of total monetary sanctions imposed and/or voluntary payments made, if their information leads to a proceeding where these amounts total $1 million or more. The maximum amount of the award has been set at $1.5 million where monetary sanctions and/or voluntary payments are not collected, and $5 million where these amounts have been collected. Since the establishment of the program, the whistleblower office has received a total of 610 tips as of March 31, 2021. The OSC paid $8.6 million in awards to seven tippers.

2.2.4 Investor Education and Awareness

The OSC's 2020/21 Statement of Priorities notes investor education as an "important component" of its investor-protection mandate. The OSC conducts investor education and awareness through many channels and initiatives including establishing an Investor Office. The OSC is the only securities regulator in Canada to create a dedicated Investor Office with an aim to achieve better investor outcomes. The Investor Office works to strengthen the OSC's efforts in investor engagement, research, education and outreach. The Investor Office also brings investor perspectives to the organization and contributes to policy development. To support this work, the Investor Office uses research and behavioural science to test policy proposals and explore how emerging capital market trends are affecting retail investors.

The purpose of the Investor Office's website, getsmarteraboutmoney.ca, is to help retail investors in their investment decisions. The website includes information on how to plan and manage investment portfolios for different life events. The Investor Office's educational resources receive over 5 million visits annually. The OSC also conducts events, such as webinars tailored to meet needs of specific investor groups such as seniors. In addition, the OSC solicits the views of investors on its policies and rule-making initiatives through its Investor Advisory Panel.

The United Nations' Principles for Responsible Investment, a group that represents 2,300 institutional investors around the world, with more than $85 trillion US in assets under management, notes that many investors are looking for business models that incorporate social and environmental considerations when making their investment decisions. Businesses that focus on sustainability are increasingly attractive to investors. In its 2020 Global Risk Report, the World Economic Forum listed that a majority of its top 10 risks listed are related to environmental, social or governance (ESG) issues.

The Capital Markets Modernization Taskforce, appointed in 2020 to review and make recommendations related to modernizing the capital markets regulatory framework in Ontario, recommended mandating disclosure by public companies of material ESG information. The 2021 Ontario Budget stated that the OSC would begin policy work to inform further regulatory consultation on ESG disclosure in the second half of 2021. The

CSA published proposed climate-related disclosure requirements in October 2021 with a due date of January 2022 for submission of public comments.

2.2.5 Key Performance Indicators

The OSC's key performance measures and indicators are focused on three areas: 1) regulatory effectiveness; 2) service standard commitments; and 3) internal activity volumes. See **Section 4.13** for further details.

2.3 Initiatives to Review the Capital Markets Regulatory Framework

We reviewed reports from the following initiatives and considered their recommendations in relation to the areas examined by our audit.

2.3.1 Capital Markets Modernization Taskforce

The Minister of Finance is required under the *Securities Act* (Act) to review the Act every four years. The Act had not been reviewed from 2004 to 2019. The Ontario Government created the Capital Markets Modernization Taskforce in February 2020 to review and propose changes to modernize Ontario's capital markets regulatory framework and legislation, and to obtain feedback on the challenges faced by businesses and investors in the capital markets sector. The Taskforce, among other activities, consulted with a number of stakeholders and obtained written comment letters on modernizing the sector. The Taskforce released its report in January 2021.

The report included 74 recommendations covering the areas of: 1) improving regulatory structure; 2) regulation as a competitive advantage; 3) ensuring a level playing field; 4) proxy system, corporate governance and mergers and acquisitions; 5) fostering innovation; and 6) modernizing enforcement and enhancing investor protection.

2.3.2 Burden Reduction Taskforce

In coordination with the Ministry of Finance, the OSC also created an internal Burden Reduction Task Force (Task Force) in November 2018. This Task Force was one component of the government's five-point plan to increase confidence in Ontario's capital markets. The Task Force initiated a consultation process with market participants and investors to find ways to make it easier to do business in Ontario. In November 2019, the Task Force released its report outlining 107 initiatives to reduce regulatory burden. In September 2021, the OSC released its annual report and reported on the status of the initiatives. The OSC reported that it had completed 62 initiatives (58%), and projected that it would complete a total of 85 (79%) by December 31, 2021. It also reported that 33 initiatives had been delayed due to COVID-19.

3.0 Audit Objective and Scope

The objective of our audit of the Ontario Securities Commission (OSC) was to assess whether the organization has effective and efficient processes and systems in place to:

- protect investors and foster fair and efficient capital markets through its regulatory activities in accordance with legislation;
- design market rules and policies;
- monitor regulatory compliance;
- conduct investigations and enforcement;
- educate investors to help them make informed decisions in relation to securities; and
- measure and publicly report on its effectiveness in achieving its mandate.

In planning for our work, we identified the audit criteria (see **Appendix 11**) we would use to address our audit objectives. These criteria were established based on a review of applicable legislation, policies and procedures, internal and external studies and best practices. Senior management at the OSC reviewed and agreed with the suitability of our objectives and associated criteria.

We conducted our audit between January and August 2021. We obtained written representation from the OSC and the Ministry of Finance that, effective November 19, 2021, they had provided us with all the information they were aware of that could significantly affect the findings or the conclusions of this report.

The scope of the audit focused on investor protection within the capital markets sector as well as on the OSC's mandate, and how the OSC's performance impacts the capital markets sector in the province and promotes the stability, integrity and transparency of the capital markets system including its market participants. Our audit did not include examination of enforcement cases before the Tribunal or evaluation of Tribunal decisions.

We interviewed senior management and appropriate staff from the OSC and Ministry of Finance.

We examined related data and files (for the last three to five years, with some trend analyses going back as far as 10 years) from both the OSC and the Ministry.

In our audit work, which included file reviews, analysis, interviews, and research on best practices, we also:

- analyzed relevant data collected and maintained by the OSC related to market participants such as exchanges, self-regulatory organizations, public issuers of securities, investment dealers and advisors, and mutual fund dealers;
- examined OSC board and board committee documentation;
- interviewed current and former OSC staff;
- examined Ministry of Finance documentation and interviewed Ministry staff;
- interviewed current and former board members of the OSC, including the chairs;
- interviewed current and former board members of securities commissions in other provinces;
- interviewed representatives from key partner regulators including the Canadian Public Accountability Board and the Ombudsman for Banking Services and Investments (relevant stakeholders are listed in **Appendix 4**);
- interviewed representatives from industry stakeholders such as the Canadian Advocacy Council, which acts on behalf of the Investment Industry Association of Canada, CFA Societies Canada, and the Private Capital Markets Association of Canada;
- interviewed representatives from investor advocacy groups such as the Canadian Foundation for Advancement of Investor Rights (FAIR Canada) and Kenmar Associates (relevant stakeholders are listed in **Appendix 12**);
- spoke with several individual retail investors about their experience with investing in Ontario's capital markets;
- engaged experts with knowledge of the capital markets sector and best practices to consult and advise us;
- interviewed an academic in the area of capital markets;
- reviewed the Capital Markets Modernization and Burden Reduction Taskforce reports to examine the proposed changes to modernize Ontario's capital markets regulatory framework and legislation and reduce regulatory burden;
- researched best practices from other jurisdictions, including other Canadian provinces, the United States and other countries including the United Kingdom and Australia; and
- reviewed the OSC's relevant internal audit reports to enhance our understanding of the OSC's operations and risks.

We conducted our work and reported on the results of our examination in accordance with the applicable Canadian Standards on Assurance Engagements—Direct Engagements issued by the Auditing and Assurance Standards Board of the Chartered Professional Accountants of Canada. This included obtaining a reasonable level of assurance.

The Office of the Auditor General of Ontario applies the Canadian Standard on Quality Control and, as a result, maintains a comprehensive quality-control system that includes documented policies and procedures with respect to compliance with rules of professional conduct, professional standards and applicable legal and regulatory requirements.

We have complied with the independence and other ethical requirements of the Code of Professional Conduct of the Chartered Professional Accountants of Ontario, which are founded on fundamental principles of integrity, objectivity, professional competence and due care, confidentiality and professional behaviour.

4.0 Detailed Audit Observations

4.1 The OSC Has Been Slow in Adopting Protections For Mutual Fund Investors and the Need for Additional Action Should Be Assessed

The OSC has led efforts, labelled as "client-focused reforms," to help ensure investors receive appropriate advice from advisors, dealers and their representatives (dealers). However, these reforms were less rigorous and narrower than the higher standards of fiduciary or similar duty that would require dealers to act in their clients' overall best interests, as we discuss in **Section 4.1.1.**

In addition, the OSC also led efforts in Canada to prohibit unfair sales practices in the mutual fund industry, such as deferred sales charges and trailing commissions. Deferred sales charges are fees an investor must pay if they sell a fund within a specified time. Trailing commissions are fees that a mutual fund company pays a dealer for as long as the dealer's client holds on to the company's fund, as detailed in **Section 4.1.2.**

Despite its efforts, we found the OSC has not effectively protected investors' interests in both a timely and effective manner. For instance, it took more than a decade for the OSC, along with the CSA, to decide to ban deferred sales charges (for advisors, dealers and their representatives) and trailing commissions (for discount brokers), as detailed in **Section 4.1.3.**

Further, the upcoming bans will only partly achieve the stated aim of protecting investors. Although trailing commissions will be prohibited under the proposed rules taking effect on June 1, 2022, for discount brokers (that is, dealers who are not permitted under existing regulations to provide advice to investors), they will still be allowed for full-service dealers. Therefore, the potential harms identified—such as dealers being incentivized to recommend funds that pay them higher commissions even if these funds underperform for their clients—will continue to exist for many investors. These sales practices cost Ontario investors an estimated $13.7 billion in commissions paid from 2016 to 2020. By contrast, securities regulators in the United Kingdom and Australia have banned these types of embedded commissions since 2012.

We found strong industry lobbying and opposition to eliminating deferred sales charges and trailing commissions. Industry stakeholders, such as industry associations and investment firms, also publicly opposed introducing a new requirement to act in the clients' overall best interests. See the details we provide in **Section 4.1.4.**

4.1.1 The OSC Could Better Ensure That Firms Act in the Best Interests of Their Clients

In 2018, the CSA with the OSC, proposed reforms to help ensure investors receive appropriate advice from dealers. The proposed reforms did not mandate a fiduciary duty or a similar overarching best-interest standard between dealer and investor/client, as is mandated in the United Kingdom, Australia and the European Union. (See **Appendix 13** for a jurisdictional comparison.) Instead, the CSA agreed to less rigorous and narrower changes labelled "client-focused reforms."

A simple illustration of the difference between employing an overarching best-interest standard and employing the client-focused reforms, would be that while an overall best-interest standard would prohibit dealers from being compensated through hidden commissions such as trailing commissions (see **Section 4.1.2**), under the client-focused reforms, such a compensation system is permitted so long as the conflicting interest is identified, documented, disclosed, and addressed.

However, an investor advocacy group that we interviewed noted that the client-focused reforms were similar to existing industry rules (within the SROs) that had not been effective in ensuring objective, professional advice in the best interest of investors. These rules have coexisted with compensation-related arrangements and incentive practices that reward dealers at the expense of investors. For example, notwithstanding these rules, both IIROC and the MFDA found issues relating to compensation and incentives in their oversight reviews of market participants. IIROC reported the three most significant areas of concern were:

- poor disclosure of conflicts of interest, and dealers disclosing conflicts but not otherwise acting to address them;
- a lack of comprehensive reviews of compensation programs and their related conflicts; and
- a shift to different compensation approaches without appropriate supervision and monitoring.

For further differences between employing an overarching best-interest standard versus employing the client-focused reforms, refer to **Figure 3.**

Many Ontario investors mistakenly believe that their financial advisors or dealers are required to put clients' interests ahead of their own. The CSA consultation paper in 2012 presented evidence that 70% of investors surveyed (approximately 2,000 online respondents who worked with dealers that make recommendations) believed their dealer had a legal duty to put the investor's interests first. The survey determined that this belief was unrelated to respondents' age and was stronger among those with investments of $100,000 or more. However, the consultation paper pointed out that this belief was mistaken except in certain circumstances, for example, where a dealer has sole discretion to make investment decisions without client consent to each transaction.

The CSA, including the OSC, published consultation papers in 2004, 2012 and 2016 to explore whether dealers should have a fiduciary duty or similar requirement to look out for their clients' overall best interests. The 2012 and 2016 consultation papers continued to summarize key investor protection concerns, as listed in **Figure 4.**

We interviewed current and former OSC staff who characterized the current client-focused reform proposals as "watered down." We found that lobbying by industry stakeholders, as detailed in **Section 4.1.4**, was a significant contributing factor in proposing these less rigorous and narrower changes. Another contributing factor were reservations expressed by other regulators, such as British Columbia, Alberta, Manitoba, Quebec and Nova Scotia securities regulators, suggesting, for example, that the change might not be workable and would create uncertainty for the industry. According to the OSC's Investor Advisory Panel, the client-focused reforms reflected a "hard-won compromise" (for example, between investor interests and industry views).

4.1.2 Trailing Commissions Banned Only for Discount Brokers

Two industry sales practices—deferred sales charges and trailing commissions—introduced in the mutual fund industry in the late 1980s were found by the CSA to have significant investor-protection and fairness issues, such as investors not knowing how much they were paying in hidden fees or even that they were paying these fees at all. These practices have been prohibited in the United Kingdom and Australia but are still permitted in Canada as a whole and in Ontario.

Deferred sales charges are monies paid where investors do not have to pay a fee to buy a mutual fund but must pay a fee or penalty if they sell the fund within a specified time. Instead of being paid directly by the investor, the dealer is paid by the mutual fund company that pays an up-front sales commission to the dealer when the investor makes the purchase. The investor pays the fee or penalty to the mutual fund company. **Trailing commissions** are commissions

Figure 3: Difference between a Fiduciary Duty or Overarching Best Interest Standard and Client-focused Reforms

Prepared by the Office of the Auditor General of Ontario

FIDUCIARY DUTY OR OVERARCHING BEST INTEREST STANDARD	CLIENT-FOCUSED REFORMS (CFRs)
An investor walks into a dealer's office and wants to make an investment.	An investor walks into a dealer's office and wants to make an investment.
The overarching best interest standard prohibits a compensation structure that is not aligned with the investor's best interest. If the dealer sells the investor a mutual fund, the dealer is paid, but not through hidden commissions in the products sold to the client, but rather through more direct and visible methods (such as an up-front commission or flat fee). This approach presumes that trailing commissions are prohibited. The investor is clear whether they are paying for and receiving investment advice from someone who is obligated to look out for the investor's overall best interest, or whether the dealer is a salesperson for that business's products (such as their own "proprietary" fund). This approach presumes that there are no misleading titles.	The dealer earns more money for selling certain products, such as: • their own company's ("proprietary") funds (yields a higher commission plus the company would also earn the management fees); and • funds from mutual fund companies that pay the dealer a trailing commission (for as long as the investor holds the fund). The dealer is required by the CFRs to have effective systems and processes to: • identify a conflict (such as getting paid more for recommending certain funds) • document the conflict • disclose it to the client • "address" the conflict If the dealer identifies a material conflict and it cannot be addressed in the best interests of the client, the dealer must avoid the conflict. In determining whether the investment the dealer proposes is suitable for the client, the dealer must put the client's interests first. The conflicts are permitted so long as the dealer can demonstrate that it has established and followed controls (and note that similar controls currently in place in the industry have proven ineffective).

Figure 4: Summary of Key Investor Protection Concerns Identified from Canadian Securities Administrators Consultation Papers in 2012 and 2016

Source of data: Ontario Securities Commission

- Clients were not getting the value or returns they could reasonably expect from investing. Failure of dealers to consider all relevant factors, including cost of product, could impede clients from obtaining the benefits that they seek;
- There was an **"expectations gap"** in that most investors wrongly assumed that their dealer must always provide advice that is in the best interest of the client;
- There was evidence of conflicts of interest. Evidence — identified during the normal course of compliance reviews — showed that the application of existing rules was "less effective than intended";
- Clients did not have the information and financial literacy available to dealers; and
- There should be a **"principled foundation"** for the standard of conduct owed to clients. That is, given the nature and subject matter of the relationship, and the reliance of clients, it should not be "just like any other business transaction."

that a mutual fund company pays a dealer for as long as the dealer's client holds on to the company's fund. These commissions purport to be compensation paid for advice given to investors. **Figure 5** provides further details of both practices.

These sales practices cost Ontario investors, directly or indirectly, based on OSC's estimates, $13.7 billion from 2016 to 2020, including:

- $13.2 billion in trailing commissions paid indirectly (the elimination of these commissions would not result in a corresponding saving to investors of $13.2 billion, as they would still need to pay advisors for advice);
- $400 million in trailing commissions paid indirectly for services and advice from discount brokers not permitted to provide advice (for 2016–2019 only; information for 2020 was not yet available); and
- $36 million paid directly to exit mutual funds with the deferred sales charge option.

At the end of 2017, there were $1.5 trillion in mutual fund assets in Canada (2020: $1.8 trillion), and it was estimated that 67% of these assets were in funds that paid trailing commissions.

The OSC estimates that Canadian investors pay approximately $6 billion per year in trailing commissions. There is no comparable figure for the United Kingdom and Australia because embedded commissions such as trailing commissions are not permitted in these jurisdictions. There is no comparable figure for the United States; while the United States does permit certain embedded commissions, there are caps on these fees that have resulted in more investors paying directly, rather than indirectly, for their investment services. The CSA observed that a similar move to more direct compensation could occur if embedded commissions were prohibited in Canada.

In their research and consultations, the OSC and CSA identified significant issues with deferred sales

Figure 5: Deferred Sales Charges and Trailing Commissions

Prepared by the Office of the Auditor General of Ontario

Deferred sales charges	An investor avoids paying up-front charges to purchase a mutual fund but must pay a penalty if they sell the mutual fund within a specified period. The dealer receives an up-front commission from the mutual fund company for making the sale. For example, if the investor sells their mutual fund in the first year, the investor could pay a fee of 6% to the mutual fund company. The fee would decrease by 1% each year until the investor could sell the fund in year seven without paying a penalty. According to OSC estimates, in November 2019, the assets held in Ontario in mutual funds with the deferred sales charge option was $76 billion. This comprised 11% of total mutual fund assets valued at about $700 billion held in Ontario. Canada's total mutual fund assets as of November 2019 were valued at $1.6 trillion. In 2019, there were 106 mutual fund companies offering mutual funds in Canada. Of these, the OSC estimated that 93 offered funds that could be purchased with the deferred sales charge option. When we refer to a ban on deferred sales charges, the ban is actually on the payment of upfront commissions by mutual fund companies to dealers, which the OSC expects to result in the discontinuation of all forms of deferred sales charge.
Trailing commissions	A dealer is paid a trailing commission by a mutual fund company for as long as the dealer's client holds the investment in that company's fund. For example, a mutual fund company will pay a dealer a commission of 1% every year that the dealer's client, the retail investor, holds the investment in that fund. The amount of the commission varies by dealer and type of fund but is often 1% for equity mutual funds bought by most retail investors. The Canadian Securities Administrators reported in 2017 that 67% ($1 trillion) of mutual fund assets that were purchased by retail investors were subject to trailing commissions.

charges and trailing commissions and presented evidence of harms.

- Conflicts of interest. Mutual fund companies pay dealers to carry their product and sell their product. Mutual funds and dealers may aim to sell products to maximize sales and commissions. These payments can misalign the interests of mutual fund companies and dealers with those of investors, which can negatively impact investor outcomes.
- The charges are "embedded" in the overall expenses of the mutual funds, making them less visible to investors, who may not notice or understand the nature of these fees.
- The commissions may not line up with the actual services being provided to the investor; that is, the investor may not get better or more service for more fees charged.
- The higher the commissions paid by mutual fund companies to dealers, the less likely that an investor will move their investment no matter the fund's performance. This suggests that dealers may be biased toward recommending funds that result in the mutual fund companies paying them higher commissions, regardless of the performance of the funds. This also removes an incentive for fund managers to maximize fund performance. Funds from mutual fund companies that pay dealers a commission for selling their products tend to underperform similar funds from companies that do not pay commissions to dealers.
- If there are deferred sales charges, investors are less likely to move their investment despite their investment's actual performance, because of the penalty that they must pay if they withdraw their money before an agreed-upon time.

In seeking to address the fairness and investor protection issues, the CSA (with the OSC) embarked on a period of research and consultations and proposals, as listed in **Appendix 14**.

Trailing Commissions to Be Banned for Discount Brokers but Not Others

Trailing commissions have attracted particular criticism when those dealers who are prohibited from providing advice to investors (that is, discount brokers who do not assess the investor's suitability for the product) are nevertheless being compensated with trailing commissions that purport to be compensation for advice. The CSA reported in 2017 that most of the funds sold by discount brokers/dealers charged full trailing commissions. The OSC estimates that Ontario investors paid $400 million in trailing commissions from 2016 to 2019 (2020 data is not yet available) to discount brokers/dealers who essentially charged for advice they did not give. Class action lawsuits have been filed against dealers.

The OSC has introduced a change to the rules to prohibit fund companies from paying a trailing commission to a dealer if the company knows or ought to know that the dealer (that is, a discount broker) was not required to assess the suitability of the fund for the client.

However, these changes will not assist investors whose dealers do not come under the ban (that is, full service dealers) and are still recommending products with trailing commissions. Mutual fund companies are obliged to report that they charged a trailing commission and advise investors that the commission was to compensate the dealer for "services and advice" provided to the client. The language for this disclosure was approved and mandated by the OSC. However, even though fund companies are required to use this language, it was not clear that these charges were used for the benefit of investors. Industry representatives indicate that such fees are used for a variety of dealer costs. Thus, investors may not know what value or service they are getting for their money.

Partial Reforms Delayed

In addition, these prohibitions were still not in force as of June 30, 2021. Dealers are permitted to sell these products up to the effective date of June 1, 2022. Thus, even discount brokers are being given up to June 1, 2022, to stop charging for services that they are not permitted to provide. The CSA announced that the delay in implementing the change was to provide dealers with time to change their systems and processes to comply with the new rules, assess their compensation arrangements and implement new fee charging systems.

Impact of Trailing Commissions

An investor can find it difficult to identify the amount being paid indirectly to a dealer in the investment products the dealer recommends. For example, for a mutual fund, the trailing commission forms part of the management expense ratio (MER) for the fund.

However, the trailing commission paid for a specific fund, and included in the MER, is not clear and transparently disclosed even in the "Fund Facts" (a document that mutual fund companies are required to provide to investors) before or at the time of making the investment. We examined a sample of funds which included only a general comment that the trailing commission is "0% to 1.00%" or a "maximum of 1.00%."

In addition, there are other fees that investors pay. For example:

- Funds will also incur trading expenses, which when compared to the assets of the fund are expressed as a trading expense ratio.
- When investors purchase mutual funds through an advisor, they may also pay a sales charge to the advisor; when they redeem from the fund, they may pay a deferred sales charge, as described above, to the mutual fund company.

Fees and commissions can significantly impact an investor's earnings on investment. Just as an investment's earnings compound over time, so do fees. We examined the MER from a range of 12 Canadian equity funds, offered by a range of mutual fund companies (an equity fund holds shares in companies rather than other types of securities such as bonds). We show the impact on an investor's earnings from these funds over 10 years using the funds' actual returns and their MER. Note that returns experienced by investors will be even lower after including any other fees or charges incurred, such as sales charges. See **Figure 6a** for 10-year stated rates of return and management expense ratios for a sample of 12 mutual funds selected by us. See **Figure 6b** for the impact that fees have on the earnings from a $100,000 investment after 10 years, based on the stated rate of return. The figure shows that on average for the 12 funds, approximately 34% of the investment's earnings were paid toward fees. The OSC, with the CSA, is evaluating the changes that led to the existing Fund Facts and annual report and examining further changes to improve disclosure for investors by mandating that the total costs of the investments be reported. This project is planned to be completed in 2023.

For the sake of transparency and accountability, prohibiting compensation schemes that result in conflicts of interest should be considered. Instead, prospective investments could be assessed solely on the basis of the anticipated performance of the investment, and advisors could be

Figure 6a: 10-Year Annualized Rate of Return and Management Expense Ratio for 12 Mutual Funds

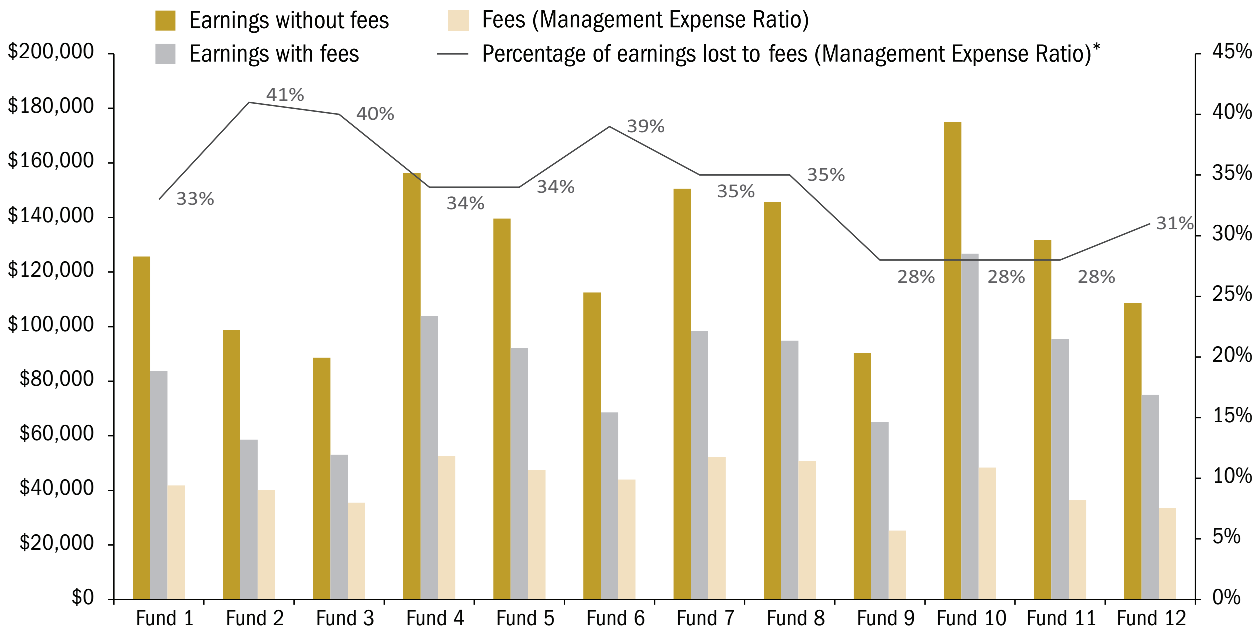
Prepared by the Office of the Auditor General of Ontario

Fund[1]	10-Year Stated Rate of Return (%)[2]	Management Expense Ratio (%)
Fund 1	6.28	2.20
Fund 2	4.72	2.39
Fund 3	4.35	2.20
Fund 4	7.38	2.49
Fund 5	6.75	2.38
Fund 6	5.36	2.47
Fund 7	7.09	2.53
Fund 8	6.90	2.50
Fund 9	5.14	1.51
Fund 10	8.53	2.12
Fund 11	6.93	1.84
Fund 12	5.76	1.87

1. Selected Canadian equity mutual funds representing mutual fund companies of varying sizes and ownership with selected funds having minimum 10-year return history.
2. Annualized, net of expenses (including MER).

Figure 6b: Impact of Mutual Fund Fees on 10-Year Return on Initial $100,000 Investment

Prepared by the Office of the Auditor General of Ontario



* The percentage represents fees paid on investment earnings. It is calculated as: Fees (Management Expense Ratio) divided by Earnings Without Fees.

openly compensated via an agreed-upon advisory fee that could more fully align their interests with the client's.

RECOMMENDATION 1

To better protect investors from unfair or improper practices, we recommend that the Ontario Securities Commission develop and implement further measures to protect investors, such as:

- complete the project to improve the transparency of total fees and costs paid by investors;
- determine within a reasonable time frame whether the objectives of the client-focused reforms have been met, including, among other things, that material conflicts of interest are addressed in the best interests of clients in the selection of products to be offered to clients; and
- if the client-focused reforms have not achieved their intended benefits, consider further policy options to protect investors, such as the complete elimination of trailing commissions and the introduction of an overarching best-interest standard to require advisors, dealers and representatives to act in the best interests of their clients.

OSC RESPONSE

The OSC appreciates these recommendations from the Auditor General that reflect on the significance of the Client Focused Reforms and the Total Cost Reporting Disclosure for Investors project.

Total Cost Reporting is intended to enhance the regular reporting on the ongoing cost of investments that have embedded fees. This project is progressing according to its mandate and remains a priority for the OSC.

The Client Focused Reforms are important policy changes based on the fundamental concept that investor interests must come first. They are designed to give investors confidence that they are receiving products that are right for them, enhanced disclosure about what to expect from their advisor, and advice that puts their interests first. These reforms set out the fundamental obligations of registrants toward their clients and are essential to investor protection.

We have begun testing for compliance with the conflicts of interest requirements of the Client Focused Reforms and will continue to conduct reviews once the rules are fully implemented on December 31, 2021.

As we have stated previously, if the Client Focused Reforms do not have the intended effect, we will consider further policy options to protect investors, such as the complete elimination of trailing commissions and the introduction of an overarching best-interest standard.

4.1.3 Rules to Protect Investors Took Too Long to Implement

We found that the process of making rules for capital markets is exceedingly slow. For example, the OSC took the lead in introducing reforms in the mutual fund industry, with the stated objective of protecting investors. But it has taken almost a decade to selectively ban sales practices, such as deferred sales charges and trailing commissions (for only discount brokers), that are often considered unfair and predatory (as noted in **Section 4.1.2**).

The reasons for the excessive delays in drafting rules include:

- The securities area is complex and making changes to the regulatory framework requires significant due diligence.
- The *Securities Act* has numerous requirements for rule changes, including research (such as qualitative and quantitative cost-benefit analyses), public consultations with mandatory minimum consultation times, responding to comments received in public consultations, and securing the Minister of Finance's approval.
- The time required to plan changes and the complexity are also greatly increased by the lack of a single national securities regulator (noted in **Section 2.1**). Developing regulatory policy that is national in scope and application requires extensive co-ordination of rule-making across all Canadian commissions, and may also involve amendments to multiple rules. The involvement of multiple jurisdictions, each with its own regulator, greatly complicates and lengthens the process.
- There has been strong industry opposition (see **Section 4.1.4**).

We provided a simplified overview of the rule-making process in **Figure 2.** However, we reviewed planning templates and guides that indicated approximately 90 steps to bring about a rule change requiring one comment period, and about 125 steps for a rule change involving two comment periods. The anticipated duration for a project was about three years, although OSC staff advised that it was possible a project could be expedited and completed within two years with considerable effort.

According to our research, the average duration the OSC, working with other regulators, took to develop a CSA rule, policy or amendment was 2.9 years. The OSC took on average 1.7 years for Ontario-only rules, illustrating the additional time required to co-ordinate with other regulators. This does not include research phases.

Further, certain projects, including the research phases, have taken much longer than this average timeframe:

- Client-focused reforms (disclosures and conflict of interest): 11.2 years (see **Section 4.1.1)**.
- Embedded commissions (deferred sales charges, trailing commissions): 10.4 years (to planned date in force, June 1, 2022) (see **Section 4.1.2)**.

During these extensive delays, Ontario investors continue to be negatively impacted by these industry practices (see **Section 4.1.2**).

We also compared the average duration of projects completed or in progress from May 2019 to August 2021. Projects were classified by the OSC according to one or more categories as relating to: [Regulatory] Burden reduction; Harmonization; Open for business; Fair and efficient capital markets; Innovation; Enhancing competitiveness; and Investor protection.

We found that projects that involved investor protection took on average 3.9 years to complete compared with two years for projects that did not include an investor protection component. We further observed that the OSC's risk-management framework described investor protection as "low priority" in terms of additional management action required to manage the risk. Conversely, regulatory burden was a "high priority," requiring management focus to reduce the risk in the near term. The OSC advised us that in this period it was addressing the recommendations in its 2019 burden reduction report. This included a larger number of projects with smaller scope than the more complex and comprehensive projects that had investor protection as their primary impetus. We also noted that "ensuring efficiencies and red tape reduction" was the first area of focus in the Minister of Finance's mandate letter for 2020/21.

RECOMMENDATION 2

To better protect investors through efficient rule-making processes, and recognizing the importance of harmonized securities regulation within Canada and the potential of Ontario Securities Commission (OSC) action impacting other provinces without the input of their securities commissions, we recommend that the OSC:

- assess, approve and implement rules independently of the Canadian Securities Administrators, where involvement by other securities regulators slows key initiatives significantly; and
- increase its focus on managing risks relating to investor protection.

OSC RESPONSE

The OSC appreciates the OAGO's acknowledgement of the importance and benefits of harmonized rulemaking by Canadian securities regulators and the need to always consider investor protection in the rulemaking process.

The OSC will continue to prioritize and advance rulemaking consistent with our multiple mandates to provide protection to investors from unfair, improper or fraudulent practices, to foster fair, efficient and competitive capital markets and confidence in the capital markets, to foster capital formation, and to contribute to the stability of the financial system and the reduction of systemic risk. We will also continue to assess and weigh the benefits of harmonized rules with the potential need, in some cases, to proceed independently in rulemaking.

Key risks are assessed within the context of the OSC's ability to deliver on our mandates (including investor protection). Investor protection is embedded in our assessment of all key risks and controls, which are reviewed regularly at senior risk committees and drive decision making at all levels. We will continue to identify and assess risks impacting investor protection, develop action plans and seek to mitigate such risks.

4.1.4 Intense Lobbying Efforts by Industry Stakeholders Lessen Investor Protection

We found lobbying by industry stakeholders was a significant contributing factor slowing reforms to protect investors, as detailed in **Sections 4.1.1** and **4.1.2**.

The extended process undertaken to ban deferred sales charges and trailing commissions provided the industry stakeholders with many opportunities to lobby for changes. The CSA reported that of 142 public comment letters from its 2017 Consultation related to the unfair sales practices, about 84% were from industry stakeholders (such as dealers, representatives, investment fund managers, industry associations and industry service providers), compared with about 16% from investors and investor advocates. The CSA reported the majority of industry stakeholders were strongly opposed to prohibiting embedded commissions such as deferred sales charges and trailing commissions.

In our interviews, current and former OSC staff described "intense" lobbying efforts from industry. We found evidence of significant lobbying activities and Ministry meetings with key industry stakeholders in the period before September 2018 when the CSA released for public comment the proposed amendments that would ban both the deferred sales charges and restrict trailing commissions. Political staff in the government in fall 2018 involved in these activities included a past lobbyist for the investment industry.

Industry stakeholders also publicly opposed introducing an overarching best-interest standard, even though a type of fiduciary or best-interest standard exists in the United Kingdom, Australia and European Union. The 2019 Notice of Amendments (the actual rule changes) indicated that there had been 135 public comment letters. Of these, 117 were from industry stakeholders and 18 were from investors, investor advocates, academics and other non-industry stakeholders. The summary of comments accompanying the changes indicated that many industry commenters did not want an overarching client best-interest standard. In their comment letters, they argued that industry rules already in existence (through IIROC and the MFDA, overseen by the OSC) that specify that dealers must deal fairly, honestly and in good faith with clients—but not imposing a fiduciary duty or best-interest standard—were sufficient to protect investors. However, as noted in **Section 4.1.1**, these industry rules already in existence had not been effective in ensuring objective, professional advice in the best interest of investors.

We noted that the Ministry supported industry positions and confirmed that many in the industry were "pleased at how 'watered-down'" the changes introducing the client-focused reforms were.

We note that the OSC's annual Statement of Priorities for 2021–22 sets out the following goals:

- promote confidence in Ontario's capital markets;
- reduce regulatory burden;
- facilitate financial innovation; and
- strengthen our organizational foundation.

The top-level goals do not include investor protection (although the text in the document observes that "investor protection is always a top priority" for the OSC and actions under existing goals relate to investor protection).

We discuss the appointment process for Board members in **Section 4.2.1.** We found that existing Board members tended to demonstrate experience and qualifications from industry, rather than from an investor protection background—for example, working for an investor or consumer protection agency. Further, the OSC has 10 policy advisory committees, including the Investor Advisory Panel, which is focused on investor protection issues. We did not find evidence of a general expectation that the policy advisory committees should include members with direct experience in investor protection matters or a demonstrated investor protection perspective. Including Board members and policy advisory committee members with experience in investor protection matters or a clear investor protection outlook would assist the OSC to ensure that investor protection receives more attention.

RECOMMENDATION 3

To help achieve its mandate of protecting investors from unfair or improper practices, we recommend that the Ontario Securities Commission:

- include investor protection as a key priority in its annual statement of priorities, with planned actions and outcomes;
- include, as a default requirement, members with retail investor protection experience and an investor protection outlook on its policy advisory committees; and
- take appropriate steps in its public consultation on rule and policy changes to identify and evaluate vested interests and weigh these interests against the benefits from changes to protect investors.

OSC RESPONSE

As the OAGO has noted, investor protection is a central element of our statutory mandate. Accordingly, protecting investors from unfair, improper or fraudulent practices has consistently featured prominently in our goals and priorities.

In 2010, the OSC established an independent Investor Advisory Panel with a mandate to solicit and represent the views of investors on policies and rule-making initiatives. Its members are required to have retail investor protection experience, and currently include a mix of thought leaders with backgrounds in investor advocacy, investment industry operations, public policy development and professional regulation. To support its crucial role, the IAP receives funding from the Commission to engage in investor outreach, conduct research and publish reports to enhance understanding of issues affecting investor interests and how these interests can be better served from policy perspective. The IAP is empowered to function independently, publicly share its views on matters impacting Ontario investors and report on its interactions with the OSC.

The OSC also has advisory committees that enable staff to gather input on specific areas of securities law and industry trends from individuals with specialized capital markets expertise.

The OSC rulemaking consultation process requires us to identify commenters, summarize their comments and respond to them as part of the policy development process. In this way, we transparently acknowledge the different perspectives in rulemaking, and evaluate the interests and needs of the stakeholders impacted by rules.

OSC's Investor Office also plays an important role in identifying investor needs and priorities, engaging with investors and providing valuable education and information to investors in the capital markets. The OSC has recently begun a multi-year plan to provide additional resources to the branch for investor education and protection.

RECOMMENDATION 4

To assist the Ontario Securities Commission (OSC) in protecting investors from unfair or improper practices, we recommend that the Ministry of Finance work with the OSC's Governance and Nominating Committee to identify, and recommend for appointment, Board members with retail investor protection experience and an investor protection outlook so that this perspective is enhanced in Board representation.

MINISTRY RESPONSE

The Ministry agrees that the OSC has a statutory mandate to protect investors from unfair or improper practices, as outlined in s. 1.1 of the *Securities Act*, and acknowledges the importance of having retail investor protection experience on the OSC Board.

The Ministry will continue to work with the OSC to ensure that diverse and relevant perspectives are represented on its Board.

4.2 Untimely Political Interference Undermined the OSC's Operating Independence in Setting Evidence-Based Market Rules

As set out in **Section 2.2**, the OSC is accountable to the Ontario Legislature through the Minister of Finance. The OSC describes itself as independent and has a Memorandum of Understanding (MOU) with the Minister of Finance. The previous MOU, signed in 2009, was revised in 2019. Both versions state the OSC's regulatory and adjudicative decisions "must be made and be seen by the public to be made in an independent and impartial manner."

However, in practice, the OSC has proven to be vulnerable to political interference, which risks undermining its independence and impartiality. As noted in **Section 4.1.2**, on the unfair sales commissions issue, the OSC had presented over the course of many years research and evidence about the unfair practices and the impact on investors. All of the Canadian provincial/territorial securities regulators (including the OSC) had reached consensus regarding reform: deferred sales charges would be prohibited, and trailing commissions would be prohibited for dealers who did not assess the suitability of clients for particular investments (that is, discount brokers).

But on September 13, 2018, the same day the CSA, with the OSC, released the proposed amendments, the then Minister of Finance released a media statement that indicated the government did not agree with CSA's consensus on needed reform, as it was then drafted. OSC's proposed amendments did not proceed. In May 2021, almost three years after CSA's proposed amendments, the OSC announced that Ontario was reversing the previous position and joining the rest of Canada in prohibiting deferred sales charges. The OSC cited concerns from industry that two sets of rules in Canada would be burdensome to implement and monitor. We found that both the original intervention by the Ontario government and its later reversal illustrated the Minister's ultimate authority and power regarding rule changes, even when in direct conflict with the OSC's judgment and related evidence on the matter.

The Minister's stated position was that the deferred sales charge option was a payment option that has enabled Ontario families and investors to save toward retirement and other financial goals. While the exercise of Ministerial authority to approve or return a rule after it is made by the OSC is unquestionably within the power of the Minister under the *Securities Act*, the manner and timing in which it was exercised raises concerns about the independence and role of the OSC. The Minister provided no new evidence to counter the weight of reasons and evidence amassed by the OSC and all other applicable regulators. As one commentator observed, the decision by the Minister undermined the rule-making process, it failed to appreciate investor-protection concerns, and it created uncertainty in capital markets. As noted in **Section 4.1.4**, we found evidence of significant lobbying activity regarding the proposed deferred sales charges ban.

Further, in September 2018, the Ministry introduced a new "pre-clearance" process requiring the OSC to provide the Minister, ahead of time, with rules—both before publishing the rule for public consultation and after public consultation but before sending the rule to the Minister for final approval.

In addition, the Minister—who has the right under the Act to reject rules submitted for final approval—also required an advance look at all policy development work, including policies and notices.

The pre-clearance process for proposed rules before they go out for public comment was codified in the revised Memorandum of Understanding (MOU) between the Minister of Finance and the OSC that became effective December 19, 2019. That MOU also included a new statement in its guiding principles: "The Government, through the Ministry, is responsible for setting the policy direction for the regulation of capital markets in Ontario."

OSC staff expressed concerns that changes to the MOU could be perceived as a potential erosion of the OSC's independence in policymaking. It was noted that the Objectives and Principles of Securities Regulation of the International Organization of Securities Commissions (of which the OSC is a member) holds that the Regulator should be operationally independent and accountable in the exercise of its functions and powers.

As well, in our interviews with current and former Board members of the OSC and staff, the Ministry's involvement was said to interfere and delay action. According to OSC data, pre-clearance has required additional time, averaging 93 days for rules before public consultation, 91 days for rules after public consultation but before sending the rules to the Minister for final approval, and 54 days for staff notices.

We recognize the legislated authority of the government to set the policy direction for capital markets—for example, the government's setting out of the plan for capital markets in its 2019 Budget. However, in the example cited, the government's actions contradict the requirement in its 2009 and 2019 memoranda of understanding with the OSC that the OSC's regulatory and adjudicative decisions "must be made and be seen by the public to be made in an independent and impartial manner." Lobbying interests overrode OSC evidence-based research in the case of deferred sales charges.

RECOMMENDATION 5

To preserve the operational independence of the Ontario Securities Commission (OSC), and eliminate perceptions of overt political interference where the Ministry of Finance disagrees with a rule proposed by the OSC, we recommend that the Ministry make public:

- criteria used to reach the differing decision;
- inputs into the decision (including advice from lobbyists and investor advocates); and
- the Minister's evaluation weighing the inputs, including vested interests against protection for investors.

MINISTRY RESPONSE

The Ministry will consider this recommendation and will work with the OSC to ensure that the OSC continues being able to respond to capital markets developments and exercise its statutory rule-making authority in an effective and timely manner.

4.2.1 The Government Did Not Follow a Consultative Appointment Process for OSC Board Members

We found that the government did not follow the established consultative process for appointments to the OSC's Board of Directors twice in 2019.

Under the *Securities Act*, Cabinet appoints the Board of the OSC. The board is to be composed of at least nine and not more than 16 members. The OSC's Charter of Governance indicates that appointments are made in accordance with the government's Agencies and Appointments Directive, the OSC's Memorandum of Understanding with the Minister, and the procedures of the Public Appointments Secretariat of the government of Ontario.

We found that, prior to the fall of 2018, the established process was for the Governance and Nominating Committee of the OSC to consider the collective competencies of the OSC and approve an advertisement to fill gaps. The advertisement would be placed on the Public Appointments Secretariat website. The Public Appointments Secretariat would forward applications to the Governance and Nominating Committee, which would then determine whom to interview. The board Chair would make the recommendations of the Committee known to the Minister, and then the Minister would make the final decision for Cabinet approval.

We found that this process was not followed for appointments in February and April 2019, resulting in a significant loss of experienced members.

At the beginning of June 2018 there were 16 board members. In the period November 2018 to February 2019, the terms of nine of the 16 were scheduled to come to an end.

- Two of the nine with terms expiring had reached the maximum number of years of service according to OSC policies and were not eligible for reappointment.
- Of the remaining seven members with terms expiring between November 2018 and February 2019, the Chair recommended reappointment of five, based on the needs of the Board. The Minister declined to follow the recommendation of the Chair and Cabinet made four new appointments, not drawn from the candidates recommended by the Chair.

At the end of April 2019, the board was made up of 11 members, including the four recently appointed by Cabinet, and seven continuing members. In total, the board lost nine experienced members between November 2018 and February 2019, including the chairs of all board committees and the Adjudicative Committee, as well as the Lead Director (a position under the OSC's Charter of Governance responsible for representing the members of the board—other than the Chair and Vice-chairs—and providing leadership and oversight of the governance obligations of the board and its committees). From February 2 to February 13, 2019, the board had only seven members, fewer than the minimum of nine required by the *Securities Act*. However, the Act also provides that so long as the deficiency is corrected within

90 days, the OSC is deemed to be properly constituted. This occurred with the appointment of the four new members, as previously discussed.

We interviewed current and former board members who indicated that there was a perception that the appointment process had been significantly politicized. They indicated that the loss of experienced members and the appointment of new members not following the consultative process had a significant negative impact on the OSC in all three of its roles: regulatory, governance and adjudicative. We were told that the changes affected Board morale, materially reduced the quality of policy making and adjudication, and adversely affected the reputation of the OSC.

We examined OSC documents that indicate there was a return to previous processes for subsequent board appointments, except that a member of Ministerial staff now participates with the Governance and Nominating Committee in interviewing candidates.

We noted that the board did not complete its performance self-evaluation between February 2018 and December 2020, when the board then approved resuming the evaluations. An evaluation questionnaire was administered in January 2019, but the results were not used. The stated reason was that there were not enough responses to complete the process and the significant transition and changes in composition of the board since the questionnaire was administered.

We note that the Capital Markets Modernization Taskforce report, published in January 2021, recommended the separation of the regulatory and adjudicative functions at the OSC. This means that there will be a board that will be dedicated to governance matters and will not have adjudicative responsibilities. The taskforce also recommended the separation of the combined positions of Chair and CEO into two distinct positions. The provincial government accepted these recommendations (as announced in the 2021 Ontario Budget); the related legislation received Royal Assent on April 2021 and is awaiting proclamation.

RECOMMENDATION 6

So that the Board of the Ontario Securities Commission (OSC) has independent board members with appropriate skills and experience, we recommend that the Ministry of Finance work with the Chair of the OSC to follow an appointment process that is responsive to the advice and recommendations of the Board and its Governance and Nominating Committee.

MINISTRY RESPONSE

The Ministry agrees that it is important that the OSC continues to have board members who have relevant skills and experience to carry out their duties and responsibilities. The Ministry will continue to work with the Chair of the OSC to ensure that appointments reflect the needs identified by the Board and Governance and Nominating Committee and that appointments continue to be made in adherence to the *Securities Act*, the Agencies and Appointments Directive, the Memorandum of Understanding, and the process articulated by the Public Appointments Secretariat.

4.3 The OSC Could Take More Enforcement Action in Deterring Violations by Unregulated Companies and Individuals

Over the five fiscal years from 2016/17 to 2020/21, the OSC closed 3,184 cases that it received from various sources including the public through its contact centre, the Whistleblower office, other branches within the OSC and from other regulators. **Figure 7** illustrates a breakdown of actions taken by the OSC, as obtained from its enforcement database. Of the 2,029 cases where the OSC took limited or no action due to various reasons, we sampled 35 cases, and found that in 49% of the cases, the OSC had sufficient information to update its warning lists to alert investors of potential harmful activity, but did not do so, as detailed in **Section 4.3.1.** We also found that OSC could have taken more action

Figure 7: Actions Taken for Closed Enforcement Cases, 2016/17–2020/21

Source of data: Ontario Securities Commission

Actions taken by the Ontario Securities Commission (OSC)	Total (#)	Total (%)
Limited or no action[1]	2,029	64
Referred externally[2]	520	16
Open[3]	124	4
Issuing cautionary letters and other warnings, in person or by phone	124	4
Assistance/information provided on reported misconduct	94	3
OSC Tribunal proceeding	77	2
Add to investor warning/alert list	51	2
Other[4]	44	1
Referred to other branches within OSC	42	1
Court proceeding	29	1
Voluntary resolution by respondent	22	1
Undertaking by respondent	14	<1
Settlement agreement	13	<1
Terms and conditions imposed	1	<1
Total	**3,184**	**100**

Note: Numbers on outcomes may have inaccuracies due to limited capabilities of the Enforcement Information System database. See **Section 4.10.3.**

1. Limited or no action was taken where, for example, OSC determined insufficient evidence was provided, evidence provided was unfounded, no feasible action to stop the misconduct was available, expending additional resources would result in minor incremental investor protection, or where OSC determined that cases were already being better addressed by another regulator or government agency. (We randomly selected 35 samples from 2,029 cases. See **Section 4.3**)
2. Cases referred externally include referrals to other regulators within the CSA; to international regulators including the UK's Financial Conduct Authority and the US Securities and Exchange Commission; and to law enforcement such as the Ontario Provincial Police (OPP) and the Royal Canadian Mounted Police (RCMP).
3. As of March 31, 2021, the 124 cases had been open from 0 to 4.5 years. 87 cases were open for less than one year, 23 cases between one and two years, 13 cases over two years and less than 3.5 years and one case was open for 4.5 years.
4. Includes cases amalgamated with existing cases.

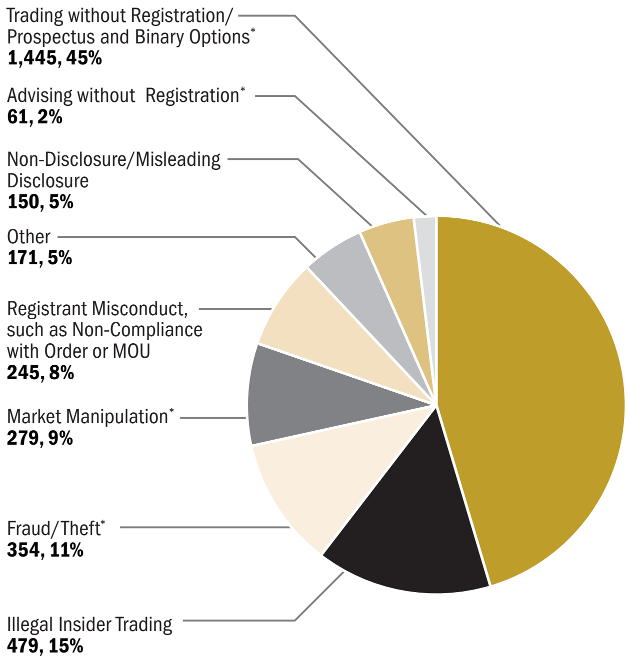
to deter non-compliance if it had additional enforcement tools, as detailed in **Section 4.3.2**, especially for less egregious or less serious confirmed cases of misconduct and also where the alleged violators are not regulated by the OSC. We noted that a significant portion of the 3,184 enforcement cases that the OSC closed, estimated by the OSC to be around 85%, were related to alleged misconduct by individuals or entities that are not registered or regulated by the OSC.

Figure 8 illustrates the types of alleged misconduct based on the Enforcement Branch's database. As shown in this figure, 67% of the misconduct related to trading without registration/prospectus and binary options (an illegal trade in Canada), advising without registration, market manipulation and fraud/theft. These cases of misconduct do not typically involve entities that are registered or are reporting issuers in Ontario.

In addition, the OSC estimates that a significant portion of illegal insider trading, comprising 15% of closed cases in the last five years, also involved individuals not registered with or regulated by the OSC. The OSC requires regular reporting, for example, of ownership and changes in ownership in securities of reporting issuers, by reporting insiders (as defined in the Act or in the securities rules) through a system called System for Electronic Disclosure by Insiders (SEDI). The Corporate Finance Branch also conducts regular reviews of these reports that are filed by reporting insiders. OSC investigates improper insider trading, including insider trading by unregistered or unregulated individuals and entities, when brought to its attention, for

Figure 8: Types of Misconduct for Enforcement Cases Closed by the Ontario Securities Commission, 2016/17–2020/21

Source of data: Ontario Securities Commission



* These types relate to misconduct by individuals or entities who are not registered or regulated by the OSC, and represent 67% of the total misconduct cases.

example, through whistleblower tips, complaints or OSC branch referrals. We reviewed the processes in place to handle whistleblower tips and found no significant issues in this area.

Regulated entities are more likely to comply with OSC enforcement orders, such as cease-trade orders. However, unregulated entities typically are less compliant with securities laws or the OSC's orders.

We noted that the Enforcement Branch has limited resources and generally investigates cases where there may be wider impact felt by investors and market participants. Sometimes this means pursuing particular cases where there is a perceived upswing in the activity (for example, cryptocurrencies and binary options). OSC indicated they must be strategic in determining which case to investigate further and use a risk-based approach in making this determination. The OSC's jurisdiction also overlaps with other regulators in and outside Canada, self-regulatory organizations such as IIROC, the stock exchanges as well as police agencies; this increases the complexity of enforcement actions.

4.3.1 The OSC's Warning Lists are Outdated or Incomplete

We reviewed a sample of 35 of the 2,029 cases with limited or no action taken, and found that in 17 cases (or 49%) the Enforcement Branch confirmed misconduct occurred but did not update the OSC's investor warning list with this information. **Appendix 15** provides some examples.

The OSC did not see the need to update its own warning list because it said that investor warnings specific to Ontario are found in several places, for example, on the international warning list maintained by the International Organization of Securities Commissions as well as the CSA's warning list. Additionally, each securities regulator in Canada has its own investor warning list which Ontarians may consult when conducting their investment due diligence. The OSC also noted that the investor warning list is only one measure of investor protection offered by the OSC and that investors should be doing due diligence prior to making an investment.

However, our view is that a more updated and complete warning list posted on the OSC's own website and further educating investors about the existence of the warning list will enhance public awareness of these misconducts in the sector.

RECOMMENDATION 7

To make Ontario investors better aware of misconducts in the capital-markets sector, we recommend that the Ontario Securities Commission:

- be more proactive in adding fraudulent companies to its own investor warning list;
- update this list regularly; and
- increase public awareness of the existence of the list.

OSC RESPONSE

The OSC agrees that investor protection and general deterrence are important goals of our Enforcement program. Additions to the investor warning list are carefully considered, and evidence is researched and assessed prior to each addition.

The investor warning list is evergreen; with warnings generally remaining on the OSC website permanently. Every warning is important and should be taken seriously by investors. OSC investor warnings are also posted on the OSC's website, getsmarteraboutmoney.ca and distributed via the OSC's social media channels. The OSC also works to build awareness of the warning list through its investor outreach events, such as investor telephone town halls, financial literacy webinars and OSC in the Community Events.

The OSC will consider how we can maximize our use of existing channels, alongside new avenues, to increase public awareness of the investor warning list. We will also continue to add companies to the list, where the facts warrant such an addition.

4.3.2 The OSC Does Not Have Adequate Tools to Pursue Less Egregious Cases

In addition to updating the warning list and issuing investor alerts, as detailed in **Section 4.3.1**, a better mechanism is needed for enforcing less egregious or less severe cases and protecting Ontario's investors in cases that are not given the full force of an investigation and the resources that are necessary for an investigation. Refer to the examples in **Appendix 15**.

However, the OSC does not have legal authority to be able to take more timely action on these types of allegations. We noted that, for example, the securities regulator in Quebec has the authority to block or remove fraudulent websites. The securities regulator in the UK has implemented a goal to block or remove such websites within 24 hours to minimize losses to potential investors. The OSC currently does not have similar authority to block or remove unregistered websites marketing and distributing fraudulent or unregulated securities or distributing information to induce investors to invest in fraudulent securities. Having such authority will help to protect Ontario's investors from investing in such products. The Capital Markets Modernization Taskforce report also recommended empowering OSC with strong enforcement tools such as obtaining orders to block or remove websites and social media sites that induce some Ontario investors to invest in fraudulent schemes.

We also noted that the securities regulator in British Columbia was given the authority in March 2020, under its provincial *Securities Act*, to impose administrative monetary penalties. These actions include issuing "tickets," based on information obtained from a review, investigation or from another source (for example, a self-regulatory organization such as IIROC, an auditor or a stock exchange) for contraventions of the *Securities Act* or regulations or a decision of the BC securities commission. The penalty was set at $100,000 for individuals and $500,000 for firms.

The OSC has not been given such authority to, for example, issue tickets to deter less egregious instances of misconduct that call for more serious sanctions than a warning letter but do not warrant the expense and resources of a full investigation or hearing.

In addition, the OSC lacks adequate technology and analytical tools to enhance its case assessment, disruption (or attempting to stop misconduct), and investigation capabilities to identify potential securities law violations and misconduct. It also does not have sufficient tools to scrutinize websites or social media, and analyze the Internet activities of those websites by Ontarians who may be victimized.

RECOMMENDATION 8

To better protect Ontario investors from financial misconduct and violations of securities laws, we recommend the Ministry of Finance adopt best practices from other jurisdictions, such as to provide the Ontario Securities Commission with the authority to:

- block or remove unregistered websites that market and distribute fraudulent or unregulated securities or distribute information to induce Ontario's investors to invest in fraudulent securities (similar to the authority provided to the Quebec securities regulator); and
- impose administrative monetary penalties, in the form of tickets, similar to the authority provided to the British Columbia securities regulator, for less egregious instances of misconduct.

MINISTRY RESPONSE

The Ministry acknowledges the need to continue to protect Ontario investors. This imperative aligns with many enforcement-related changes proposed in the Ministry's draft Capital Markets Act (CMA), published for stakeholder consultation in October 2021. The draft CMA includes tools aimed at modernizing the enforcement of securities law. The Ministry will work with the OSC to consider this recommendation and determine next steps.

RECOMMENDATION 9

To improve its ability to assess, investigate and disrupt securities misconduct and fraud, we recommend that the Ontario Securities Commission develop a formal roadmap and budget for reviewing and implementing new data analytics tools and approaches, including the ability to identify, evaluate and reduce Ontario securities law violations and misconduct occurring on websites or social media, and be fully aware of the extent of the impact on Ontarians by analyzing the Internet activities of those types of websites and social media sites.

OSC RESPONSE

The OSC agrees with this recommendation.

Building an Enterprise Data Platform with modern data, reporting and analytical tools is one of the key initiatives identified as part of the digital and data transformation at the OSC. The platform will have the ability to ingest data from multiple sources, including social media. Third party tools that allow bespoke analytics will also be considered to support specific needs as prioritized by the enforcement branch.

The OSC will develop a formal plan, with specific timelines and budget for phased development and implementation of the data platform and for onboarding bespoke tools.

4.3.3 The OSC Did Not Evaluate Whether Its Disruptive Actions Were Effective in Stopping Misconduct

Over a two-year period (2019/20–2020/21), we noted the Disruption team of the Enforcement Branch attempted to stop misconduct in 154 cases. A "disruptive action" is taken when a case does not warrant a full investigation and enforcement action. However, we found that the OSC closed the cases based on the fact that a disruptive action was taken, rather than whether the misconduct completely stopped. In instances where the misconduct continues, Ontario's investors may be left inadequately protected.

OSC staff conducted disruption activities either through direct interactions with individuals suspected of having breached Ontario's securities laws and/or by warning Ontario investors of these individuals and companies. Actions ranged from issuing warning letters, making unannounced in-person visits to the individuals' homes or work premises, directing the removal of misleading information from websites, issuing press releases that warn Ontario investors of individuals' and entities' ongoing misconduct, and referring the matter to other regulatory and law enforcement agencies. **Figure 9** presents the breakdown of the OSC's disruption actions over the last two fiscal years. The OSC informed us that it has begun to assess the outcome of disruption activities by determining whether there have been any additional

Figure 9: Number of Disruptive Cases and Actions Taken by the Ontario Securities Commission (OSC), 2019/20–2020/21[1]

Source of data: Ontario Securities Commission

	# of Cases[2]	# of Actions
Interactions with individuals suspected of misconduct		
Warning letters[3]	104	124
In-person interactions (e.g., door knocks)[4]	37	42
Telephone calls[5]	21	22
Warning to investors in Ontario of individuals suspected of misconduct		
Investor warning list[6]	24	24
Investor alert press releases[7]	3	3
Referral to external agency/partners[8]	34	39

1. Complete data is only available in 2019/20 and 2020/21 since data began to be collected following the creation of the Disruption Team in March 2018.
2. Cases may result in more than one disruptive action being taken. A case can also have more than one of the same disruptive actions.
3. Warning letters are issued to individuals suspected of breaches of Ontario securities law in order to encourage compliance and/or cessation of misconduct.
4. In-person visits include unannounced visits with a police officer to the business or personal premises of individuals suspected of having breached Ontario securities law to deliver a warning letter. In 2020/21, no in-person visits were made due to COVID-19.
5. Telephone calls can include discussions regarding the actual warning letter.
6. The investor warning list is on the OSC's website and includes unregistered entities known to be dealing with Ontario residents.
7. Investor alerts are press releases regarding entities or individuals actively engaged in misconduct that present a material risk to Ontario investors. Where applicable, alerts are co-ordinated with other jurisdictions.
8. Referrals are made to other securities and non-securities regulators (e.g. Law Society of Ontario), law enforcement or financial institutions in order to inform them of misconduct in their jurisdictions or with respect to matters that may be of interest to them (e.g. spoofed website of a well-known financial institution).

complaints regarding the same matter. However, we noted that this is being done on a trial basis in only a few cases.

RECOMMENDATION 10

To evaluate the effectiveness of disruptive activities to stop misconduct by fraudulent market players, we recommend that the Ontario Securities Commission:

- conduct timely follow-ups to confirm whether the misconduct has actually stopped before closing the case; and
- take necessary action to stop activities that have not ceased.

OSC RESPONSE

The OSC agrees with the Auditor General that our disruption activities are an important element of our oversight framework. The OSC continually refines and evaluates the effectiveness of our oversight processes in response to emerging risks, new technology and evolving regulatory best practices.

Complaints and prior enforcement history are currently tracked and form key inputs to our risk-based case assessment process. The OSC has initiated a pilot project to follow up on disruption cases and looks forward to continuing those efforts and evaluating the program. The new powers and analytics tools mentioned in **Recommendations 8** and **9** will provide additional options for the OSC to stop activities that have not ceased.

4.4 The OSC Has Limited Legislated Tools to Collect Unpaid Monetary Sanctions

Over the last 10 years, we found that the OSC's Tribunal imposed $525 million in monetary sanctions, including disgorgement (an OSC-imposed order that requires the respondent to pay any amounts obtained as a result of their non-compliance with securities law), payments for investigation costs and administrative penalties, but collected only 28%, or $145 million (as shown in **Figure 10**). We noted that while the OSC has been successful in collecting amounts through monetary sanctions from legitimate and regulated market participants, the vast majority of the uncollected balance is owed by unregistered and unregulated individuals and entities. As noted in **Section 4.3**, these types of unregulated respondents typically are less compliant with legal or regulatory obligations, including the monetary sanctions ordered against them.

Although the OSC has various tools at its disposal that it uses to enforce the collection of monetary sanctions, as listed in **Appendix 10**, the tools are not adequate to improve collections from fraudsters who are not regulated individuals and entities.

Figure 10: Monetary Sanctions Imposed and Collected by the Ontario Securities Commission, 2011/12–2020/21[1]

Source of data: Ontario Securities Commission

	Imposed ($ million)	Collected ($ million)	Collected (as % of Imposed)
2011/12	40	4	11
2012/13	78	1	1
2013/14	63	3	6
2014/15	58	11	20
2015/16	62	12	20
2016/17	16	8	49
2017/18	14	6	47
2018/19[2]	135	48	36
2019/20[2]	44	42	96
2020/21	11	6	53
Total	**525**	**145**	**28**

1. The total collection rate over 10 years was used to eliminate large year-over-year fluctuations influenced by large individual disgorgement orders, depending on the nature of the cases.
2. Fluctuations from year to year are normal and depend on the egregiousness and type of cases brought forward. There were two large cases that impacted the numbers in fiscal year 2018/19 and one in fiscal year 2019/20.

When monetary sanctions are unpaid, it can weaken the impact that the OSC's orders have in deterring wrongful conduct, the OSC's enforcement authority and the confidence that investors have in Ontario's markets.

We noted that British Columbia amended its provincial securities law in 2019 to provide its securities regulator additional powers to collect financial sanctions. For instance, it can ask BC agencies to refuse the renewal of driver's licences of someone sanctioned, or order the seizure or freezing of assets from third parties who have received assets below fair market value from someone sanctioned or under investigation, and disposing of frozen assets. The OSC currently does not have such powers.

Following British Columbia's amendments, we noted that the Capital Markets Modernization Taskforce recommended, in its January 2021 report, that OSC be given additional powers to collect sanctions similar to those provided to the BC Securities Commission. We noted that as of June 2021 the Ministry has not taken any action toward granting more collection powers to the OSC.

As a result of the low collection rate, we noted the OSC had accumulated about $424 million of unpaid amounts as of March 31, 2021. The sum was owed by 259 individual respondents who were still alive or 152 groups of respondents still in existence and that had not declared bankruptcy. We noted that $112 million, or 26%, of the balance is at most five years old, and the remaining $312 million, or 74%, of the balance is over five years old.

The OSC informed us that to deter and discourage misconduct it sometimes imposes sizeable monetary sanctions irrespective of the respondent's ability to pay. In addition, even if the OSC is concerned that the amount of the sanctions will not be repaid, seeking a lower amount could be cited as precedent by a registered market participant that finds itself in a similar situation. The OSC's collection rate almost entirely depends on the cases it selects to enforce (as noted in **Section 4.3**) and it does not select those cases with the collection rate in mind.

Imposing sizeable monetary sanctions on respondents sends a strong deterrence message. However, the seriousness of the regulatory message can be undermined when the respondent does not pay.

RECOMMENDATION 11

To better enforce and increase the collections rate for monetary sanctions for individuals with unpaid amounts owing to the Ontario Securities Commission (OSC), we recommend that the Ministry of Finance provide the OSC with collection enforcement authority, similar to those provided to the British Columbia Securities Commission, such as powers to:

- freeze, preserve and dispose of assets that were transferred below fair market value to family or third parties; and
- restrict a person's ability to access a driver's licence or licence plate.

MINISTRY RESPONSE

The Ministry recognizes the importance of the OSC having appropriate tools to collect monetary sanctions. This policy priority aligns with many enforcement-related changes proposed in the Ministry's draft Capital Markets Act (CMA), published for stakeholder consultation in October 2021. The draft CMA includes provisions aimed at modernizing the tools available to the OSC. The Ministry will work with the OSC to consider this recommendation and determine next steps.

4.5 The OSC Only Paid Out 6% to 11% of the Financial Sanctions Collected That Can Be Used for the Benefit of Investors

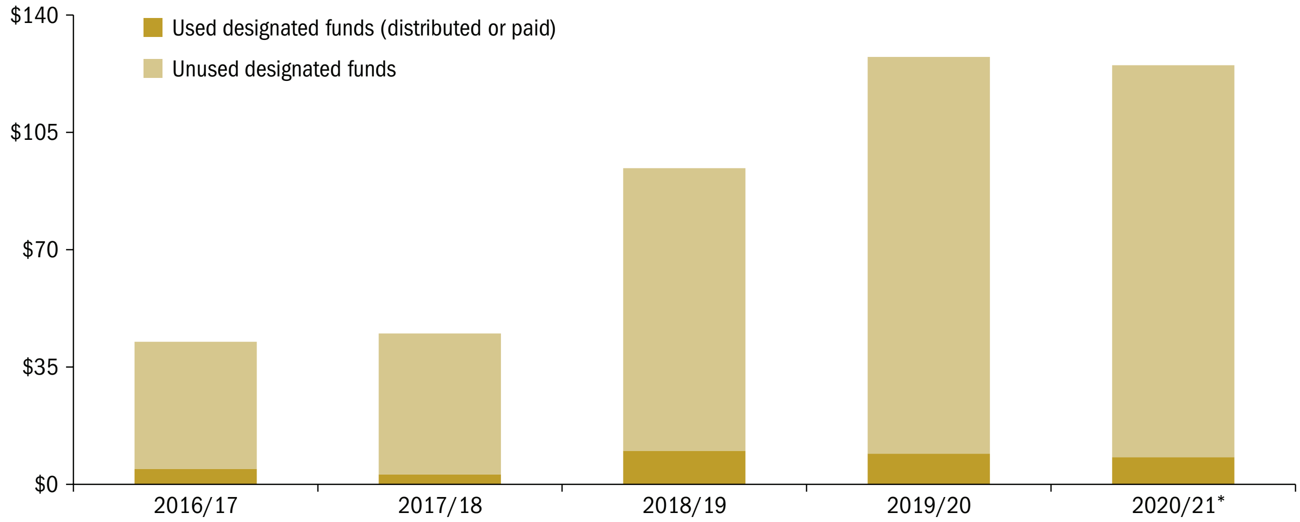
We noted that the OSC's Designated Fund cash balance more than tripled from $38 million in fiscal 2016/17 to $117 million in 2020/21. This excludes the general surplus balance of $89 million as at March 31, 2021, as noted in **Section 2.2.** However, despite the significant growth in the balance, we found the OSC only paid out 6% to 11%, or $3 million to $10 million, of the available funds in each year, leaving the vast majority of the funds unallocated and unused. Note that in addition, through settlement agreements approved by the OSC, respondents paid $208 million directly to investors in the last five years. **Figure 11** shows the amount of funds paid out in comparison to the balance of the fund over the five-year period.

The Designated Fund includes the money from administrative penalties, disgorgement orders and settlement orders that the OSC collects from enforcement actions. The Act permits designated funds to be used by the OSC for the purpose of educating investors, promoting and enhancing knowledge and information of persons regarding the operation of the securities and financial markets and to be allocated to or for the benefit of third parties, for undertaking initiatives that further the purposes of the *Securities Act* or *Commodity Futures Act.* As shown in **Appendix 16,** the payments from the designated funds, which vary year to year, have appropriately included whistleblower payments, payments to harmed investors, and payments to other third parties such as the investor advocacy group FAIR Canada and an investor protection clinic operated by Osgoode Hall Law School. The intent is that the monetary sanctions collected by the OSC can be used for the benefit of investors, used for educational purposes or given to other third parties to support initiatives that promote the purposes of the Act, as opposed to being used to fund the OSC's general operations.

We reviewed the OSC's allocation plan for the beginning of fiscal year 2021/22 and noted that of the $117 million in cash in the Designated Fund, the OSC reserved $43 million, or 37%, for potential use in future years in accordance with the provisions of the Act. This includes allocations reserved for potential whistleblower payments ($20 million), and for recoveries of investor education costs and knowledge enhancement costs ($20 million) for the next four years.

Figure 11: Designated Fund Balances from 2016/17 to 2020/21 versus Funds Paid Out ($ million)

Source of data: Ontario Securities Commission



* For details of the drop in fund balance in fiscal year 2020/21 compared to fiscal year 2019/20 please see **Appendix 16**.

However, we noted in the previous year (2020/21), the OSC also similarly reserved $22 million (including the $20 million reserved for potential whistleblower payments), but only ended up paying out $4 million of the reserved amount. We observed that the reserved amounts are significant and the OSC paid out much less than planned.

As per the OSC's internal policy, compensation is generally made to investors identified by the OSC as incurring losses as a *direct* result of misconduct against which the OSC was able to collect monetary sanctions. In cases where the funds were not returned to investors, it was because the OSC could not identify the specific harmed investors (such as in insider trading and market abuse cases where the investors were distributed across the market). In some cases, funds were not returned as the OSC determined that it was not practical to distribute the funds, for example, because of the complexity and costs of distribution.

We noted that currently, the Act allows the OSC to apply to the Superior Court of Justice for an order to appoint a receiver over property of any person or company. The OSC has used this provision to have a receiver appointed to manage a claims process to distribute designated funds to harmed investors. In some cases, designated funds are also distributed in accordance with the *Civil Remedies Act* and this process is managed by the Ministry of the Attorney General. There are currently no set criteria or thresholds established by the OSC for the selection of cases for which a receivership will be sought or cases will be referred to the Ministry of the Attorney General to distribute designated funds.

In a few cases, OSC staff have also carried out direct distributions of designated funds in circumstances where there were a very small number of identifiable investors with readily quantifiable losses. Since the OSC's approval of an allocation framework to distribute designated funds in 2012, it has distributed or is in the process of distributing such funds in 19 cases where sanction amounts owing were collected or subject to freeze directions at the conclusion of the OSC proceeding, through the following methods:

- court appointed receivers in three cases;
- through the Ministry of the Attorney General in six cases;
- direct distributions by OSC staff in five cases; and

- other methods such as third-party claims administrator and alternative court-supervised distributions in five cases.

We also noted that the *Securities Act* does not prescribe a specific framework or process for the distribution or allocation of designated funds. For example, there is no prescribed process for distributions that are smaller in scale or less complex.

Comparatively, other jurisdictions have prescribed procedures to administer such distributions. For example, the Quebec securities regulator has the authority to establish terms to administer and distribute disgorged amounts. Once the terms have been approved by its tribunal, amounts can be distributed in accordance with the approved terms. The *Securities Act* in British Columbia also has prescribed procedures for how applicants, that is, harmed investors, can make a claim for payment if the BC Securities Commission received disgorged funds and how its commission can assess the eligibility of applicants and decide whether payments can be made to them.

The Capital Markets Modernization Taskforce report recommended that OSC should develop criteria to use to determine when the appointment of a receiver would be sought, in circumstances where it is efficient to do so, and how to communicate information relating to potential distributions of disgorged funds to the public.

With the current process in Ontario, we noted that the receivership method of distributing funds is not efficient in cases where limited funds have been recovered for distribution, as the costs of a receivership including the receiver's fees, disbursement and legal costs, are significant and may not result in significant compensation being paid to individual investors. For example, in one case where a receiver was appointed to distribute designated funds, of the $6.9 million monetary sanctions imposed by the OSC, it could only collect approximately $560,000. This was paid out to 35 claimants who recovered only approximately 9% of their losses each. The receivership fees and disbursements, including related external legal fees, funded out of the designated fund amounted to approximately $120,000, that is, 21% of the sanctions amount recovered.

We also noted that the OSC has limited control over the timing and pace of distribution of funds through the Ministry of the Attorney General (MAG), and the process has been comparatively slower than distributions carried out by a receiver. For example, two receiverships that were used to distribute designated funds were completed in under 12 months from the date the receiver was appointed to the date the receiver was discharged. In contrast, the six distributions conducted through the MAG took between 14 months and three years.

If the OSC were to be given similar powers as have been given to the Quebec and BC securities commissions, the distributions would likely result in more efficient and timelier distributions to investors.

RECOMMENDATION 12

To compensate harmed investors and protect them from improper, unfair or fraudulent market activities, we recommend that the Ministry of Finance work with the Ontario Securities Commission (OSC) to ensure that monetary sanctions collected by the OSC are distributed to harmed investors in an effective and timely manner, after reviewing the process in other jurisdictions.

MINISTRY RESPONSE

The Ministry supports improving the OSC's ability to distribute disgorged funds to harmed investors and has initiated work to consult on a framework to support those distributions based on the recommendations of the Capital Markets Modernization Taskforce. The draft Capital Markets Act, published for stakeholder consultation in October 2021, includes a statutory framework for the distribution of disgorged amounts and contemplates OSC rules relating to the distribution, including conditions, restrictions, and requirements.

The Ministry will work with the OSC to consider this recommendation and determine next steps.

RECOMMENDATION 13

To distribute the funds accumulated in its Designated Fund balance in accordance with the *Securities Act*, we recommend that the Ontario Securities Commission (OSC):

- develop an overarching policy to support the allocation and use of the designated funds, informed by best practices for using similar funds in other jurisdictions such as Quebec and British Columbia;
- define the process to support the distribution of disgorged funds to harmed investors in cases where funds have been collected and there is sufficient evidence to establish that investors suffered direct financial losses;
- establish criteria and thresholds for the timely use of the funds, including the assessment of opportunities to support third-party initiatives that support the OSC's investor protection mandate; and
- establish criteria and thresholds to continue the existing uses of allocations from the fund to whistleblowers and investor education activities, such as raising awareness of the OSC's warning list.

OSC RESPONSE

The OSC agrees there are opportunities to enhance our existing processes and criteria for the use and allocation of designated funds, and that these should be codified in a policy or bylaw. As part of this work, we will consider the establishment of threshold amounts to be allocated or used each year based on the balance of available funds. These amounts would be separate from funds that are set aside for distribution to harmed investors.

4.6 Limited Review of Special Purpose Acquisition Companies, Capital Pool Companies and Reverse Takeovers

We found that the OSC conducts very limited reviews of regulatory filings and disclosures of companies seeking to enter Ontario's capital markets through alternative methods versus through traditional Initial Public Offerings (IPOs). These methods include distributing securities through companies set up as Special Purpose Acquisition Companies (SPACs) or Capital Pool Companies (CPCs), or through reverse takeovers (RTOs) of existing publicly traded companies, at the time of their entry to the market. There were 145 such entrants in the last five years (2016/17–2020/21), compared with 88 that went public by issuing IPOs. Because issuing securities in the public markets through the traditional IPO method tends to be more expensive for companies due to related legal costs, regulatory scrutiny and the volume of documentation required, the alternative methods of entering the public markets are becoming more popular.

A SPAC, also known as a blank-cheque company, is a business formed strictly to raise capital through an IPO for the purpose of acquiring an existing company, called a qualifying transaction (QT). In early 2021, the Neo Exchange piloted a program called the Growth Acquisition Corporation or G-Corp, to facilitate QTs with smaller private companies. This program is similar to the SPAC program, but the minimum capital to be raised is $2 million (rather than $30 million for a SPAC), and the resulting issuer must have a market capitalization of at least $30 million. CPCs are also similar but for smaller, Canada-only transactions, and differ, for instance, by not giving investors the same redemption rights. In RTOs, private companies can become publicly traded while avoiding a formal IPO by acquiring an existing public company.

These kinds of ventures might pose risks for investors relating to conflicts of interest, founder/promoter compensation and the difficulties these companies might face to remain viable or profitable. Ontario's investors could be better protected from potential losses if the OSC did a more thorough vetting of these entrants by reviewing their regulatory filings prior to their entry into the capital markets.

We also noted that the OSC does not communicate and highlight new distributions of securities by companies that have entered the market through these alternative methods, nor has it alerted investors to specific risks inherent in these types of transactions.

Upon inquiry, OSC staff noted that SPACs are a relatively new method of raising capital in Canada and said that it is too early to assess the risks associated with SPACs, although they have been used for five years in Canada. They also informed us that the OSC is part of an international team that will be studying and monitoring SPAC activity and issues internationally starting 2020/21.

Other international jurisdictions have raised concerns about these alternative capital-raising methods. For instance, in 2011, the SEC issued an investor bulletin in the United States highlighting the risks of investing in reverse mergers. In April 2021, the SEC issued a public statement on “SPACs, IPOs and Liability Risk under the Securities Laws.” The SEC noted in that public statement its staff “will continue to be vigilant about SPAC and private target disclosure so that the public can make informed investment and voting decisions about these transactions.”

In our audit, we also noted that the OSC does not regularly track the companies that have entered the capital markets through RTOs or as CPCs, and therefore does not use this information as a key criterion in selecting market participants for compliance reviews. See **Section 4.7** for details.

In the last five years (2016/17–2020/21), for instance, the OSC performed a detailed review of seven CPC IPOs (that is, 9% of the 77) only because it identified potential concerns with the promoters of these CPC IPOs, which were subsequently addressed. The OSC reviewed only another seven of the regulatory filings, such as non-offering prospectus, of the 130 CPC qualifying transactions and RTOs that entered the Canadian capital markets in the same period and that issued or traded securities.

The current regulatory framework, approved by the OSC and other Canadian securities regulators, provides primary authority and responsibility to the stock exchanges (which are non-government companies) to set the rules for entry and listing requirements and to review all regulatory filings and disclosures prior to the entry of these companies seeking alternative ways to enter the public markets. For example, there is an operating agreement between most of the CSA jurisdictions, including the OSC, and the TSXV that sets out the standards that the exchange will apply in review of CPC prospectuses and qualifying transactions. The agreement notes that the securities regulators that are part of the CSA intend to rely primarily on the analysis and review carried out by the exchange. However, each regulator may conduct a detailed review of a CPC prospectus and retain its discretion to refuse approval.

The operating agreement further notes that “nothing in this Agreement is intended to create an obligation on any Commission [securities regulator] to review a CPC prospectus or draft QT Circular [one of the many regulatory filings].”

According to the current regulatory framework, for all these types of alternative methods the OSC *may* approve some documents, such as the prospectus at the time of the IPO, or a document called a “non-offering prospectus” similar to a regular prospectus at the time of or before issuing securities or a takeover or qualified transaction is conducted, as detailed in **Appendices 17a** and **b.**

In addition, the OSC only reviews the stock exchanges’ rules and approves rule changes but does not regularly review the exchanges’ processes to approve these alternative methods of public offerings to ensure that the stock exchanges have complied with the rules. We found that between 2016/17 and 2020/21, the OSC has not performed any proactive oversight reviews of the stock exchanges’ processes to monitor if they have appropriately approved these new entrants at the time of their entry, where the OSC is the principal regulator as defined in **Appendix 3.** Nor has the OSC reviewed whether these companies have complied with the legislative requirements imposed on them.

As noted above, there were 88 new entrants to the capital markets through the traditional IPO process in that five-year period, where the OSC was the principal regulator as defined in **Appendix 3.** That compares with 145 entrants through SPACs, CPCs and RTOs, as shown in **Figure 12**. **Appendix 17a** provides a summary of the risks that these types of entrants pose to investors as well as additional background information.

Perhaps the most prominent case of a troubled RTO transaction in Canada was the collapse in 2011 of the shares of Sino-Forest Corp., a forest plantation operator in China, after it was accused of fraud.

Through our own research, we found issues relating to two companies that entered the market through alternative methods. See **Appendix 18** for details. Subsequent to our identification of the issue noted in Example 1, when we enquired into the actions that could have prevented this failure, OSC staff informed us of several 'red flags' that could have highlighted the risks related to this company, including:

- Staff conducted background checks on the CPC promoters but did not review the other regulatory documents related to the CPC, for example, personal information forms for each director, executive officer and initial founder, among other things (although OSC staff note that the

Figure 12: New Entrants to Canada's Capital Markets, 2016/17–2020/21

Source of data: Ontario Securities Commission

	# of Alternative Methods of Entry to Markets			
Industry	**Capital Pool Companies**	**Reverse Takeovers**	**Special Purpose Acquisition Companies**	**# of Traditional Initial IPO**
Psychedelics	0	11	0	0
Cryptocurrency	2	3	0	1
Gaming	3	1	0	0
Finance	2	1	1	4
Manufacturing	3	2	2	5
Cannabis	6	17	5	10
Biotech/Pharma	2	1	0	5
Technology	8	6	0	11
Real Estate	3	2	0	13
Mining	10	7	0	24
Other[1]	38	2	7	15
Total	**77**	**53**	**15**	**88**
Minimum total value of capital raised through IPOs	**$38 million Cdn**	**Not applicable[2]**	**$3 billion Cdn[3]**	**$13 billion Cdn[4]**
	Total alternative market entrants = 145			

1. The 38 Capital Pool Companies marked "Other" did not have any industry specified in their public disclosures on the Sedar system at the time of IPO and a Qualifying Transaction (QT) was not yet completed. For Reverse Takeovers, and traditional IPOs, other industries include industrial products, retail and energy. For SPACs, "other" refers to cases were a QT was not completed but the companies indicated an intention to enter the cannabis and financial sectors.
2. Reverse Takeovers, or RTOs, are one of the ways in which a company can issue securities to the investing public. RTOs, also known as "reverse mergers" or "back-door listings," involve a private company, which has operating assets or an operating business, to complete a statutory amalgamation, arrangement or procedure with a publicly traded company that is already a market participant or reporting issuer in Ontario.
3. 6 SPACs raised an aggregate of $702 million Cdn and 9 SPACs raised an aggregate of $1.9 billion US. At a five-year average exchange rate of 1.3, this amount totals approximately $3 billion Cdn.
4. The 88 IPOs raised an aggregate of $4.8 billion Cdn plus $6.2 billion US. At a five-year average exchange rate of 1.3, this amount totals approximately $13 billion Cdn.

exchange would likely have conducted certain security checks as part of their review).

- Staff noted that, if they had reviewed the other regulatory filings at the time of the RTO transaction or CPC QT, they could have highlighted the financial condition, such as a history of net losses and negative cash flows, as being a concern and would have raised comments regarding whether the Issuer had sufficient resources to continue operations and achieve the business objectives disclosed in the regulatory filings.

From information that the OSC put together at our request, we found that of the 53 RTOs that entered the market from 2016/17 to 2020/21, there were 60 complaints filed involving 25 different RTO companies (representing almost 50% of the total). Of these, 13 complaints related to Example 1 in **Appendix 18**, and nine of these complaints were received prior to the OSC issuing a cease-trade order in September 2019. The complainants were concerned about potential fraud (2 complaints), that the company was not issuing share certificates to investors (1 complaint), significant loss in their shareholdings (4 complaints) and that the RTO company was not responding to their concerns (2 complaints).

In light of the perceived concerns with RTOs, including that the RTO regime may be less robust from a regulatory compliance perspective, in early 2020 a group of Canadian securities regulators including the OSC agreed to conduct a review of two exchanges, the CSE and TSXV. They were specifically focused on the quality of disclosure in the documents used to become a reporting issuer through an RTO; for example, an information circular, listing statement or a filing statement.

This process was completed in the Fall of 2020 and covered the disclosure of around 60 issuers including around 20 where the OSC was the principal regulator. A number of deficiencies were identified in the overall review of RTOs by the CSA; TSXV had significant concerns noted in 30% of files reviewed and CSE had significant concerns in 74% of files reviewed.

The CSA communicated the results of the review and identified deficiencies with the specific exchanges' processes both verbally and in writing and recommended changes to issuer disclosures in the RTO context.

OSC staff also communicated, in the fall of 2020, key recommendations to the exchanges to revise their policies, including relating to RTOs and oversight of issuers in general. One of the exchanges is currently in the midst of a policy amendment project that will, among other things, better align its listing requirements with regulations. The proposed policies are expected to be published for public comment in the fall of 2021.

RECOMMENDATION 14

To further the Ontario Securities Commission's (OSC) investor protection mandate in situations where companies seek to enter the capital markets through alternative methods, we recommend that the OSC:

- propose revisions to the current regulatory framework that would enable the OSC to ensure all key regulatory documents of these transactions are effectively reviewed, including prospectuses, non-offering prospectuses and personal information forms, in a timely manner, and using a risk-based approach;
- provide greater oversight of exchange processes to approve these types of alternative listings;
- publish the names of new reporting issuers in Ontario, detailing the means by which each issuer raised capital in the public markets, for example, by IPO, Capital Pool Companies, Special Purpose Acquisition Companies as well as reverse takeovers; and
- provide educational resources to investors highlighting the risks of investing in these companies.

OSC RESPONSE

The OSC will enhance its regulatory framework to review key documents and oversee exchange processes, using a risk-based approach, for alternative listings that are not currently subject to review by OSC staff. The OSC will also publish the names of new reporting issuers in Ontario, detailing the means by which each issuer raised capital in the public markets, and will offer additional resources about the different methods of becoming a public company and the risks associated with each.

4.7 The OSC Can Expand Its Existing Processes to Provide Broader and More Proactive Oversight over Market Participants

The OSC's Corporate Finance and Compliance and Registrant Regulation Branches have fairly comprehensive risk-assessment processes to select market participants and review their compliance with securities legislation. We found that the branches could enhance their existing risk assessment processes, by selecting key criteria such as location of operations of reporting issuers or key deficiencies found in registrant firms, to enhance their risk evaluation and assessment processes, identify and select additional or other market participants for proactive review and provide better oversight over market participants to better protect investors.

4.7.1 Corporate Finance Branch Does Not Use Key Criteria such as Location of Operations of Reporting Issuers

From 2016/17 to 2020/21, the Corporate Finance Branch conducted proactive continuous disclosure reviews of about 370 out of about 1,000 reporting issuers, active as at March 2021, with an aggregate market capitalization of $1.2 trillion. However, it had not conducted a proactive review of about 630 reporting issuers (representing 63% of the 1,000 total reporting issuers) with an aggregate market capitalization of $697 billion (representing 36% of total market capitalization).

We found that the branch does not collect or use the following key metrics or information as input for the purpose of regularly evaluating market participants' risk level and to select them for proactive reviews. For example:

- location of operations—data not collected (**Section 4.9.2**);
- frequent changes in senior management—data not collected;
- if market participants entered the markets through alternative methods, that is as Special Purpose Acquisition Companies, Capital Pool Companies, or through reverse takeovers (**Section 4.6**)—data collected but not used.

For example, information such as location of operations is an important factor to consider when determining the appropriateness of required disclosures, but this information is not collected by the Corporate Finance Branch. Frequent changes of senior management in reporting issuers can be indicative of issues within the company, but this information is also not collected.

We noted that the branch conducts other reviews such as analysis of prospectuses when companies seek to raise capital in the markets, reviews of applications for exemptions from legislative requirements, or reviews triggered by public complaints. Such reviews include analyzing the entity's financial statements and other disclosures. In the last five years (2016/17—2020/21), the branch conducted 784 such reviews. However, we found that these reviews were more reactive in nature and triggered by an external source, such as by the company making an application to the OSC, filing a prospectus or by a public complaint.

4.7.2 Compliance and Registrant Regulation Branch Does Not Use Key Criteria such as Key Deficiencies Found in Registrant Firms

The Compliance and Registrant Regulation Branch did not conduct a proactive review of 133 or 17% of 775 firms active as of May 2021, in the same five-year period, although 642 firms reviewed had the same average risk score (as calculated by us) assigned by the branch.

The branch does not collect or use the following key metrics or information as input for the purpose of regularly evaluating market participants' risk level and to select them for proactive reviews. For example:

- late filing of forms—data collected but not used; and
- deficiencies identified in past reviews—data collected but not used.

We found that 73 registrant firms (representing 9% of the total 775 firms) were delayed in making filings to the branch between 2011/12 and 2015/16. The firms were assessed a late fee by the branch for late filing of forms required to maintain registration status. The branch conducted a targeted review based on an analysis of late filings as of 2016, and 43 firms with the highest incidence of late filings were sent a warning letter. However, the branch does not conduct regular proactive reviews of frequently delinquent firms, as late filing data is not used as a criterion when selecting firms for review. Delinquency issues with filings may be indicative of a lack of due diligence or a negative tone at the top, especially for repeat offenders. For example, if firms do not respect the timelines for making required filings, they may have similar issues with maintaining proper documents to comply with OSC rules.

We also examined compliance reviews conducted by the branch between the fiscal years 2015/16 and 2017/18 and found that the branch identified 559 deficiencies in 77 firms—18 firms had 11 to 23 deficiencies each, 36 firms had between five and 10 deficiencies each, and 23 firms had less than five deficiencies each. The top three deficiencies related to compliance issues, that is inadequate written policies, inadequate information collected on clients and issues relating to client account statements not being complete. However, these 77 firms were not reviewed subsequently from 2018/19 to 2020/21 to confirm that the deficiencies, especially the more significant ones, were fixed permanently. Without consistent tracking and analysis of significant deficiencies from prior reviews, the branch could potentially miss identifying repeat offenders.

In contrast, we found that the securities regulator of British Columbia uses a predictive risk model to select market participants that have a higher likelihood of compliance failures due to significant repeat deficiencies.

RECOMMENDATION 15

To sufficiently identify and evaluate the risk associated with reporting issuers and registrant firms by considering additional key risk factors, we recommend that the Ontario Securities Commission:

- collect and analyze data, such as location and size of operations, frequent changes of senior management, late filings and deficiencies identified in prior reviews; and
- use the additional data when selecting additional reporting issuers and registrant firms for compliance reviews.

OSC RESPONSE

The OSC's risk models are continuously updated to reflect changes in the regulatory environment. The OSC agrees with the Auditor General and the additional data points mentioned in the recommendation will be collected and added to the risk models used for our review selection processes.

4.8 The Corporate Finance Director Lacks Statutory Authority to Require Companies Using Regulatory Exemptions to Make Sufficient Disclosures

We found that the OSC's Corporate Finance Branch does not have adequate legislative authority to respond effectively or quickly when it identifies non-compliance by companies that are not reporting issuers and that qualified for regulatory exemptions. For example, the Corporate Finance Branch cannot issue an order to cease trading of securities when it identifies a lack of required disclosures by companies that distribute securities without a prospectus directly to retail and "accredited" investors. Under securities laws, companies that qualify for these prospectus exemptions nevertheless are supposed to make the necessary disclosures to the investing public. However, the OSC is unable to sufficiently respond to issues of non-compliance on a timely basis, and protect investors who rely on the disclosures by the company instead of relying on a prospectus to buy the securities.

Prospectus exemptions allow a company or fund to quickly raise money without the expense of preparing a prospectus. This part of the financial world is called the exempt market. The legislative rules also require that companies using certain prospectus exemptions report the distribution to the OSC by filing a "Report of Exempt Distribution (RED)." Under securities laws, companies are required to file this Report within 10 days after the first sale of securities. Companies must also provide offering materials and other disclosure documents to the OSC. For example, the "Offering Memorandum" exemption, detailed in **Appendix 1**, requires a company that has used this exemption to deliver audited annual financial statements to the OSC and make them reasonably available to each investor.

The Corporate Finance Branch implemented a pilot project where branch staff reviewed a sample of RED filings to determine whether companies that use prospectus exemptions have complied with the disclosure requirements. Between 2016/17 and 2019/20, the branch conducted 104 reviews of exempt distributions and identified concerns related to a potential lack of adequate disclosures in 36 reviews (35%). We randomly selected and examined 10 samples from the 36 reviews and found that:

- in six cases, staff inquired with the company and subsequently accepted the disclosures;
- in one case, staff requested the company to provide accurate disclosures to investors along with an offer of rescission of their previous purchase;
- in one case, staff requested the company to cease distributing securities and offer rescission to investors who already purchased the securities based on inaccurate disclosures, while the company corrected their disclosures; and
- we noted two examples (**Figure 13**) where we determined that potential investors could be better protected if the Director of the Corporate Finance Branch had the legislative authority to issue a cease-trade order to the company for insufficient disclosures.

As noted previously, in cases where the Corporate Finance Branch has confirmed non-compliance, its approach has been to contact the company and only ask that the company voluntarily cease distributing securities until it has complied with the requirement. The Corporate Finance Branch Director does not have legislated authority to require the exempt-market company to cease trading securities.

In cases where companies refuse to comply with the OSC's request to cease trading securities, the only practical option available to branch staff is to refer these matters to the OSC's Enforcement Branch. This could result in the OSC commencing an investigation into the matter to determine if a securities-law violation actually occurred and only then issuing a cease trade order. It might also lead to a potential hearing before the OSC, which would increase costs and drain resources from more urgent matters. In the meantime, thousands of investors may have already invested in these securities.

Through discussions with Corporate Finance Branch staff, we also noted an example where staff were concerned that an issuer had failed to comply with the terms of a prospectus exemption regarding a complex security product. The issuer voluntarily, in this case, ceased distribution pending resolution of the concerns identified. Although the issuer complied with the request to cease distributing securities, an issuer may put forward a proposal to rectify the potential non-compliance and resume distributions. If Corporate Finance staff continue to disagree with an issuer on whether the issuer has adequately addressed the non-compliance concerns, Corporate Finance staff may have to refer the matter to the Enforcement Branch. Branch staff may have to rely on an exempt market issuer's voluntary cessation of

Figure 13: Examples of Issues Relating to the Exempt Market

Source of data: Ontario Securities Commission

Example 1

This company conducted four offerings of securities to investors, totalling $40.6 million, using the "Accredited Investor" exemption and the "Offering Memorandum" exemption. The proceeds from the sale of securities were expected to be used to purchase undeveloped land (typically from the developer) with the intention of constructing a residential housing project in partnership with the developer. The success of the project depended on the ability of the company and the developer to secure required approvals and financing as well as to construct and sell the project. These are illiquid investments and pay no distributions other than the distribution of profits near completion of the project. The company did not provide enhanced disclosure regarding its valuation methodology, the rationale for fees charged, prior experience in similar offerings, and the assumptions underlying forecasted returns.

In their review, staff noted that these offerings appeared to be very high-risk investments due to the early stage of the developments, lack of liquidity and significant anticipated term. The risk was also compounded by the high level of fees, conflicts of interest and dependence on the property developer. Staff also noted that the company had several projects in development but very few that had been completed and paid returns to investors. However, staff determined that the disclosure provided did not appear to contain any misrepresentations or specific non-compliance, indicated the fees paid and conflicts of interest and clearly stated that there were no assurances of any return of, or on, invested capital. Therefore, the Corporate Finance Branch director asked for some prospective disclosure enhancements, but as there were no misrepresentations or breaches of securities law, the company was not asked to cease distributions. Branch staff also noted that dealers sold these securities as high-risk investments. However, in our Office's opinion, if the Corporate Finance Branch director had the power to issue a cease trade order, the director could have asked the company to provide enhanced disclosures for the current distribution instead of for future offerings and also provide an offer of rescission (i.e., the right to rescind the transaction) for investors who already purchased the securities.

Example 2

In April 2016, the Corporate Finance Branch initiated a review on a company that had filed a Report of Exempt Distribution indicating the use of the Offering Memorandum exemption. Corporate Finance staff observed that the Enforcement branch had opened a case against this company due to an anonymous tip received by OSC's contact centre in March 2015. As this case was open and being actively investigated by the Enforcement Branch, the Corporate Finance Branch did not continue its review. The tip alleged that this company and an individual were conducting registerable activities without being registered with the OSC, and expressed concerns with the company's website. OSC's investigation found that a father and son raised over $10 million from more than 150 investors, by continuously selling shares in a company. A hearing concluded before the OSC in December 2019 which determined that these individuals sold securities without being registered and these distributions were illegal as the company did not file a prospectus nor was it entitled to any prospectus exemptions. The OSC concluded that the respondents put investors' funds at risk and ultimately caused investor losses by using the funds in a way that was inconsistent with the commitments made by them. The OSC ordered a permanent cease trade in the securities of the company and the respondents to pay administrative penalties of $2.1 million and disgorgements of $8.7 million. The respondents were also ordered to pay costs of the investigation and hearing in the amount of $597,000. In our Office's opinion, if the Corporate Finance Director had the power to issue a cease-trade against this company on identification of non-compliance after their review, then the OSC could have started protecting investors while the Enforcement Branch conducted a more detailed investigation.

distributions or refer the matter to Enforcement. It would be beneficial for the Branch Director to have the power to issue a cease-trade order in respect of an exempt market issuer, on a more timely basis, in scenarios like the above where there are significant concerns with the issuer and its compliance with prospectus exemptions.

We found that a similar authority to issue a cease-trade order, relating to both the exempt and non-exempt market, has been provided to the Alberta securities regulator under that province's laws.

The number of securities distributed by using prospectus exemptions has been increasing over the last three calendar years, particularly relating to the

"Offering Memorandum" and "Accredited Investor" exemption rules. See **Figure 14** for activity under these two exemptions over the last three calendar years. We also noted that the number of companies that issued securities in the exempt market from 2017 to 2019 increased from 3,000 to 3,200 (6.7%).

In addition, on July 28, 2021 the OSC published for comment a new exemption for reporting issuers to raise capital without a prospectus, subject to a maximum limit of $10 million, provided such issuers have been listed on a Canadian stock exchange for at least 12 months. If such a prospectus exemption were to be introduced, the OSC anticipates a further increase in the number of prospectus-exempt distributions and the amount of capital raised from retail investors.

Given this increasing use of prospectus-exempt offerings to retail investors, the Capital Markets Modernization Taskforce proposed that the Director of the Corporate Finance Branch should have the legislative authority to impose terms and conditions on companies in connection with current and future distributions subsequent to identifying non-compliance issues from their compliance reviews. The scope of the terms and conditions would depend on the specific compliance issues identified but should include cease-trade orders, the possibility of continued trading of securities and the ability of a company to rely on prospectus exemptions for future distributions, as described in **Figure 15.**

Based on the Taskforce's recommendation, the Ministry of Finance has consulted with the OSC on a draft statutory provision that could either be enacted by the Legislature or published for comment as part of the Capital Markets Act consultation.

RECOMMENDATION 16

To enhance the ability of the Ontario Securities Commission to enforce compliance with securities law by companies selling securities in the exempt market, including disclosure requirements and conditions of prospectus exemptions, we recommend that the Ministry of Finance provide the Director of the Corporate Finance Branch with the authority to cease trade or impose terms and conditions on these exempt-market companies when issues are found in their compliance reviews, after reviewing the authority provided to other jurisdictions such as Alberta.

MINISTRY RESPONSE

Ensuring that the OSC has the ability to enforce compliance with securities law is an important priority for the Ministry.

The draft Capital Markets Act (CMA), published for stakeholder consultation in October 2021, contemplates providing additional regulatory powers to the Chief Regulator, including the ability to cease trade or impose terms and conditions on

Figure 14: Number of Investors and Amount Invested in Exempt Securities, 2017–2019

Source of data: Ontario Securities Commission

	2017	2018	2019	3-Year Change (%)
# Investors				
Through "Offering Memorandum" exemption rule	5,600	8,400	9,000	**61**
Through "Accredited Investor" exemption rule	14,400	17,300	17,100	**19**
Amount Invested ($ million)				
Through "Offering Memorandum" exemption rule	120	160	190	**58**
Through "Accredited Investor" exemption rule	1,890	2,570	2,880	**52**

Figure 15: Examples of Orders That Could Be Imposed by the Corporate Finance Director Related to Non-compliance Identified in the Exempt Market

Source: Ontario Securities Commission

Example 1
An order that a company cease distributing securities could be appropriate for a company that relied on the Offering Memorandum exemption but then failed to deliver audited financial statements to the OSC or make them available to investors. The order could provide that the company cease distributions of its securities until it has remedied the default.

Example 2
An order that a company be allowed to continue distributing securities with specific terms and conditions could be appropriate if the company had failed to deliver the audited annual financial statements to the OSC, but had prepared them and made them available to investors. The order would provide that the company be allowed to continue trading securities on condition that it delivers its financial statements to the OSC within a specific period of time.

Example 3
An order that a company not be permitted to rely on a prospectus exemption for future distributions could be appropriate where the company has a history of non-compliance with the conditions of the prospectus exemption.

exempt-market companies. These powers could be further delegated to OSC staff.

The draft CMA includes additional compliance tools that could be helpful in promoting overall compliance in Ontario's securities market.

The Ministry will work with the OSC to consider this recommendation and determine next steps.

4.9 The OSC Has Limited Power to Require Formal Communication from the Public Accounting Firm Oversight Body

We found that the OSC does not have the legislated authority to require the Canadian Public Accountability Board (CPAB)—the pan-Canadian regulator created by the CSA, OSFI and other regulators to provide oversight over public company auditors—to communicate certain information about audit firms and the public companies that they audit, to the OSC. In comparison, the federal Securities and Exchange Commission (SEC) in the United States has greater authority over the Public Company Accounting Oversight Board (PCAOB). Both bodies were created in response to the same concerns after the accounting scandals in the late 1990s such as Enron and WorldCom, and around the same time, although CPAB is of the view that its governance framework was designed to ensure greater independence from securities regulators. See **Figure 16** for the key differences in the regulatory framework governing the authority that OSC has over the CPAB, in comparison with the SEC's oversight powers over PCAOB.

It should be noted that CPAB's focus is on audit quality. It is not charged with inspecting audit firms for the purpose of identifying potential breaches of securities laws. In this regard, we noted that the CPAB is not required to communicate certain information in writing to the OSC under the provisions of the *CPAB Act*. For example:

- Although the OSC receives verbal communication on overall inspection results from the CPAB, it does not receive actual copies of the CPAB's inspection reports of individual audit firms, including the deficiencies identified in each audit engagement inspected and the identity of

Figure 16: Selected Differences in the Regulatory Framework Between the PCAOB[1] and the CPAB[2]

Prepared by the Office of the Auditor General of Ontario

Selected Areas in Corresponding Regulatory Framework	PCAOB	CPAB
Funding	The PCAOB is funded by the public companies (and broker-dealers) that are audited by the audit firms regulated by the PCAOB.	The CPAB is funded by the public companies that are invoiced by the audit firms CPAB regulates, on CPAB's behalf.
Appointment and removal of board members	The SEC appoints and removes board members.	The Council of Governors (includes the Chair of the OSC) appoints and removes board members.
Approval of rules (of the audit of public companies, and operations of the oversight body)	The SEC approves rules governing audits of public companies and the PCAOB's operations.	The CPAB Board approves rules governing the CPAB's operations and oversight. In Canada, the Auditing and Assurance Standards Board (AASB) sets standards governing the audits of public companies.
Public reporting of inspection results	The PCAOB publishes inspection reports on specific audit firms.	The CPAB publicly reports aggregated inspection results twice a year. It does not publicly report individual audit firm's inspection results.
Inspection reports of specific audit firms	It provides the SEC with information including reporting issuers whose audits were deficient.	The CPAB is required to provide the OSC with information on overall inspection results when it has reasonable grounds to believe that there has been a contravention of securities laws. It does not otherwise provide the OSC with inspection reports of specific audit firms or information on reporting issuers whose audits were deficient.
Information about investigations involving potential violations of securities laws	The PCAOB is required to notify the SEC of any pending investigations involving a potential violation of securities laws.	The CPAB is required to notify the OSC when it has reasonable grounds to believe that there has been a contravention of securities laws.
Reporting of inspection results of specific audit firms to the audit committees of public companies that they audit	Audit committees have access to the publicly available inspections results of specific audit firms.	The CPAB does not require the audit firms to report its specific inspection results to the audit committees. Such reporting is voluntary.

1. PCAOB: Public Company Accounting Oversight Board
2. CPAB: Canadian Public Accountability Board

the respective reporting issuer(s) where deficiencies were identified.

- Although the OSC receives verbal information regarding investigations conducted by the CPAB that involve an actual violation(s) of securities laws, it does not receive documented information about potential violation(s) of securities laws.

In comparison, the PCAOB is directly accountable to and required to provide all the above information to the SEC, under the provisions of the *Sarbanes-Oxley Act*. CPAB has informed us that in their view, it was initially determined that the CPAB should be independent and not an agent of Canadian securities regulators.

If the CPAB has discovered evidence that provides reasonable grounds to believe that there has been a contravention of securities law, it shares such information with the OSC. However, the *CPAB Act* restricts it from sharing specific information about the business, affairs or financial condition of an audit firm or client except to the extent the disclosure is authorized in writing by all persons whose interests might be affected by the disclosure. In the CPAB's view, the statutory confidentiality provisions are intended to give confidence to all of the CPAB's stakeholders (in particular, the audit firms and the reporting issuers) in the maintenance of the confidentiality of highly sensitive and privileged information so as to ensure their co-operation which, in turn, facilitates effective monitoring. It was also deemed important that the CPAB not be used as an alternative way for securities regulators to get access to reporting issuer information via the "back door," as that could undermine the CPAB's relationship with the audit firms and reporting issuers. The CPAB has noted that Canadian securities regulators have independent and much broader investigatory and enforcement powers than does the CPAB.

However, we noted that the current language and restrictions of the *CPAB Act* present a high threshold for formal communication on file matters, and are subject to significant interpretation.

OSC staff noted that formal, written information from the CPAB provided in a timely manner would assist the OSC in communicating with (or investigating) reporting issuers and auditors.

The Memorandum of Understanding (MOU) between CPAB and the OSC requires CPAB to notify the OSC about any violation of professional standards or the CPAB's rules relating to the audits of publicly traded companies that create a heightened risk to the investing public, however, such notification is subject to applicable laws, including the *CPAB Act*.

Regular reporting is important so that OSC staff can determine whether there has been a securities law violation in cases where the CPAB inspections identify material deficiencies in the audits of reporting issuers as such deficiencies may create a heightened risk to the investing public.

4.9.1 *The CPAB Act* Gives Limited Authority to the OSC over the Public Accounting Firm Oversight Body due to its pan-Canadian Mandate

The oversight regime over the CPAB in Ontario is defined by the *CPAB Act*. The Act (**section 5**(2)) specifies that the CPAB is independent from but accountable to the OSC and the provincial government to the extent and in the manner specified therein. The *CPAB Act* requires its Council of Governors (which is composed of representatives of the Canadian Securities Administrators, including the OSC, and the Superintendent of Financial Institutions) to annually review the manner in which CPAB has carried out its mandate.

We found that when OSC staff met with Ministry staff in 2009 and 2010 to gain a better understanding of the statutory requirements, Ministry officials confirmed that the requirements result in the OSC performing only a "light touch" review of the CPAB and that the *CPAB Act* requirements result in the OSC's direct assessment being limited to a review of the CPAB's Annual Report. In CPAB's view, this is due, in part, to the annual review of CPAB being performed by the Council of Governors.

The Ministry noted that the CPAB's mandate in Ontario is to contribute to public confidence in the integrity of financial reporting by public companies. It does not have a mandate to enforce aspects of securities legislation as is the case with the PCAOB in the United States.

We also noted that the CPAB published a consultation paper in July 2021, in which it sought public input and feedback regarding the current framework by the end of September 2021. The issues it sought feedback on include the following, with the intent to improve the transparency of information shared:

- disclosure of results of the CPAB's regulatory oversight activities;
- disclosures related to the CPAB's enforcement actions; and
- communication to audit committees, discussed in **Section 4.9.2.**

RECOMMENDATION 17

To enable the Ontario Securities Commission (OSC) to be able to fully monitor market participants and protect investors from the risk of improper financial reporting practices, we recommend that the Ministry of Finance work with the OSC and the Canadian Public Accountability Board to review and identify opportunities to improve information-sharing practices, including potential legislative changes.

MINISTRY RESPONSE

The Ministry supports the objective of ensuring that the OSC can continue to appropriately oversee Ontario's capital markets, including monitoring public companies and ensuring investors continue to be protected from improper financial reporting. The Ministry will consider this recommendation and work with the OSC and CPAB in determining any changes regarding information-sharing between the two entities.

4.9.2 Need for Greater Transparency in Relation to CPAB Findings

Access to Audit Working Papers of Component Auditors in Foreign Jurisdictions

The CPAB publicly reported that the work of component auditors outside of Canada can impact the execution of quality audits if the work is not executed in accordance with the group auditor's direction and carefully supervised and evaluated by the group auditor. The CPAB (along with counterpart audit oversight bodies in other jurisdictions) has noted that without access to the component auditors' working papers in foreign jurisdictions, it is restricted in fulfilling its mandate.

The CPAB also reported that it has been denied access to component auditor working papers in four jurisdictions—Bermuda, China, Mexico and Tunisia. The CPAB also reported that for 2020 audits, component auditors were used in the performance of the audits of 242 Canadian reporting issuers located outside of the United States, United Kingdom and Australia. These 242 issuers had an aggregate market capitalization of over $316 billion as at December 31, 2020.

However, as noted in **Section 4.7,** since the OSC does not track the location of operations of its about 1,000 publicly traded companies or reporting issuers that it regulates, it does not know how many of its reporting issuers have significant operations in the four countries which denied access to the work of component auditors to the CPAB.

In October 2019, the CSA published proposed amendments to existing rules that will assist the CPAB in accessing audit work performed by component auditors outside of Canada. Final amendments are expected to be operational by the end of 2021/22.

RECOMMENDATION 18

To strengthen the oversight of reporting issuers with significant operations in foreign countries, we recommend that the Ontario Securities Commission continue to actively support the Canadian Securities Administrators and the Canadian Public Accountability Board in accessing audit working papers of component auditors outside of Canada.

OSC RESPONSE

The OSC agrees with the Auditor General's recommendation and will continue to work with the CSA and the CPAB to access audit working papers of component auditors outside of Canada.

Audit Firms That Are Outside the CPAB's Voluntary Protocol

The current regulatory framework governing the CPAB includes a voluntary "Protocol" that sets out how audit firms communicate the CPAB's inspection findings to audit committees of reporting issuers. Under the Protocol, audit firms provide the inspection findings report detailing any significant findings specific to a reporting issuer's inspection to the audit committees of the reporting issuer. This is in addition to the publicly available annual audit quality assessment report that highlights the CPAB's common findings across its inspections in a given year, as well as recommendations to improve audit quality.

As of June 2021, we found that 20 of the 248 firms registered with the CPAB that audit reporting issuers in Ontario did not participate in this voluntary Protocol. These 20 firms audited approximately 170 public companies regulated by the OSC. Of those 20 firms, two of them are annually inspected firms, and audited approximately 110 public companies that are regulated by the OSC. The market capitalization of these 170 public companies, as of December 31, 2020, ranged from approximately $500,000 to over $3 billion.

We also noted that the Corporate Finance Branch does not use this fact (of audit firms not participating in the CPAB's Protocol) as a key criterion in its risk assessment while selecting public companies for a detailed compliance review. We found that the branch did not perform proactive compliance reviews of approximately 90 of the 170 public companies (and 50 of the 110 public companies that were audited by the two annually inspected firms by the OSC) between 2016/17 and 2020/21. We believe that non-participation in the CPAB Protocol indicates general lack of transparency and potential issues with an audit firm's operational approach. Therefore, in our view, this should be a key criterion for the OSC to consider to enhance its own risk assessment process and select public companies audited by such firms for a compliance review.

The CPAB also noted that audit committees, being responsible for overseeing the work of the external auditors, have indicated to the CPAB that they would like more transparency with respect to audit-inspection findings in order to improve the effectiveness of their own oversight role.

The CPAB has launched a public consultation seeking comment on whether the Protocol should be made mandatory. The consultation contains a proposal that the CPAB's rules be changed to require mandatory sharing of file-specific information with the audit committee of a reporting issuer.

RECOMMENDATION 19

To better monitor market participants and to provide protection to investors from potentially unfair and improper financial reporting practices, we recommend that the Ministry of Finance work with the Ontario Securities Commission (OSC) and the Canadian Public Accountability Board (CPAB) to:

- review public feedback on the CPAB's consultation paper requesting input on the Protocol for audit firm communication of the CPAB inspection findings with audit committees;
- assess the appropriateness of the existing Protocol; and
- determine whether the Protocol should be mandatory for all participating audit firms.

MINISTRY RESPONSE

The Ministry will consider this recommendation and work with the OSC and the CPAB to assess the appropriateness of the Protocol and whether it should be mandated.

4.10 The OSC Lacks the Technology and Analytical Tools to Provide Efficient Oversight over Market Participants

4.10.1 Lack of Data Analysis Capabilities

Lack of Ability to Effectively Identify Trends and Perform Data Analysis

The OSC lacks data analysis tools to enable it to effectively identify trends and analyze market participants' compliance with securities laws. This includes, for example, identifying market participants trading in particular problematic areas, markets or investments, such as cryptocurrency. The OSC currently relies on third-party data providers to assess such trends and analyses. The OSC has identified the limitation of relying on these third parties because of their narrow coverage; they only extract subsets of information and documents.

We also noted that financial statement filings by reporting issuers that are submitted to the OSC through the System for Electronic Document Analysis and Retrieval (SEDAR)—a decades-old filing system developed for the CSA to facilitate the electronic filing of securities information—are filed in a format that cannot readily be used for data extraction and analysis. Therefore, OSC staff are unable to use modern technologies to effectively and efficiently monitor reporting issuers and their related filings through extracting trends and performing other analyses. For example, OSC staff do not use tools such as the Beneish Model, generally used to identify and prevent financial statement fraud.

Lack of Integration of Information Regarding Directors and Senior Management of Market Participants

We found that necessary information regarding directors and senior management of companies issuing securities is found in various databases that the OSC uses and collected in different formats. The OSC's Corporate Finance Branch must conduct manual searches in these various databases, which are not integrated with one another, to obtain a comprehensive view of issuer or insider capital market activity. This presents challenges for OSC staff in integrating critical information and identifying potential securities law breaches by issuers across the public and private or exempt capital markets areas on a timely basis.

Apart from improving efficiency, having a single searchable database will enable Corporate Finance staff to obtain a more comprehensive and integrated view of any problematic behaviour and trends by individual. For example, this can involve situations where there has been continuous disclosure problems identified associated with an individual, or if an individual has been the subject of prior enforcement proceedings.

There are currently several OSC databases that contain critical information about public-financing activity (Management Information Tracking System or MITS), exempt-market filings as well as director and senior management information for companies selling securities in the exempt market (Reports of Exempt Distribution or RED), past compliance reviews (Continuous Disclosure or CD Workflow) and insider participation (SEDI).

The OSC informed us that this issue was escalated to senior management. In response, the OSC established the Digital Solutions Branch in September 2020. This branch is expected to build an enterprise data approach to allow for "improved data insights and efficient data sharing between branches within the OSC and with industry stakeholders." The OSC's draft 2021–22 Statement of Priorities indicates it wishes to increasingly transition from "stand-alone, legacy systems to integrated enterprise platforms."

RECOMMENDATION 20

To enhance the effectiveness and efficiency of monitoring market participants for compliance with securities laws and conducting enforcement actions for non-compliant activity, we recommend that the Ontario Securities Commission (OSC):

- develop a formal plan, with a specific timeline and budget, to replace separate, legacy systems and databases with an integrated platform;
- equip and train OSC staff in the use of modern technologies;
- include a centralized view of information regarding directors and senior management of market participants in the integrated platform; and
- prioritize an integrated approach to monitoring compliance and flagging problematic behaviour on a timely basis through the use of integrated technology tools, data and other processes.

OSC RESPONSE

The Ontario Securities Commission agrees with this recommendation.

The OSC has developed a Digital Platform Strategy for OSC application and data modernization. Key components of this strategy are technology platforms that will support streamlined end-to-end regulatory activities and integrated data reporting and analytics.

The OSC will ensure that these platforms support a centralized view of information regarding directors and senior management of market participants, and an integrated approach to monitoring compliance and flagging problematic behaviour in a timely manner.

As the OSC implements and transitions to these new platforms, we will replace legacy applications and databases.

The OSC will develop a formal plan, with specific timelines and budget for phased development and transition to the new platforms. These plans will be reviewed annually as part of our business planning process.

4.10.2 No Formal Plan Is in Place to Integrate the Complaint Databases Used by the Contact Centre and Various Branches

We noted that there is a lack of integration in the databases used to record investor complaints received by the OSC's Contact Centre with those received directly by the other regulatory branches of the OSC. For example, the tracking of external complaints, tips and inquiries are kept in two separate databases which are neither reconciled nor consolidated.

This lack of co-ordination was also mentioned in the OSC's 2017 internal audit report, which noted that data was often duplicated and neither database contained complete information. At the time of our audit, the OSC still did not have a formal plan to consolidate the systems or move to one platform so that the weaknesses can be addressed.

RECOMMENDATION 21

To better record, manage and analyze investor complaints consistently within the Ontario Securities Commission (OSC), we recommend the OSC:

- develop and implement a formal plan with a specific timeline and budget to integrate the applications, data and processes across the organization used to record and manage investor complaints; and
- complete the integration of operations, data and processes around OSC.

OSC RESPONSE

The Ontario Securities Commission agrees with this recommendation.

As stated in response to **Recommendation 20**, a key component of the OSC's digital strategy is a platform that will support streamlined end-to-end regulatory activities, including processes to record and manage investor complaints.

The OSC will develop a formal plan, with specific timelines and budget for development and transition to new platforms and processes, with integrated complaints management as one of the early milestones.

4.10.3 Enforcement Branch Does Not Have an Integrated Case Management System to Track Its Cases

We found that the OSC's Enforcement Branch does not have a robust and integrated case-management system that effectively and efficiently tracks case progress or the life-cycle of cases from beginning to end. During our audit, the branch staff had difficulty providing us with the case volume or other high-level enforcement data, such as the number of cases received and closed by each unit within the branch.

We found that the branch did not have critical data analytics and reporting capability to assess the effectiveness of its own performance. For example, it was unable to track the average time from the receipt of a case to closure of the case, and flag cases that are taking exceptionally long. Currently, this is tracked manually by the branch. It is also unable to perform meaningful trend analyses on misconduct by individuals or firms, such as duration of misconduct, number of investors impacted and actual loss in dollar value to investors. The branch cannot easily calculate the total amount of loss to investors annually across all enforcement cases received.

Also, as noted in **Section 4.3**, of the 3,184 enforcement cases, due to the limited capabilities of the Enforcement Information System database, the OSC is only able to estimate the percentage of alleged misconduct related to individuals and entities not registered or regulated by the OSC. At the time of our audit, it was unable to reconcile the data with various other internal systems used by the OSC to obtain an accurate analysis of registered versus unregistered individuals or regulated versus unregulated entities alleged to have violated the provisions of the *Securities Act*. The Enforcement Information System is a more than 20-year-old Lotus Notes database that was not designed to track case evidence or investigation work. As a result, a lot of that work exists outside of the system, forcing manual tracking via spreadsheets. That limits Enforcement's reporting capabilities and makes it more difficult to consolidate branch reporting metrics. In addition, there is no integration between EIS and other databases used by the OSC.

As of July 2021, there was a project under way, led by the Digital Solutions Branch, to move to a new system, with the aim to consolidate the OSC's internal systems. This would include replacing EIS as well as other databases across the OSC.

RECOMMENDATION 22

To help improve case management, tracking and monitoring capabilities by its Enforcement Branch, we recommend that the Ontario Securities Commission identify a deadline and budget, and move forward and implement an integrated information system.

OSC RESPONSE

The Ontario Securities Commission agrees with this recommendation.

As stated in response to **Recommendation 20**, the OSC has developed a strategy to transition to an integrated regulatory operations platform, that will enable more effective case management, tracking and monitoring across the Commission. The OSC has initiated the high-level design and planning phase, after which a formal plan, with a specific timeline and budget will be approved. These plans will be reviewed annually as part of our business planning process.

4.11 The OSC's User-Access and Change-Management Controls for Information Technology (IT) Systems Can Be Further Strengthened

4.11.1 OSC Staff Access to IT Systems and Facilities Needs to Be Strengthened

We found that the OSC can further strengthen its controls relating to staff access to its IT systems. User-access controls for managing staff's access to IT systems and facilities are an important way to prevent unauthorized modification to data and programs.

The OSC has established a quarterly user-access review process to ensure employees who no longer require access to IT systems are removed in a timely manner. But we found that the OSC has never performed an access review to determine if user access to IT systems and data centre is appropriate and relevant for most of the key IT systems that we selected.

We also found that changes to access provided to the data centre are not adequately recorded and reviewed by the OSC's staff. Unauthorized and inappropriate access to computer facilities may lead to theft or loss of critical data.

In addition, we noted that the OSC does not retain logs of user account deletion for terminated employees. We found that for eight out of 30 terminated employees that we looked at, the OSC was unable to provide evidence access was disabled or removed on the employees' last day of work. As per industry best practices, access for terminated employee should be removed on the day of termination. Delay in removal of user accounts may lead to unauthorized modifications to data and operational downtime.

Of 17 systems that we reviewed, we also found that detailed user activities were not being recorded and retained for 10 systems and not logged for seven systems. Insufficient logging and monitoring may lead to untraceable modifications to system and data. As per industry best practices, user activity logs should be enabled, and reviewed on a periodic basis.

RECOMMENDATION 23

To prevent unauthorized modification to data and programs, we recommend that the Ontario Securities Commission implement controls to:

- enforce its existing process for all IT systems to periodically review users' roles or permissions and implement any required changes in a timely manner;
- document physical access permissions and modification approvals via a ticketing tool, and review changes regularly;
- retain and review logs showing when access was removed for terminated employees and staff to ensure access was removed on the same day of termination; and
- review and retain user activity logs for events/alerts that are necessary for its operations based on the system criticality to the business.

OSC RESPONSE

The Ontario Securities Commission agrees with the recommendation. The OSC will ensure its existing process is enforced on all IT systems where appropriate and will implement additional periodic reviews of user roles and system permissions.

The OSC has recently added physical access requests and modifications for our data centre to our IT ticketing system. We will continue to review access to our data centre monthly.

The OSC will continue to remove (disable) employees' access on the same day as their termination as requested in our Delete – Move, Add, Change ticketing process. The OSC will develop a process to retain evidence of when the accounts are deleted following disablement.

The OSC will review user activity logs and enable additional logging details where appropriate considering the business criticality of each IT system.

The OSC maintains that it is not practical to log and review all activity in all of our systems and accepts the residual risk.

4.11.2 The OSC Does Not Have an Effective Process to Manage Changes to IT Systems

Changes to IT systems to add new features and capabilities must be managed in a controlled manner to ensure only authorized changes are implemented. However, for changes made to key IT systems in the past year, we found that the OSC does not have a change management ticketing or tracking tool to track necessary information such as approvals, test details and evidence of implementation of changes it makes to its IT systems. Changes made to its systems are manually tracked through Microsoft Excel spreadsheets and e-mails instead of an automated change management tracking tool.

In addition, for 36 out of 113 change records, we noted the IT staff who developed the IT system changes also applied the changes. As per industry best practices, changes should be developed and applied by separate teams in order to ensure segregation of duties to prevent unauthorized changes.

RECOMMENDATION 24

To control that only authorized changes are made to the IT systems, we recommend that the Ontario Securities Commission:

- implement a centralized change-management tracking tool so that changes are tracked efficiently and unauthorized changes cannot be implemented, and retain all testing evidence related to the changes for traceability;

- implement controls to restrict access to apply changes to IT systems; and
- implement user activity logging and perform a review to assess the risk associated with the development team having access to production environment for legacy IT systems where access cannot be restricted.

OSC RESPONSE

The Ontario Securities Commission agrees with this recommendation. We will implement a centralized change management authorization and tracking tool.

The OSC will enable additional logging details and implement a process for reviewing user activity logs as appropriate, based on the business criticality of individual applications. The OSC maintains that it is not practical to log and review all activity in all of our systems and accepts the residual risk.

Where possible, we will ensure there is segregation of duties between the application development team and technical services/production systems teams. However, given the limited size and capacity of our IT team, we have several roles that will continue to have a shared responsibility for both development and production system support. The OSC has reviewed and accepted the risk of its development team having access to production systems in these limited circumstances.

4.11.3 OSC's IT Administrator Access Controls Can Be Further Strengthened

IT administrator accounts are used to manage system activities such as adding a new user, creating new user roles and managing changes to the IT system. Administrator accounts should be assigned to authorized users as per their job function and should be periodically reviewed for unauthorized activities.

Organizations use Privileged Identity/Access Management tools to secure their privileged accounts by restricting access to authorized users, monitor user activities and automatically reset password for privileged accounts.

The OSC utilizes a Privileged Identity/Access Management software tool that stores usernames and passwords for administrator accounts for multiple IT systems. However, for certain key operational systems supported by legacy technologies, administrator accounts and passwords are not maintained by this tool. When assessing whether administrator accounts are restricted to authorized users, we found instances where two IT staff shared credentials, such as IT system user ID and password, for one system administrator account.

If credentials are being shared, there is a risk that accountability for activities performed using administrator accounts cannot be traced back to individual staff.

RECOMMENDATION 25

In order to establish accountability and restrict the use of system administrator accounts, we recommend that the Ontario Securities Commission:

- assess appropriate access permissions required and assign individual user administrator accounts (username and password) for IT staff; and
- enroll the legacy system as part of the Privileged Identity/Access Management tool to ensure that actions performed using administrator accounts are recorded and monitored.

OSC RESPONSE

The Ontario Securities Commission agrees with this recommendation. We have already reviewed IT Administrator accounts and ensured staff requiring admin access are assigned individual IT administrator accounts. As per our current policy, we will continue to ensure segregation of accounts.

The OSC will review the elevated system IDs for legacy systems and enroll them in the Privileged Identity/Access Management tool.

4.12 Additional and Emerging Areas of Interest

During our audit, a number of additional and emerging areas of interest were noted during our discussions with OSC and stakeholders in the following areas:

- **Alternative Performance Measures**—the increasingly prevalent use of corporate information, including non-financial information, that is not covered by existing accounting standards. The lack of established standards means that there can be significant variations in definitions and application between reporting issuers and even between reporting periods for the same company.
- **Minimum pricing increments**—regulated minimum trading spreads in equity marketplaces. Reduction or elimination of these minimum increments could save significant money for investors, improve liquidity and eliminate undesirable incentives and practices that harm efficient and fair market operation.
- **Fixed income markets**—Although some bonds trade on the Canadian marketplaces, the majority of Canadian bonds are traded in over-the-counter markets between investment dealers. Therefore, there is lack of transparency in information available to retail investors. An improvement in order execution in fixed income markets to mirror equity markets could lead to significant benefits for retail investors and improved market efficiencies.
- **Digital/Crypto assets and trading**—the crypto sector, including raising capital through offering crypto assets, as well as the trading of these assets, is rapidly evolving with limited regulatory oversight. Crypto trading platforms may act as intermediaries (dealers) as well as marketplaces to trade in crypto assets directly with retail investors.
- **Insider trading**—In its 2020/21 Enforcement Report, the CSA reported a significant increase in enforcement proceedings related to insider trading cases from the previous year.
- **Tied-selling**—coercive selling of in-house products or services, for example, by financial institutions, as a condition for providing other services required by clients. Although coercive tied selling is prohibited, the Capital Markets Modernization Taskforce reported that it heard repeatedly from dealers and issuers that commercial lenders, through their affiliated investment dealers, continue to engage in these practices.
- **Title protection**—accreditation for the use of titles by individuals in the investment industry providing advice to retail investors, in order to promote the quality of advice given.

RECOMMENDATION 26

To regulate evolving capital markets effectively, we recommend that the Ontario Securities Commission develop regulatory strategies in these areas and implement appropriate actions on a timely basis.

OSC RESPONSE

The OSC agrees with the Auditor General's observation that capital markets are complex, transboundary and rapidly evolving. Technology has accelerated the introduction of new investment products and services. The OSC collaborates with regulators around the world to keep abreast of emerging areas and develop new regulatory frameworks that are fit-for-purpose in the Ontario and Canadian context.

4.13 Key Performance Indicators Are Consistent with Other Jurisdictions

We noted that the OSC's performance measures are consistent with those used by other Canadian securities regulators as well as securities regulators in the United States and the United Kingdom. **Appendix 19** provides examples of key performance measures and indicators reported by the OSC.

Appendix 1: Glossary of Terms

Prepared by the Office of the Auditor General of Ontario

Term	Definition
Accredited investor	Under securities law, an accredited investor means an individual with: • net assets, alone or with a spouse, worth more than $5 million; or • income of more than $200,000 per year or $300,000 with a spouse, in each of the past two years, and who is expected to reasonably exceed that income in the current year; or • financial assets, alone or with a spouse, worth more than $1 million. Accredited investors also include non-individuals, such as Canadian and foreign governments, Canadian financial institutions, pension funds, charities and other entities if they meet certain criteria.
Accredited investor exemption	Allows companies to sell securities to investors who generally meet certain income or financial assets criteria that demonstrate they have the ability to tolerate financial loss and the financial resources to obtain expert financial advice. Under this exemption, there are no limits on how much investors can invest.
Advisor	Often used interchangeably with “adviser.” However, an adviser provides discretionary portfolio management (i.e., can make investment decisions on behalf of the client) and is directly regulated by the OSC. An “advisor” is a term commonly used by firms or individuals that may be regulated by a self-regulated organization (IIROC or MFDA). In the 2019 Ontario Budget, the government announced that the Financial Services Regulatory Authority of Ontario (FSRA) would regulate the use of the titles “financial advisor” and “financial planner.” FSRA has developed and sought public comment on a draft framework to require that individuals using these titles have appropriate credentials.
Clearing agency or clearing house	A clearing agency is an entity that facilitates the clearing and settlement of trades. A clearing house is an entity through which trades in contracts made on a commodity futures exchange are cleared. A clearing house may be part of a commodity futures exchange or may be a separate entity.
Component auditor	The auditor who performs work on the financial information of a component that will be used as audit evidence for a group audit. This auditor may be a part of the group auditor’s firm in a different location, a network firm or another firm.
Crypto asset and cryptocurrency	A digital representation of value or contractual rights, which may be transferred or stored electronically, using distributed ledger or similar technology. Cryptocurrency is a subset of crypto assets and is digital currency that can be used to buy goods and services. A cryptocurrency uses an online ledger with strong encryption to secure online transactions.
Dealer/Full service dealer	A person or company engaged in (or holding themselves out as engaged in) the business of trading in securities. This can be either as principal (on their own account) or agent (for clients). Categories include: • investment dealer • mutual fund dealer • scholarship plan dealer • exempt market dealer • restricted dealer A dealing representative acts on behalf of a registered dealer.
Discount broker	A dealer approved by IIROC to provide “order execution only” services. That is, a discount broker may not provide advice or make a suitability determination of a security for the client.

Term	Description
Disgorgement order	An order imposed by a securities regulator (such as the OSC) that requires the respondent to pay any amounts obtained as a result of their non-compliance with securities law. The amount of a disgorgement order depends on the circumstances of each proceeding.
Disruption	The OSC's Enforcement Branch conducts disruption. A "disruptive action" is taken when a case does not warrant a full investigation and enforcement action. Disruption activities are conducted through direct interactions with individuals suspected of having breached Ontario's securities laws and/or by warning Ontario investors of these individuals and companies. Actions range from issuing warning letters, making unannounced in-person visits to the individuals' homes or work premises, directing the removing of misleading information from websites, issuing press releases that warn Ontario investors of individuals' and entities' ongoing misconduct, and referring the matter to other regulatory and law enforcement agencies.
Exchange	A marketplace to buy and sell securities and/or derivatives. It may also list companies, and provides a platform for investors to trade with each other in accordance with defined and structured rules and regulations. The following exchanges list Canadian securities: TSX, CSE, TSXV and Neo. Note that alternative trading systems are also marketplaces to buy and sell securities and/or derivatives but do not have a listing function.
Financial Stability Board (FSB)	An international body with the purpose to monitor and make recommendations about the global financial system. Established in 2009, its members are made up of 25 jurisdictions, four international financial institutions and six international standard-setting, regulatory, supervisory and central bank bodies.
Group and lead auditor	The group auditor takes responsibility of the direction, supervision and performance of the group audit and the appropriateness of the group audit report.
Group of Seven (G7)	An inter-governmental organization made up of the nations of France, Germany, Italy, Japan, the United States, the United Kingdom and Canada. Leaders of these countries meet regularly to address international economic and monetary issues.
Group of Twenty (G20)	An international forum formed in 1999 by the world's major economies. Members regularly meet and co-ordinate global policy on trade, health, climate and other issues.
Insurtech	Refers to the use of technology innovations designed to bring efficiency, including savings, to the insurance industry.
Investor protection fund	Covers losses to eligible investors as a result of an insolvency of an investment dealer or mutual fund dealer. The OSC oversees two approved investor protection funds: the Canadian Investor Protection Fund (CIPF) and MFDA Investor Protection Corporation (MFDA IPC).
Issuer	A person or company who has outstanding issuances or proposes to issue securities such as stocks and bonds to investors.
Management expense ratio (MER)	Indicates the cost of owning an investment fund such as a mutual fund. It is a ratio because it compares the management expenses for the year to the total size of the fund, as a percentage. The components of the MER will differ for different funds. It includes fees to compensate fund managers, operating/administrative costs (such as audit and legal fees), taxes, and commissions such as trailing commissions paid to dealers.

Term	Description
Marketplace	A marketplace may be an exchange, a quotation and trade reporting system, or an alternative trading system in Canada. It is a facility that: • brings together buyers and sellers of securities or derivatives; • brings together the orders for securities or derivatives of multiple buyers and sellers; and • uses established methods under which the orders interact with each other, and the buyers and sellers entering the orders agree to the terms of each trade.
Offering memorandum exemption	Allows companies to sell securities to any investor by providing them with an offering memorandum, which outlines a company's business, operations and information about the investment. Under this exemption, there are limits to the amount certain categories of investors can invest.
Registrant	In general, a firm and its individuals who sell securities, offer investment advice or manage an investment fund must register with the applicable securities regulator (such as the OSC in Ontario), unless they have an exemption. They are referred to as a "registrant," and collectively called "registrants."
Regtech	Refers to the use of technology innovations designed to improve regulatory processes, including regulatory monitoring, reporting and compliance.
Trade repository	A repository that collects and maintains records of completed trades, including derivatives transactions, with the purpose of improving transparency and to ensure that the designated trade repositories operate in a manner that promotes the public interest.

Appendix 2: Recent Events in the Attempted Creation of a National Securities Regulator in Canada

Prepared by the Office of the Auditor General of Ontario

The securities regulators from the provinces and territories meet and seek to co-ordinate their separate regulatory activities in what became known as the Canadian Securities Administrators (CSA). Their collaboration became more structured in 2003 with the establishment of a chair, vice-chair and Policy Coordination Committee, and in 2004 with the establishment of a permanent secretariat located in Montreal.

2009	The federal government prepares draft federal securities legislation and attempts to establish a national securities regulator. The intent is to build on the recommendations of the 2009 Final Report and Recommendations by the federal government-appointed Expert Panel on Securities Regulation. These followed previous royal commission and expert panel/committee findings over decades that supported a national approach to securities regulation in Canada.
2011	The Supreme Court of Canada rules that the draft federal securities legislation exceeds the federal government's constitutional powers, except for aspects aimed at addressing matters of national importance and scope, including management of systemic risk and national data collection. The ruling does not preclude the ability of provinces to establish a co-operative approach to pan-Canadian securities regulation.
2013	The Ministers of Finance for Ontario, British Columbia and Canada agree in principle to establish a Co-operative Capital Markets Regulator for securities regulation. The co-operative approach would be based on uniform legislation in each province/territory and complementary federal legislation to address federal matters.
2014	Between 2014 and 2019, the governments of Saskatchewan, New Brunswick, Prince Edward Island, Nova Scotia, Newfoundland and Labrador, and Yukon also agree to join the Co-operative Capital Markets Regulatory System. The participating jurisdictions, beginning in 2014, sign agreements to implement a national co-operative capital markets regulatory system. The system includes establishing a single authority to administer the co-operative regime to be called the Capital Markets Regulatory Authority (Authority). This Authority would be supervised co-operatively by the federal, provincial and territorial governments through a Council of Ministers comprising the federal Finance Minister and provincial ministers. Between 2014 and 2016, participating jurisdictions publish draft provincial / territorial legislation, called the *Capital Markets Act* and draft federal legislation, called the *Capital Markets Stability Act*, for initial public consultation. These have not been enacted.
2015	A Capital Markets Authority Implementation Organization is established by the participating provinces and territories as well as the federal government to support creating the Authority and the co-operative system for those jurisdictions that had joined or would subsequently be willing to join.
2018	Following a challenge from Quebec on the constitutionality of the proposed co-operative system, the Supreme Court of Canada rules that the proposed voluntary co-operative system is constitutional.
2021	The federal government and eight provincial and territorial governments (Ontario, British Columbia, Saskatchewan, New Brunswick, Nova Scotia, PEI, Newfoundland and Labrador, and Yukon) remain participating members of the co-operative system. Effective March 31, 2021, after about six years of operation, the Capital Markets Authority Implementation Organization put its operations on pause and terminated staff. As of that date, the following jurisdictions continue to not participate: Quebec, Alberta, Manitoba, Northwest Territories and Nunavut.

Appendix 3: Regulatory Oversight Model within Canada

Source of data: Ontario Securities Commission

Principal Regulator Model[1]		Lead Regulator Model[2]	Modified Lead Regulator Model[3]
Registrants and Issuers	**Self-regulatory Organizations (SROs) and Investor Protection Funds (IPFs)**	**Exchanges**	**Clearing Agencies and Trade Repositories**
• The principal provincial regulator has the primary decision-making responsibility in addition to the co-ordinator or administrator role with the rest of Canadian Securities Administrators (CSA). • Other CSA provincial jurisdictions may register or recognize the registrant or issuer and conduct oversight activities. • As part of the co-ordination requirements with CSA, the principal provincial regulator will co-ordinate some activities with other CSA jurisdictions; for example, where a firm operates in multiple jurisdictions.	• Multiple provincial regulators recognize SROs and IPFs and provide joint oversight. • For each SRO and IPF, there is a principal provincial regulator that co-ordinates CSA oversight. • Required consensus decision-making model.	• A lead provincial regulator recognizes an exchange and has primary responsibility for oversight. • Other provincial regulators rely on the lead regulator for oversight.	• Multiple provincial regulators recognize or designate clearing agencies and trade repositories. • For each recognized or designated clearing agency and trade repository, there is either a lead provincial regulator or multiple co-lead provincial regulators sharing primary responsibilities for oversight.

1. For example, the OSC is principal regulator for one of the two self-regulatory organizations (SROs) that the OSC recognizes in Canada—the Investment Industry Regulatory Organization of Canada. This is a co-ordinating role. The OSC is also principal regulator for registrant firms with head offices in Ontario and individuals with a working office in Ontario, corporate issuers with a head office in Ontario and investment funds issuers with a head office of the investment fund manager in Ontario. In this context, the principal regulator role includes primary decision-making responsibility.
2. There could be more than one lead regulator for certain exchanges. For example, the OSC and the BC Securities Commission are co-lead regulators for the Canadian Securities Exchange. The OSC is lead regulator for the Toronto Stock Exchange. The lead regulator for the Bourse de Montréal is the Autorité des marchés financiers.
3. For example, the OSC is the co-lead authority along with other provincial securities regulators for the Canadian Depository for Securities Limited (a centralized depository service and an electronic clearing and settlement system used in Canada).

Appendix 4: Key Partners of the Ontario Securities Commission (OSC) and Other Financial Service Regulators

Prepared by the Office of the Auditor General of Ontario

Key Partners

Canadian Securities Administrators (CSA)

The CSA is a national body that brings provincial and territorial securities regulators together to build consensus and design policies and regulations that are consistent across the country. The CSA, which describes itself as an informal body, established executive positions and a co-ordinating committee in 2003, and a permanent secretariat in 2004. The OSC works through the CSA to collaborate on a harmonized set of securities legislation in an effort to streamline the regulatory process.

Canadian Public Accountability Board (CPAB)

Subsequent to the failures of Enron and WorldCom, among others, that significantly impacted the US capital markets, the US government enacted the Sarbanes-Oxley legislation in 2002, to hold senior management as well as auditors of public companies accountable for attesting to the reliability and accuracy of their financial statements. The Public Company Accounting Oversight Board (PCAOB) was also created in the United States in 2002 to oversee accounting professionals (individuals and firms) who provide independent audit reports for publicly traded companies.

The Canadian Public Accountability Board (CPAB) was formed in 2003 as part of Canada's response to accounting scandals that were happening worldwide. It was created as a federal not-for-profit corporation by Canada's provincial securities commissions, the federal Office of the Superintendent of Financial Institutions and the Canadian Institute of Chartered Accountants (now known as CPA Canada). CPAB is the national and independent body responsible for the regulation and oversight of public accounting firms that audit Canadian reporting issuers. Canadian reporting issuers are legislatively required to issue financial statements audited only by these registered audit firms.

CPAB inspects the quality control systems of audit firms and examines a sample of individual engagement files. It also inspects participating audit firms to assess their compliance with CPAB's rules, professional standards and the firms' own quality control policies. Each year, CPAB inspects all firms that audit 100 or more reporting issuers. All other firms are typically inspected at least once every three years.

Under CPAB's bylaws, representatives of provincial and federal financial regulators and CPA Canada act in an oversight capacity as CPAB's Council of Governors. The Chair of the Ontario Securities Commission, the Chair of the Québec Autorité des Marchés Financiers (AMF), the Chair of the British Columbia Securities Commission (BCSC), the Federal Superintendent of Financial Institutions and the president and CEO of CPA Canada act as CPAB's Council of Governors.

The Board of CPAB submits an annual report to the OSC, which must review it and report on it to the Minister of Finance. The Board's report, along with the OSC's report, must be tabled in the Assembly.

The Council of Governors is required to deliver, by the same date, a certificate that provides its opinion whether CPAB "has carried out its mandate in a manner that is consistent with the public interest in maintaining the integrity of financial reporting by reporting issuers and the objectives of National Instrument 52-108."

Heads of Regulatory Agencies

The Heads of Regulatory Agencies serves as a federal-provincial forum for discussing financial sector issues. The agency is chaired by the Governor of the Bank of Canada and includes representatives from the Department of Finance Canada, the Office of the Superintendent of Financial Institutions, the Québec Autorité des Marchés Financiers, the OSC, the Alberta Securities Commission, and the British Columbia Securities Commission.

International Organization of Securities Commissions (IOSCO)

IOSCO comprises the world's securities regulators and sets global standards for the securities sector. IOSCO develops, implements and promotes adherence to internationally recognized standards for securities regulation. It works with the Group of 20 and the Financial Stability Board on the global regulatory reform agenda related to securities. Its membership regulates more than 95% of the world's securities markets in more than 115 jurisdictions.

The OSC contributes to the international securities regulatory agenda by participating and interacting with IOSCO through sitting on various committees and task forces.

Self-Regulatory Organizations (SROs)

The OSC, in common with all of the regulators of the other Canadian provinces and territories, relies on two outside agencies to carry out regulatory functions relating to specific participants in capital markets. The *Securities Act* (Act) permits the OSC to recognize these agencies, also called self-regulatory organizations or SROs. Under the Act, the SROs are responsible to "regulate the operations and the standards of practice and business conduct" of their respective members. At the same time, the OSC, with each of the other securities regulators in the provinces and territories, is responsible to provide oversight over the SROs. The OSC also must approve the rules and practices of the SROs. Currently, two SROs have been recognized: Investment Industry Regulatory Organization of Canada (IIROC) and Mutual Fund Dealers Association (MFDA).

In August 2021, the CSA announced a plan to consolidate the functions of IIROC and MFDA to establish a new single SRO. A date for implementation has not been set. The CSA announced that the consolidation will take place over two phases.

The Investment Industry Regulatory Organization of Canada (IIROC)

IIROC oversees investment dealers and trading activities in debt and equity marketplaces. While the activities are overseen by IIROC, the marketplaces themselves are regulated and overseen by the securities regulators in the various provinces and territories.

The Mutual Fund Dealers Association (MFDA)

The MFDA oversees mutual fund dealers across Canada, except in Quebec, where a separate organization, the Chambre de la sécurité financière, provides oversight.

Other Financial Service Regulators

The OSC interacts with these additional stakeholders on various areas of common concern regarding financial services regulation.

Financial Services Regulatory Authority of Ontario (FSRA)

The Financial Services Regulatory Authority of Ontario (FSRA) is a self-funding Crown agency established in 2017. On June 8, 2019, FSRA was given the mandates of the Financial Services Commission of Ontario and the Deposit Insurance Corporation of Ontario.

The agency regulates the following:

- Property and casualty insurance
- Life and health insurance
- Credit unions and caisses populaires
- Loan and trust companies
- Mortgage brokers
- Health services providers (related to auto insurance)
- Pension plan administrators
- Financial planners and financial advisors (proposed)

Office of the Superintendent of Financial Institutions (OSFI)

OSFI is an independent federal agency of the government of Canada reporting to the federal Minister of Finance. It is the sole regulator of banks and federally incorporated pension plans and insurance companies in Canada.

Ombudsman for Banking Services and Investments (OBSI)

OBSI is an independent, not-for-profit organization that operates on a cost recovery basis and is funded by participating members from four industry sectors—banks and deposit-taking institutions; members of the self-regulatory organizations (IIROC and MFDA); other investment firms including portfolio managers and exempt market dealers; and scholarship plan dealers.

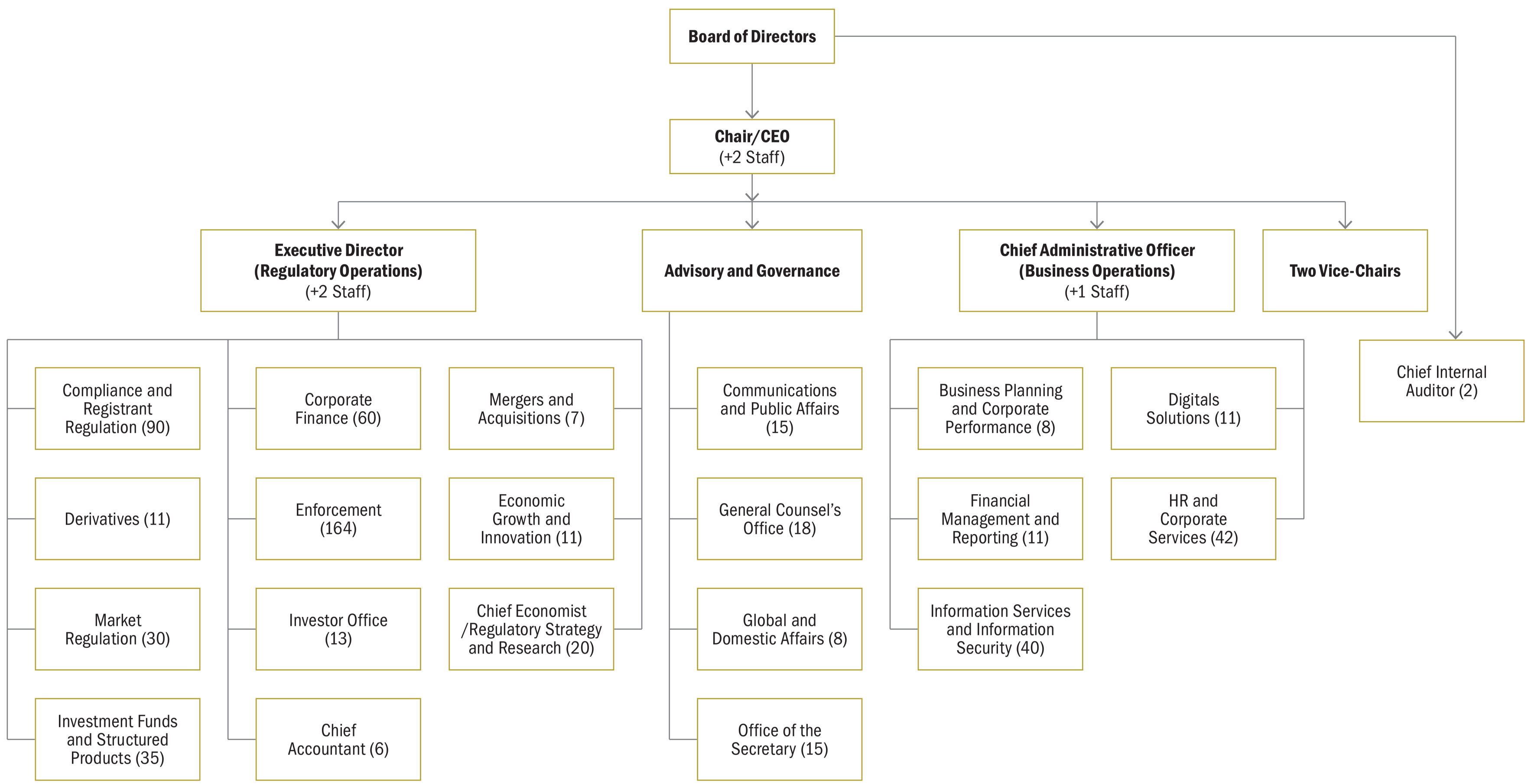
The organization, which is an alternative to the legal system, resolves disputes between participating banking services and investment firms and their customers. It is not a regulator and is overseen by an independent Board of Directors from the community. The community comprises individuals who have not been part of the industry or government for at least two years. A minority of the directors are appointed from shortlists of nominees provided by industry bodies. The community also appoint an Ombudsman. The Ombudsman's decisions are independent from the Board.

The organization has signed a Memorandum of Understanding (MOU) with the CSA that lays out the regulatory oversight framework as well as a framework for co-operation and communication.

In recent years, three of Canada's five biggest banks—Royal Bank, TD and Scotiabank—have opted out of using the dispute-resolution services offered by the organization and use their own internal services.

Appendix 5: Ontario Securities Commission Organization Chart, as of March 31, 2021

Source of data: Ontario Securities Commission



Note: Numbers in parentheses are full-time equivalents (FTEs). There is a total of 629 FTEs.

Appendix 6: Regulatory Branches within the Ontario Securities Commission (OSC)

Source of data: Ontario Securities Commission

Branch	Key Roles and Responsibilities
Corporate Finance[1]	Responsible for regulating issuers (other than investment funds) in the public and exempt markets, supervising insider reporting, designating and regulating credit rating agencies (CRAs) as Designated Rating Organizations (DROs) and overseeing the listed issuer function for the stock exchanges recognized by the OSC. • **Policy Work/Rule Making** • **Gatekeeping:** Review of public distributions of securities, including prospectuses (disclosure of key information) and personal information forms of senior management, for companies wanting to offer securities to the public. Review of Mergers & Acquisitions activity and related information provided in "circulars" and other offering materials. • **Exemptive Relief to Market Participants:** Review and consideration of applications and approval to market participants who apply for exemption from regulatory requirements and are eligible under the regulatory framework. • **Monitoring Compliance**[2]**:** Continuous disclosure reviews of reporting issuers, review of insider reporting and reviews on credit rating activities of the CRAs in Canada.
Compliance and Registrant Regulation[1]	Responsible for regulating firms and individuals who are in the business of advising or trading in securities or commodity futures, and firms that manage investment funds in Ontario. • **Policy Work/Rule Making** • **Gatekeeping:** Initial and ongoing registration of firms and individuals. • **Exemptive Relief to Market Participants:** Review applications and consider approval for market participants who apply for exemption from regulatory requirements and are eligible under the regulatory framework. • **Monitoring Compliance**[2]**:** Compliance oversight reviews of registrants, including working with registrants to resolve non-compliance issues. Financial oversight of registrants; communicating with FINTRAC.
Investment Funds and Structured Products[1]	Responsible for regulating investment products that offer securities for sale to the public in Ontario, including mutual funds, exchange-traded funds (ETFs), structured products and scholarship plans. • **Policy Work/Rule Making** • **Gatekeeping:** Prospectus reviews to assess disclosures for all types of publicly offered investment funds. • **Exemptive Relief to Market Participants:** Administration of exemptive relief from regulatory requirements provided to investment fund issuers. • **Monitoring Compliance:** Risk and oversight of the sector.
Market Regulation[1]	Regulation of key market infrastructure entities, including exchanges, self-regulatory organizations, clearing agencies and trade repositories. Policy making relating to market structure, trading and post trade clearing and settlement.
Derivatives[1]	Oversees exchange traded derivatives and administers the *Commodity Futures Act*. • **Policy Work/Rule Making:** Registration and business conduct rules • **Monitoring Compliance:** Responsible for compliance and oversight of derivatives market participants in Ontario. Conduct compliance reviews of Over the Counter (OTC) derivatives rules. Enhanced data analytics to support systemic risk oversight.

Branch	Key Roles and Responsibilities
Investor Office	Sets the strategic direction for, and leads the OSC's efforts in investor engagement, education, outreach and research.
Enforcement	Responsible for investigating and litigating breaches of securities laws and seeking orders before the OSC's Tribunal and the courts. The branch has seven business units or groups including: • case assessment, which assesses all incoming matters to refer for possible investigation; • regulatory enforcement action team, which investigates and prosecutes regulatory enforcement matters; • market abuse team, which investigates market abuse and quasi-criminal matters; • Office of the Whistleblower and case support, which administers the Whistleblower Program; and • co-ordinates international co-operation efforts with other regulators.
Mergers and Acquisitions	Responsible for monitoring and reviewing transactions relating to takeover bids, issuer bids, business combinations, related-party transactions and significant acquisitions of securities of reporting issuers.
Office of the Chief Accountant	Responsible for advising the Chair, the OSC Board, OSC staff, and market participants on financial reporting, auditing and related policy issues. The branch also manages the OSC's relationships with the Canadian Public Accountability Board, the accounting profession, and with national and international accounting and auditing standard setters. Certain financial reporting rule-making and policy objectives reside with the branch as well.
Regulatory Strategy and Research	Responsible for the delivery of economic, regulatory and financial research and analysis that supports the development of the OSC's regulatory strategy and policy recommendations. The branch also manages the Inquiries and Contact Centre.
Office of Economic Growth and Innovation	Responsible for leading the OSC's efforts to promote innovation and capital formation in Ontario's capital markets, including modernizing regulation and reducing burden.

1. See **Appendix 7** for types and number of market participants (in Ontario and Canada) regulated by the branch.
2. Continuous disclosure and compliance oversight reviews include examination of regulatory filings and disclosures by public companies (such as interim and annual financial statements and certifications) and books, records and documents required to be maintained by registered firms such as portfolio managers and exempt market dealers.

   Reviews follow a risk-based approach with various criteria used to evaluate the level of risk, including market capitalization of publicly traded companies and industry.

   A variety of formal and informal actions are taken by different regulatory branches following the reviews, including ordering the refiling of financial statements, issuing warning letters and compliance deficiency reports to market participants and referring serious breaches identified to the OSC's enforcement branch.

Appendix 7: Overview of the Ontario Securities Commission's Regulatory Activities, by Types and Number of Market Participants

Source of data: Ontario Securities Commission

		# of Participants	
Regulatory Branch	**Market Participants**	**Ontario Is Principal Regulator[1]**	**Active in Ontario[2]**
Corporate Finance	• **Public and private companies** offering securities in Ontario[3] • **Public companies** and shareholders of public companies involved in mergers and acquisitions	1,119 issuers	2,782 issuers[4]
Compliance and Registrant Regulation	• **Individuals and firms** offering investment products and/or investment advice to Ontarians[5] • These include investment dealers, mutual fund dealers, portfolio managers and investment fund managers	957 firms[6]	1,322 firms[7]
		1,671 International firms relying on an exemption	
		53,850 individuals	67,783 individuals
Investment Funds and Structured Products	• **Investment products** offered to Ontarians such as mutual funds and exchange traded funds (ETFs)[8]	2,718 mutual funds	3,413 mutual funds
		820 ETFs	872 ETFs[9]
Market Regulation	• **Market infrastructure entities** such as stock exchanges, marketplaces, clearing agencies, trade repositories and self-regulatory organizations such as IIROC and MFDA	70 regulated entities[10]	
Derivatives	• **Over the counter (OTC) derivatives** dealers and trade repositories	98% of all Canadian OTC derivatives trading (as measured by outstanding notional value excluding commodities) involves an Ontario market[11].	

1. Ontario is the principal regulator as defined in **Appendix 3.**
2. Regulated by other CSA members or by regulators in jurisdictions outside of Canada.
3. Numbers as of March 31, 2021. The top three industries that have the highest number of reporting issuers in Ontario were mining, financial services and technology companies.
4. This includes the 1,119 issuers where Ontario is the principal regulator, and 1,663 issuers that are active in Ontario but regulated by other CSA regulators.
5. Numbers as of March 31, 2021. The compliance oversight function is coordinated with the Investment Industry Regulatory Organization of Canada (IIROC) for around 114 investment dealer firms and 22,363 individuals (171 and 30,429 respectively in Canada), and the Mutual Funds Dealers Association of Canada (MFDA) for around 60 mutual fund dealer firms and 54,484 individuals (108 and 78,079 respectively in Canada).
6. The 957 firms include 368 investment fund managers, 230 portfolio managers and 170 exempt market dealers.
7. The 1,322 firms include 542 investment fund managers, 301 portfolio managers and 221 exempt market dealers.
8. Numbers as of March 31, 2021. The value of the investment fund industry is about $2.07 trillion in assets under management as of January 2021. The value of structured notes outstanding is about $22.1 billion as of December 2020.
9. Of the 52 ETFs with a principal regulator outside of Ontario, 37 are from Quebec, 14 are from Alberta and one is from Manitoba.
10. This includes 26 entities where the OSC plays the lead oversight role and 44 entities where they rely on other CSA members or regulators in jurisdictions outside of Canada for day-to-day oversight.
11. Ontario is not the principal regulator for non-OTC derivatives in Canada. For example, Bourse de Montréal, the financial derivatives exchange in Canada, is regulated by the Quebec securities regulator.

Appendix 8: Enforcement Case Management Process at the Ontario Securities Commission (OSC)*

Prepared by the Office of the Auditor General of Ontario

Tips from whistleblowers

Referrals from other regulators

Referrals from other branches

Complaints from the Contact Centre

Case Assessment

(Case Assessment Team)

Reviews all incoming matters and completes a Risk Assessment Profile to assess a risk score

Matters involving misconduct that do not warrant a full investigation and enforcement action

Disruption

(Disruption Team)

Actions are conducted through direct interactions with individuals suspected of having breached Ontario's securities laws and/or by warning Ontario investors of these individuals and companies.

Matters that reach a threshold score

Case Prioritization

(Enforcement Prioritization Committee)

Reviews the submissions and selects those to be investigated

Matters selected for investigation

Investigation

(Quasi-Criminal Team, Regulatory Enforcement Action Team, Market Abuse Team)

Investigates all matters referred

Matters deemed appropriate to move forward to litigation

Litigation

(Quasi-Criminal Team, Regulatory Enforcement Action Team, Market Abuse Team)

Prosecutes individuals or companies for alleged violations of the Act

Quasi-criminal and Criminal Code proceedings

Ontario Court of Justice

Outcomes include:

- Jail sentences;
- House arrest;
- Fines;
- Restitutions.

Amounts are collected by the Ministry of Attorney General.

Administrative proceedings

Tribunal of the OSC/ Superior Court of Justice

Outcomes include:

- Cease trade orders;
- Exemptions removed;
- Director and officer bans;
- Registration restrictions;
- Administrative penalties;
- Disgorgement amounts;
- Settlement amounts.

Amounts are collected by the OSC.

* Please refer to **Figure 7** for actions taken for closed enforcement cases, from 2016/17–2020/21.

Appendix 9: Proceedings Concluded before the Ontario Securities Commission's (OSC) Tribunal and before the Courts, 2016/17–2020/21

Source of data: Ontario Securities Commission

	2016/17	2017/18	2018/19	2019/20	2020/21[1]	Total
Proceedings concluded before the OSC's Tribunal						
Total # of proceedings concluded	11	20	25	14	7	**77**
Total # of Sanctions:						
# of Cease trade orders	13	29	20	6	10	**78**
# of Exemptions removed	13	27	20	4	9	**73**
# of Director and Officer bans	9	19	22	5	11	**66**
# of Registration restrictions	13	22	17	7	12	**71**
Administrative penalties, disgorgement orders, settlement amounts ($)	19,187,711	13,677,706	126,488,622[2]	41,307,703[2]	11,159,316	**211,821,058**
Costs ordered ($)	658,993	2,027,333	8,440,720[2]	3,120,307[2]	480,000	**14,727,353**
Amounts ordered or undertaken to be returned directly to investors ($)	147,933,167	49,396,644	10,970,518	995,966	0	**209,296,295**
Proceedings concluded before the Courts						
Total # of proceedings concluded	8	7	7	4	3	**29**
Total # of Sanctions:						
Jail sentences (total # of months)	102	22	51	119	0	**294**
Conditional sentences/ House arrest (total # of months)	12	6	0	24	24	**66**
Fines ($)	49,550	50,000	100,000	15,676,088	1,000	**15,876,638**
Restitution ($)	66,729,551	2,059,997	2,707,636	14,624,163	24,000	**86,145,347**

Note: Fluctuations from year to year are normal and depend on the egregiousness and type of cases brought forward.

1. OSC advised that fiscal year 2020/21 numbers were affected due to the COVID-19 pandemic impact on the OSC hearings and trials that led to sanction orders. The OSC took time to set up new procedures and test out technology, with consideration to parties who argued over processes, health concerns and financial hardships. Others wanted hearings adjourned until they could resume in person.
2. There were two large cases that impacted the numbers in fiscal year 2018/19 and one in fiscal year 2019/20.

Appendix 10: Examples of Enforcement Tools Used by the Ontario Securities Commission (OSC) to Collect Monetary Sanctions

Source of data: Ontario Securities Commission

Enforcement Tool	Details
Asset traces	To perform searches, such as title searches and requests to financial institutions, to identify and locate assets where there may be investor funds.
Bankruptcy	Some respondents seek to use the bankruptcy process in an attempt to absolve themselves of their debt to the OSC. The OSC participates in these processes by, for example, acting as inspectors and appointing trustees who will make greater efforts to uncover assets and by opposing discharge in appropriate cases.
Collection agency	In May 2017, the OSC hired an external collections firm under a contingency arrangement to provide legal services such as commencing legal actions and pursuing legal remedies to collect unpaid monetary sanctions. Under the arrangement, the firm would only be paid when it collects the sanctions referred to it. (This is money that the OSC would not have otherwise collected.) Many of the cases referred were either older or where collection was uncertain given the nature and location of the perpetrator.
CRA set-off program	This program directs tax refunds payable to individuals with outstanding debts to the OSC instead.
Delinquent respondent list	Publish the names of respondents with unpaid monetary sanctions (after the expiry of an appeal period) on the Canadian Securities Administrators and OSC websites.
Filing OSC order with Superior Court	This allows the OSC to use the full range of tools available for enforcement of court orders. It also serves as notice to other creditors that have an outstanding order for payments.
Filing and enforcing writs of seizure and sale or garnishments	Filing writs against respondents in jurisdictions where they may own property, accounts or have sources of income. This can be effective when a respondent attempts to sell or mortgage property or if they are employed and wages can be garnished.
Freeze directions	Freezing known assets such as bank accounts, trading accounts and property at an early stage means these assets cannot be dissipated or hidden.
Letter to respondent	Inform a respondent of a sanction decision or order against them, explain how they can make a payment and what might happen if they fail to comply.
Payment plans	In some cases, the OSC negotiates payment plans with respondents which can result in getting the full value of the order from them over a period of time.
Referral to external counsel	In select cases, the OSC retains external counsel to pursue complex and/or cross-border collections matters, particularly when respondents are suspected to have hidden assets offshore.

Note: In addition to the above enforcement tools, the OSC also publishes the list of violators who have not paid the monetary sanctions on its website, on a page titled “Individuals or companies with unpaid OSC sanctions.”

Appendix 11: Audit Criteria

Prepared by the Office of the Auditor General of Ontario

1. Effective and efficient governance and accountability structures are in place to oversee the operations of the OSC in fulfilling its regulatory mandate.
2. Effective and efficient processes are in place to protect investors and minimize any undue regulatory burden when creating and amending rules, and granting exemptions from certain requirements.
3. Effective and efficient processes are in place to monitor compliance by regulated businesses and individuals, and to follow up on non-compliance to ensure corrective action is taken on a timely basis.
4. Effective and efficient processes are in place to deter, identify, investigate, and take appropriate enforcement action when necessary for non-compliant activity by market participants.
5. Effective and efficient processes are in place to proactively monitor market activity, global trends and emerging risks, and enable the OSC to respond on a timely basis.
6. Effective and efficient processes are in place to educate investors and provide the information they need to make informed decisions in relation to securities.
7. Effective and efficient processes are in place to ensure that complaints and whistleblower tips are recorded, followed up on and resolved in a timely manner.
8. Meaningful performance indicators and targets are established, and performance is monitored against indicators and targets. Results are publicly reported and corrective action is taken when needed in a timely manner.

Appendix 12: Key Industry Stakeholders and Investor Advocacy Groups

Prepared by the Office of the Auditor General of Ontario

Key Industry Stakeholders
Canadian Advocacy Council (CAC) The CAC, on behalf of Chartered Financial Analyst (CFA) Societies Canada, states that it advocates to Canada's securities regulators, standard setters, self-regulatory organizations, industry groups and legislators through the publication of comment letters on proposed rules and notices.
Canadian Bankers Association This organization reports that it represents more than 60 domestic and foreign banks operating in Canada and their employees, with the stated aim to provide governments and others with a centralized contact on banking issues.
Canadian Capital Markets Association This organization is a national, federally incorporated not-for-profit launched in 1999. Participants include dealers, custodians, asset managers, key securities infrastructure, such as exchanges, the Canadian Depository of Securities and Fundserv, which acts as a centralized data sharing facility for transaction information.
Canadian Coalition for Good Governance (CCGG) The stated mission of CCGG is to represent institutional investors through the promotion of best corporate governance practices and to align the interests of boards and management with those of the shareholder.
Investment Funds Institute of Canada (IFIC) Represents 150 organizations in the investment fund industry, including fund managers, distributors and industry service entities. IFIC indicates that its members represent approximately 91% of mutual fund assets under management.
Investment Industry Association of Canada (IIAC) Representing Canada's investment dealer firms, the IIAC is a national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of 121 IIROC-regulated investment dealer member firms in the Canadian securities industry.
National Angel Capital Organization (NACO) NACO is the national industry association for Canada's 45 regional angel investment groups, 50 accelerators and incubators, and 4,200 angel investors. Its stated purpose is to facilitate collaboration, investment opportunities and faster access to Canada's investment ecosystem.
National Crowdfunding and FinTech Association of Canada (NCFA Canada) NCFA Canada sees itself as a financial innovation organization that provides education, market intelligence, industry stewardship, networking and funding opportunities and services to community members. NCFA engages with global stakeholders with the stated purpose to incubate projects and investment in fintech, alternative finance, crowdfunding, peer-to-peer finance, payments, digital assets and tokens, blockchain and cryptocurrency, regtech, and insurtech sectors.

Private Capital Markets Association of Canada

This not-for-profit association was originally founded in 2002 by a group of Canadian business professionals whose firms were active in the exempt securities market. Its stated purpose is to be a national voice of Canada's private markets and represent the interests of exempt market dealers, issuers and professionals.

The organization also reports that it assists members with their regulatory responsibilities, provides regulatory updates and increases public awareness of Canada's private capital markets.

Key Investor Advocacy Groups

Canadian Association of Retired Persons

This is an advocacy association for older Canadians with the stated aim of promoting equitable access to health care, financial security and freedom from ageism.

Canadian Foundation for Advancement of Investor Rights (FAIR Canada)

The mission of FAIR Canada is stated as being "a catalyst for enhancing the rights of Canadian shareholders and individual investors, including being a national voice for investors in securities regulation." FAIR has received funding from securities regulators, self-regulated organizations (SROs) and private donors but indicates that it operates independently from government, regulators and SROs. A key activity for FAIR Canada is to respond to requests for comments from securities regulators, such as the OSC, from the perspective of retail investors.

Ken Kivenko, Kenmar Associates

Kivenko is president of Kenmar Associates, a privately funded organization that provides information on investor protection issues and participates in regulatory consultations such as requests for comments from the OSC.

Prosper Canada

This is a national charity with the stated aim of expanding economic opportunity for Canadians living in poverty through program and policy innovation.

Appendix 13: Fiduciary or Overarching Best Interest Standard in Jurisdictions

Prepared by the Office of the Auditor General of Ontario

Canada
Note that certain advisors may have a fiduciary duty to their client because: • They are a "portfolio manager" (regulated separately under the *Securities Act* by the OSC) • Certain professional standards apply (e.g., for a Chartered Financial Analyst) • The advisor is empowered to make investment decisions without consulting the client (called a "discretionary account")
Australia
Must act in the best interests of the client. Legislation provides a "safe harbour" clause where advice providers can show they have met specific criteria.
European Union
Must act in accordance with the best interests of the client.
United Kingdom
Must act in accordance with the best interests of the client.
United States
Investment advisers are held to a fiduciary standard under long-standing legislation. The SEC attempted to bring in a fiduciary rule for broker-dealers, beginning in about 2010 but was opposed by industry and faced a court challenge. The SEC subsequently introduced a more limited rule for broker-dealers in 2020.

Appendix 14: Papers, Consultations and Proposals Regarding Mutual Fund Fees

Prepared by the Office of the Auditor General of Ontario

Date	Project Step
Dec 13, 2012	Canadian Securities Administrators (CSA) Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees*
2013 (Multiple dates)	Roundtable consultation and discussion forums on mutual fund fees
Dec 19, 2013	CSA Staff Notice 81-323 *Status Report on Consultation under CSA Discussion Paper and Request for Comment 81-407 Mutual Fund Fees*
Jun 11, 2015	Commissioned research: *Mutual Fund Fee Research* by the Brondesbury Group
Published on Oct 22, 2015 and updated Feb 9, 2016	Commissioned research: *A Dissection of Mutual Fund Fees, Flows, and Performance*, by Douglas Cumming, Sofia Johan and Yelin Zhang (Schulich School of Business, York University)
Jun 29, 2016	CSA Staff Notice 81-327 *Next Steps in the CSA's Examination of Mutual Fund Fees*
Dec 15, 2016	CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to Their Representatives*. "The CSA identified various compensation arrangements and incentives that give rise to conflicts of interest …"
Jan 10, 2017	CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions*
Jun 21, 2018	CSA Staff Notice 81-330 *Status Report on Consultation on Embedded Commissions and Next Steps.* Contains policy decisions on embedded commissions and proposed client focused reforms. "Under proposed enhanced conflict of interest rules in the Client Focused Reforms, all embedded commissions would be considered conflicts that must be addressed in the best interests of clients or avoided."
Sep 13, 2018	CSA Notice and Request for Comment: *Proposed Amendments to National Instrument 81-105 Mutual Fund Sales Practices and Related Consequential Amendments*
Sep 13, 2018	Minister of Finance media release: "Statement on the Ontario Securities Commission's Proposal Regarding the Mutual Fund Industry"
Dec 19, 2019	CSA Staff Notice 81-332 *Next Steps on Proposals to Ban Certain Investment Fund Embedded Commissions*: • Upfront sales commissions by investment fund organizations to dealers (would end deferred sales charges) • Trailing commissions by investment fund organizations to order-execution-only (OEO) dealers Background and media release indicate Ontario will participate only in ban of trailing commissions to OEO dealers
Dec 19, 2019	Ontario Securities Commission (OSC) Staff Notice 81-730 *Consideration of Alternative Approaches to Address Concerns Related to Deferred Sales Charges*
Feb 20, 2020	CSA, with the exception of Ontario, published Multilateral CSA Notice of Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*, Changes to Companion Policy 81-105CP to National Instrument 81-105 *Mutual Fund Sales Practices* and Changes to Companion Policy 81-101CP to National Instrument 81-101 *Mutual Fund Prospectus Disclosure* relating to Prohibition of Deferred Sales Charges for Investment Funds (the 2020 Multilateral CSA Notice)
Feb 20, 2020	OSC Notice & Request for Comment-Proposed OSC Rule 81-502 Restrictions on the *Use of the Deferred Sales Charge Option for Mutual Funds* and Proposed CP 81-502 to OSC Rule 81-502 *Restrictions on the Use of the DSC Option for Mutual Funds & Related Amendments*

Date	Project Step
Sep 17, 2020	CSA Notice of Amendments to National Instrument 81-105 *Mutual Fund Sales Practices* and Related Consequential Amendments Prohibition of Mutual Fund Trailing OSC's Where No Suitability Determination Was Required
Dec 10, 2020	Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*
May 7, 2021	Media release: *Ontario Securities Commission to implement ban on deferred sales charge option, harmonizing rule across Canada*
May 7, 2021	OSC Staff Notice 81-731 *Next Steps on Deferred Sales Charges*
Jun 3, 2021	OSC Notice of Local Amendments to National Instrument 81-105 *Mutual Fund Sales Practices*, Local Changes to Companion Policy 81-105 *Mutual Fund Sales Practices* and Related Consequential Local Amendments and Changes—Prohibition of Deferred Sales Charges for Mutual Funds
Jun 1, 2022 (planned)	Changes to mutual fund sales practices for discount brokers planned to be in force, but not full-service dealers

Appendix 15: Examples of Enforcement Cases Where the Ontario Securities Commission (OSC) Could Have Taken Further Action

Prepared by the Office of the Auditor General of Ontario

Example 1

In May 2020, a resident of Ontario submitted a complaint to the OSC indicating he had invested $1,000 with a company for trading securities and cryptocurrencies. His online account showed that he earned an unrealistic amount of $75,000 overnight. When this individual attempted to withdraw his earnings, he was asked to pay extra fees. He realized this scheme was a scam and refused to pay any additional fees and lost his initial $1,000 investment.

The OSC noted this company ran three other similar websites and was trading in binary options. Binary options are an illegal trade in Ontario, due to the risks involved. They offer either a fixed monetary or an asset-based return on the amount invested or else nothing at all, depending on the outcome of the transaction. The OSC referred this case to the US regulator for commodity futures and closed the case in August 2020 on the basis that it did not meet the threshold score on the OSC's Risk Assessment Profile.

Through research conducted by our Office, we found that the website remained active as of June 2021 and there were many complaints on online forums about this company. We also found two similar complaint cases in our audit sample where these cases were closed for the same reasons, after referrals were made to other securities regulators (the Cyprus Securities and Exchange Commission and the United Kingdom's Financial Conduct Authority).

Although the loss amounts were small, we found that the OSC could have taken additional action to disrupt the illegal trade in binary options and to prevent future risk of financial loss to other Ontario investors who may be deceived into investing more significant funds by, for example, simply adding the company's name to the OSC's own investor warning list.

Example 2

The OSC received several complaints between August and September 2020 from Ontario residents who invested between $250 and $80,000 in bitcoin from a company online. The company denied investors the chance to withdraw their investments and ceased all communication, effectively defrauding investors of the funds. The OSC noted that the company was operating from Bulgaria and contacted that country's securities regulator, the Financial Supervision Commission, which informed the OSC that it was already aware of the issues and was investigating the fraud. The OSC also noted that the company was listed on the investor warning list of British Columbia and New Zealand. However, by the time the OSC completed its own review of the file, six months later in January 2021, the company's website had become inactive. The OSC subsequently closed the file without further action.

We noted that the OSC could have acted earlier, when the first complaint came in August 2020, or when it became aware of the action taken by BC's and New Zealand's securities regulators, by issuing its own investor warning while the company's website was still active to prevent other Ontarians from potential financial loss.

Example 3

In May 2020, an Ontarian invested approximately $11,000 with a company that sells various financial instruments. After a series of trades, the resident had a remaining balance of $2,000, which the individual attempted to withdraw. The company refused to allow the individual to withdraw the funds and ceased communication. In August 2020, the individual submitted a complaint to the OSC, who noted that the website used for trading in these securities was registered through an agent in a foreign country, and that the company was headquartered in England. The OSC referred the matter to the UK securities regulator and subsequently closed the case on the basis that it did not meet the threshold score on the OSC's Risk Assessment Profile.

Although the loss amount was small and there was only one known complaint received by the OSC, we found that the OSC could have taken action to prevent future risk of financial loss to other potential Ontarian investors by, for example, adding the company's name to the OSC's own investor warning list.

Example 4

A resident of Ontario invested $35,000 in binary options with a company registered in Belize and was unable to retrieve their funds. The individual submitted a complaint to the OSC in January 2019. The OSC reviewed and closed the case on the basis that the company was listed on its investor warning list in 2015 and it had issued an investor alert (news release) in the same year.

We performed a search in the complaints database and found that in May 2020 the OSC received another complaint from an Ontario investor who lost $22,000 to the same company but closed it without action. The OSC could have flagged repeat offenders more visibly on their investor warnings and alerts website.

Appendix 16: Allocations Made by the Ontario Securities Commission (OSC) from the Designated Fund, 2016/17–2020/21 ($ 000)

Source of data: Ontario Securities Commission

	2016/17	2017/18	2018/19	2019/20	2020/21	5-Year Total
Opening balance	35,556	37,996	42,095	84,380	118,394	
Increases to fund[1]						
Monetary sanctions OSC imposed during the year	163,956	60,449	137,437	42,304	11,123	**415,269**
Amounts respondents paid directly to investors[2]	(148,058)	(48,397)	(10,971)	(996)	0	(208,422)
Net amounts owed to OSC	15,898	12,052	126,466	41,308	11,123	**206,847**
Amounts OSC deemed uncollectible	(7,989)	(5,956)	(80,072)	(1,238)	(5,379)	**(100,634)**
Net amounts OSC collected or deemed collectable in the year	**7,909**	**6,096**	**46,394[3]**	**40,070[3]**	**5,744**	**106,213**
Bank interest earned on fund balance	255	505	1,118	2,077	713	**4,668**
Add: Adjustments to amounts assessed in prior years	(1,195)	437	4,748	990	193	**5,173**
Total increases to balance fund	**6,969**	**7,038**	**52,260**	**43,137**	**6,650**	**116,054**
Allocations made from fund						
Payments made to harmed investors	3,117	1,069	1,157	6,471	4,030	**15,844**
Payments made to whistleblowers[4]	0	0	7,499	525	585	**8,609**
Payments made for the benefit of the investor community						
OSC Investor Office (office was created to enhance investor education and knowledge)	1,413	1,799	1,146	1,235	2,483	**8,076**
Canadian Foundation for Advancement of Investor Rights (FAIR)	n/a	n/a	n/a	n/a	750	**750**
York University for Osgoode Investment Protection Clinic	n/a	n/a	n/a	n/a	75	**75**
Payments made to external collection firm and distribution firms (such as Speigel Nichols Fox LLP for facilitating the collection of unpaid amounts)	n/a	72	173	892	119	**1,256**
Total allocations made	**4,530**	**2,940**	**9,975**	**9,123**	**8,042**	**34,610**
Closing balance	37,995	42,094	84,380	118,394	117,002	

1. Fluctuations from year to year are normal and depend on the egregiousness and type of cases brought forward.
2. Amounts paid directly to investors by respondents as a term of settlement vary from year to year, and depend on the nature of the cases that are settled in a given year. For example, in 2016/17, there were three settlements reached with registered entities where under the terms of these settlements the entities agreed to pay a total of $143 million directly to their affected clients as compensation.
3. Two large cases impacted the numbers in fiscal year 2018/19 and one in 2019/20.
4. The OSC imposed and collected $43 million in sanctions for seven whistleblower awards issued in the last five years. In 2018/19, three awards totalling $7.5 million were paid for three tips that led to $37.3 million of the total $43 million collected in sanctions; in 2019/20, one tip resulted in one award of $525,000; and in 2020/21, two tips resulted in three awards totalling $585,000.

Appendix 17a: Special Purpose Acquisition Companies, Capital Pool Companies and Reverse Takeovers

Prepared by the Office of the Auditor General of Ontario

There are various paths for companies seeking to distribute securities to the public through the exchanges which are part of the Canadian capital markets. One is the traditional route of issuing securities through filing a prospectus. There are other paths as detailed below.

Special Purpose Acquisition Companies and Capital Pool Companies (SPACs/ CPCs)

- The United States has seen a significant spike in the growth of new listings through SPACs. According to a Bloomberg report, SPACs accounted for over half of the value of all IPOs in February 2021. The number of companies launched through the SPAC process in the first quarter of 2021 and the value of capital raised exceeded the total launched in all of 2020.
- A SPAC is a company with no operating business or assets that is created by a sponsor, typically an institutional or experienced investor, to raise capital (minimum $30 million) by issuing securities to the public through an IPO.
- The proceeds are then used to acquire a target business or asset to be identified following the completion of the IPO. A SPAC is also referred to as a “blank cheque” company as investors have limited or no visibility of the acquisition target at the time of the IPO.
- The acquisition of the target company (called the ‘Qualifying Transaction’) must be completed within a maximum of 36 months of the IPO. Until then, the proceeds from the IPO are placed in escrow. If the Qualifying Acquisition (“QT”) is unable to be completed, the proceeds must be returned to the investors and the SPAC’s securities are delisted from the exchange.
- When a target company is identified by the SPAC sponsors, the SPAC is typically required to obtain approval from a majority of directors unrelated to the QT and a majority of the votes cast by shareholders of the SPAC at a meeting duly called for that purpose. However, shareholder approval is not required if shareholders have a redemption right over 100% of its IPO proceeds which are placed in escrow.
- Various publicly available reports and articles have noted that SPACs are becoming popular vehicles to raise capital, among institutional and experienced investors as well as private companies, as they find it to be more efficient and cost-effective compared to raising capital through a traditional IPO.
- These publicly available reports and articles also commented that retail investors often invest in SPACs on the basis of the credibility and past performance of the SPAC sponsors.
- Retail investors often do not have the opportunity to purchase shares in a traditional IPO. The opportunity of retail investors to purchase shares in a SPAC IPO will ensure that they have the right to hold shares in the resulting issuer following the QT, unless they elect to exercise their redemption rights.
- However, the publicly available reports and articles noted some significant risks associated with SPACs.
- In May 2021, the SEC said it is planning to devote significant resources to addressing emerging issues in SPACs because of concerns retail investors were not adequately protected.
- Some of the significant risks include:
  - **Easy return on investment for SPAC sponsors:** One industry expert quoted by Reuters has noted that “SPACs are structured to deliver favourable terms that guarantee a modest, yet predictable, payoff [to early investors/sponsors] no matter what happens.” Therefore, there is a risk that SPAC sponsors are more interested in getting a fast and easy

return on their investment than being invested in the target company for the long term.

- **SPAC sponsors can make optimistic projections about a target company to raise capital; traditional IPOs have to provide reliable financial forecasts to support their profitability:** According to a research paper published in November 2020 by professors from Stanford University and New York University titled "A Sober Look at SPACs," the professors claimed that SPAC companies (that is, post acquisition) in the United States deliver far worse returns than traditional IPOs. Through their research, they found that companies that went public through SPACs fell in value by an average of 3% after three months, 12% after six months and by more than 33% a year later.
- **Inadequate due diligence by sponsors:** The rush to acquire a target company by the regulatory timelines may cause sponsors to not conduct adequate due diligence of a target company.
- **Conflicts of interest:** The Financial Industry Regulatory Authority in the United States warned that "underwriters and SPAC sponsors may possess material, non-public information regarding potential SPAC acquisition targets and trade around that knowledge." The SEC's chairman also noted SPACs as being a particular area of focus for the regulator, specifically for the equity interests that they hold and their compensation, before and after acquisition of the target company.

- The TSX adopted rules to approve SPACs in December 2008.
- The exchanges have primary responsibility to approve the listing of SPACs. In Ontario, the TSX and Neo approve SPAC listings.
- The SPAC cannot complete an IPO without filing a prospectus with, and obtaining a receipt for it, from the Ontario Securities Commission (OSC). Also, every SPAC may complete its QT only after filing a non-offering prospectus with, and obtaining a receipt for it, from the OSC.
- The listing involves a two-stage process. The first stage includes filing and clearing the IPO and listing the securities on the exchange. The second stage involves the identification and completion of a qualifying transaction.
- Capital Pool Companies (CPCs) are similar to SPACs in certain ways. However, there are differences. For example, shareholders who have invested in CPCs do not have the same redemption rights as SPACs' shareholders. See **Appendix 17b** for key differences in structure and regulatory oversight responsibility between SPACs and CPCs.

Reverse Takeovers

- Reverse Takeovers, or RTOs, are one of the ways in which a company can issue securities to the investing public. RTOs, also known as "reverse mergers" or "back-door listings," involve a private company, that has operating assets or an operating business, completing a statutory amalgamation, arrangement or procedure with a publicly traded company that is already a market participant or reporting issuer in Ontario. The private company will generally own a higher value of the operating assets or business than the publicly traded company. Once the private company buys enough shares to control the publicly traded company, the private company's shareholders then exchange their shares for shares in the publicly traded company.
- The Canadian Stock Exchange (CSE) has been an active marketplace for RTOs, especially for companies operating in the cannabis sector. That is partly because its rules allow cannabis companies with domestic operations in the United States to become reporting issuers in Ontario. In contrast, the TSX and the TSXV restrict publicly listed companies from engaging in or investing in United States cannabis cultivation and distribution operations.
- The SEC issued an Investor Bulletin in June 2011 about investing in companies that enter US markets

through RTOs or reverse mergers. The Investor Bulletin explains the reverse merger process, describes the potential risks of investing in reverse merger companies, and details some of the recent enforcement actions that the agency has brought against reverse merger companies.

- Some of the risks related to RTOs highlighted in this investor bulletin include:
  - Many companies either fail or struggle to remain viable following a reverse merger;
  - As with other kinds of investments, there are risks of fraud and other abuses;
  - Foreign companies attempting to access the US markets through the reverse merger process may use small auditing firms, some of which may not have the resources to meet auditing obligations when all or substantially all of the private company's operations are in another country. As a result, such auditing firms might not identify circumstances where these companies may not be complying with the relevant accounting standards. This can result in increased risks for investors.
- The June 2011 investor bulletin also noted recent enforcement actions involving RTOs.
- RTOs have been subject to added scrutiny by securities regulators in the US after about 300 Chinese companies issued IPOs through RTOs by listing on major US exchanges such as Nasdaq and the NYSE in the late 2000s after the 2008 financial crisis. These companies were found to be mostly fraudulent as they significantly overstated their revenues to attract investors. The Chinese government prohibited the SEC from overseeing their operations and the PCAOB (the public company accounting firm watchdog) did not flag that the Big Four accounting firms allegedly provided unqualified audit opinions on these companies without adequate due diligence. The fraud reportedly cost investors over $500 billion US between 2009 and 2012.
- In Canada, the Sino-Forest Corp. issue brought the risks of investing in IPOs involving RTOs to Canadian investors.
- This fraud caused the OSC and the exchanges to re-examine the risks and challenges of listing, auditing, and providing oversight over foreign issuers, particularly companies based in emerging markets.
- In November 2012, the OSC issued guidance through two staff notices (OSC Staff Notice 51-719 Emerging Markets Issuer Review and OSC Staff Notice 51-720 Issuer Guide for Companies Operating in Emerging Markets) that applies to all emerging market issuers regardless of method of entry into the Canadian markets. All Canadian exchanges have similar guidance regarding risks related to emerging market issuers.
- The key differences, as related to structure and regulatory oversight responsibility, between SPACs, CPCs and RTOs are illustrated in **Appendix 17b**.

Appendix 17b : Key Differences in Structure and Regulatory Oversight Responsibility Between SPACs, CPCs and RTOs

Source of data: Ontario Securities Commission

Area	Special Purpose Acquisition Companies (SPACs)	Capital Pool Companies (CPCs)	Reverse Takeovers (RTOs)
Exchange where listed	TSX, NEO	TSXV	All exchanges (CPC and SPAC Qualifying Transactions or QTs are usually RTOs)
Minimum Capital raised (IPO)	$30 million No minimum for QT	$300,000 No redemption right	n/a
Maximum capital raised	No limit	$10 million	n/a
Exchange approvals	Review and approve IPO and listing (of SPAC) Review and approve QT and listing (of resulting issuer)	Review and approve IPO and listing (of CPC) Review and approve QT and listing (of resulting issuer)	Approve RTO and listing (of resulting issuer)
Ontario Securities Commission approvals	Review and approve IPO prospectus Review and approve non-offering prospectus (filed before completion of QT)	Where Ontario is Principal Regulator, IPO prospectus reviewed **solely to conduct background checks on CPC promoters.** Review and approve non-offering prospectus (filed before completion of QT) if private company is located outside Canada and United States, and resulting issuer is not a resource issuer. In other words, only non-resource issuers located outside Canada and the United States required to file a non-offering prospectus under CPC rules. CPCs can voluntarily file non-offering prospectus before completion of QT, which OSC would review and approve.	RTO issuer can voluntarily file a non-offering prospectus or a prospectus to qualify concurrent distribution before completion of QT, which OSC would review and approve. RTO issuer may also require relief from prospectus requirement or information circular requirements, in which case OSC would review and approve the relief required to complete the RTO (including relevant disclosure about RTO to be provided to shareholders for their approval).

Area	Special Purpose Acquisition Companies (SPACs)	Capital Pool Companies (CPCs)	Reverse Takeovers (RTOs)
Shareholder approvals required?	Shareholder approval of QT required. Such approval is evidenced by at least one of the following mechanisms (and in most cases both): (i) collective approval by majority vote; or (ii) individual approval by electing NOT to exercise their redemption rights immediately before the QT.	Shareholder approval of QT required for non-arm's-length transactions, or as otherwise required by law, but shareholders don't have redemption rights. Shareholder approval of QT not required for arm's length transactions, provided that the CPC files the appropriate TSXV disclosure document or a non-offering prospectus. If majority shareholders don't approve, the CPC will continue its search for another QT.	Shareholder approval requirement determined under corporate law. Generally, approval of the RTO by shareholders of the public company is required, but there may be instances where such approval is not required. Whether shareholder approval is required and the mechanics of how shareholder approval may be obtained is tied to how the RTO is structured and the requirements of corporate law.
IPO proceeds held in escrow until QT identified	At least 90% Note that founders shares may not be sold until after completion of QT.	n/a Note that founders shares may not be sold until after completion of QT.	n/a
Time limit	If a QT is not completed within 36 months, the SPAC is liquidated and shareholders can redeem their shares for the IPO proceeds held in escrow. The SPAC can also ask for an extension, with shareholder approval.	**Prior to Jan 1, 2021:** If a QT is not completed within 24 months, and subject to approval of a majority of disinterested shareholders, CPC shares may be delisted or suspended, or transferred to list on a junior tier (NEX) of the TSXV exchange, and founders shares may be cancelled. **Since Jan 1, 2021:** The time limit of 24 months to complete a QT has been removed.	n/a

Appendix 18: Issues Found in Companies Regulated by the Ontario Securities Commission (OSC) and That Entered Canadian Capital Markets through Alternative Methods

Prepared by the Office of the Auditor General of Ontario

Example 1

This entity entered the market as a CPC in 2015 and was listed on the TSXV. In 2018, it acquired a target private company in the cannabis sector. The president and CEO of the CPC was a director of the target private company as well. We also noted, from a press release, that for the purposes of the transaction, the parties agreed to value the original CPC at $1.7 million and value the target private company at $50 million. From this information, we inferred that the value of the CEO's equity holding was $15,000 (0.9% of $1.7 million) in the CPC and $3.5 million (7% of $50 million) in the target private company. Prior to the acquisition by the CPC, the target private company generated negligible revenue and incurred a net loss of $5.7 million and negative cash flows from operations of $4.6 million, based on its audited financial statements for year ended Dec. 31, 2017. This was deemed the qualifying transaction (QT) for the original CPC and was not subject to the CPC's shareholder approval. Subsequent to the QT, the resulting public company continued to trade on TSXV. In November 2018, the company delisted from TSXV and began trading on the CSE. Thereafter, the publicly traded company on CSE was acquired by another company through an RTO transaction in April 2019.

Although the Board of the publicly traded company engaged a qualified independent third party to provide advice on the viability of the RTO, the independent third party did not provide a recommendation to the Board as to whether the RTO transaction was in the best interest of the company. However, the Board determined that the transaction was in the best interest of the company and unanimously approved the RTO transaction. Note that certain executives and directors had conflicts of interest, due to equity ownership, in both the target company and acquiring company, which was disclosed in a press release.

Subsequent to the RTO transaction, the company was unable to file its regulatory filings for the quarter ended June 30, 2019. Consequently, in September 2019 the OSC issued a Cease Trade Order in respect of the company's common stock. Subsequent to the Cease Trade Order, a substantial portion of the company's employees in Canada were laid off and all of the management and most of the Board members resigned. Ultimately in February 2020, the company's Board resolved that they would file for bankruptcy along with certain Canadian related subsidiaries. The company was delisted from the CSE on September 2020.

Example 2

Prior to August 2016, this publicly traded company was engaged in the leasing of various kinds of operating and manufacturing equipment such as industrial and construction machinery. The company was inactive until March 9, 2018 when it entered into agreements to acquire another company, a licensed producer of medical cannabis in Canada. The reverse takeover transaction closed on May 24, 2018.

In September/October 2018 and July 2019, there were investor complaints alleging insider trading, plunging stock prices and misleading news reports.

In February 2021, the Ontario Superior Court of Justice approved a proposed settlement with this company for $5.5 million to be distributed to investors who purchased the shares between September 20, 2018 and February 6, 2019. This was a result of a class action alleging that the company omitted material facts about a proposed expansion of its operational facilities that resulted in an artificial inflation of the company's share price.

Over the period July 2018 to April 2021, there were a total of 17 complaints against this company, of which three had no securities law concerns.

Appendix 19: Examples of Key Performance Measures and Indicators

Source of data: Ontario Securities Commission

Key Area 1: Regulatory Effectiveness

These measures, including actions and planned outcomes, are used by the Ontario Securities Commission (OSC) to evaluate if it is effectively meeting its statutory objectives, strategies and goals. Progress is then self-assessed at year-end and publicly reported as part of the annual Statement of Priorities published on the OSC's website.

Goal	Priority	Planned Actions	Progress/Outcomes/Measures of Success
Promote Confidence in Ontario's Capital Markets	Improve the Retail Investor Experience and Protection	Stakeholder consultations on ways to improve the investor experience	**Completed:** Published the Investor Experience 2020 research study that explored several topics relevant to the retail investing experience in Canada including working with an advisor, understanding investments, avoiding investment fraud, and the impact of the COVID-19 pandemic.
Reduce Regulatory Burden	Complete Actions Identified in the OSC's Burden Reduction Plan	Complete the burden reduction items identified in the Report for completion by the planned dates	**Completed:** The OSC reported that it has completed 62 of the initiatives set out in the 2019 report Reducing Regulatory Burden in Ontario's Capital Markets. **In Progress:** By December 31, 2021, 85 of the initiatives (79% of the total) are projected to be complete. **Ongoing/Delayed:** 33 of the initiatives have been delayed due to impacts of the COVID-19 pandemic. Many of these are joint CSA projects and follow CSA timelines.
Facilitate Financial Innovation	Engage with Fintech and Support Innovation in Capital Markets	Evaluate additional tools to assist fintech firms that want to test novel products and services.	**In Progress:** The Innovation Office is developing a user-friendly dedicated website to support the innovation community and its mandate to foster innovation, economic growth and capital formation.
Strengthen Our Organizational Foundation	Modernize the OSC's Technology Platform	Replacement of legacy systems with modern technology	**Completed:** Implemented a new e-discovery solution, Relativity, and decommissioned the legacy Summation system. Implemented a new CSA Market Analytics Platform and decommissioned MICA, the OSC's legacy application. **In Progress:** OSC's legacy systems are being modernized using new technologies and platforms. As the first step, a OSC platforms landscape was published. Existing legacy systems will be ported to the new platforms as a multiyear initiative. Currently working on the prioritization of these initiatives.

Key Area 2: Service Standard Commitments

These measures, along with targets, outline what external stakeholders can expect when dealing with the OSC. The measures are implemented for the various branches of the OSC.

		Actual Performance (%)[1]				
Activity	**Target %**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21**
Corporate Finance						
Initial response to long-form prospectus	80% in 10 days	100	100	100	100	92
Routine applications for exemptive relief completed[2]	80% in 40 days	100	100	100	94	86
Compliance and Registrant Regulation						
Routine applications for exemptive relief completed[2]	80% in 40 days	97	94	71	90	94
Investment Fund and Structured Products						
Routine applications for exemptive relief completed[2]	80% in 40 days	99	91	90	97	100
Enforcement Branch						
Enforcement case assessment of general matters	65% in 60 days	n/a[3]	n/a[3]	n/a[3]	75	76

1. Actual performance represents the percentage achieved for the activity. For example, the 100% achieved in 2019/20 for Corporate Finance's initial response to long-form prospectus activity means that 100% of initial responses were sent in 10 days, exceeding the target set of 80%.
2. The OSC notes on its website that applications that are complex or raise new policy issues take longer for it to review.
3. No data was collected prior to the branch reorganization in 2018/19.

Key Area 3: Internal Activity Volumes

These measures look at statistics of key branch activity. They are tracked over time for internal use and decision-making such as reviewing impact to workforce and efficiency as well as external circumstances impacting key branch activities that may require additional resources.

Internal Activity Volumes	**5-Year Avg**
Compliance and Registrant Regulation Branch: Applications for individuals who provide investment products and/or advice to the public, and seeking, terminating and making changes to their registration	74,949
Corporate Finance Branch: Prospectuses filed by reporting issuers	453
Investor complaints received by OSC's Contact Centre	2,470
Investor education resources website – # of page views	5,385,147
Investor News newsletter – # of subscribers	11,704
Market Regulation Branch: Reviews of filings made by market infrastructure entities such as stock exchanges, clearing agencies, etc.	1,066
Office of the Whistle Blower: # of website hits	21,247

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ISSN 1911-7078 (Online)
ISBN 978-1-4868-5654-1
(PDF, 2021 ed.)

Cover photograph credits: