Office of the Auditor General of Ontario
Bureau de la vérificatrice générale de l'Ontario

Ontario Securities Commission 2021 Value-for-Money Audit

Why we did this audit

- The capital markets sector is large, complex and critical to our economy. It requires public attention and understanding regarding Ontario Securities Commission's (OSC) role in making rules, regulating the capital markets through its monitoring and enforcement activities, and protecting investors.

Why it matters

- Through access to well-regulated capital markets, business owners can more easily and confidently raise money to invest in business ventures, which also helps create jobs and boost our economic growth.
- Well-regulated capital markets also benefit investors by providing opportunities for creating wealth and funding retirement.

What we found

Investment Dealers Do Not Have a Fiduciary or Similar Duty to Act in Overall Best Interests of Clients

- The OSC could better ensure that dealers act in the overall best interests of their clients; reforms proposed by CSA and led by the OSC were narrower than was originally considered, more complicated and would allow systemic conflicts of interest to continue.
- A fiduciary duty or similar overarching best interest standard is required in the UK, Australia and the European Union.

OSC Allows Sales Practices Banned in Other Jurisdictions

- Deferred sales charges and trailing commissions have taken over a decade to be partially banned. The ban on trailing commissions only applies to discount brokers, not to full-service dealers.
- Deferred sales charges and trailing commissions are banned in the UK and Australia since 2012, cost Ontario investors an estimated $13.7 billion in commissions paid between 2016 and 2020.

RECOMMENDATION 1

Lengthy Delays for New Rules

- The OSC's rule-making processes are lengthy and not always timely, especially when these rules have to be drafted with other securities regulators in the Canadian Securities Administrators (CSA).
- The OSC took, on average, 2.9 years to develop a new CSA rule, more than a year longer (an average of 1.7 year) for Ontario-only rules not requiring coordination with other CSA regulators.

RECOMMENDATION 2

Vulnerability to Lobbying and Political Interference

- Delays in rulemaking have also been attributed to the complexity of the sector and strong industry opposition to change.
- The OSC is vulnerable to political interference, which risks undermining its independence and impartiality.
  - On deferred sales charges, the Finance Ministry first publicly opposed the OSC-led CSA's consensus on needed reform in September 2018, but then reversed its position in May 2021.
  - The incident illustrated the government's ability to override the OSC's judgment and evidence on a proposed reform.

RECOMMENDATIONS 3–6

OSC Lacks Enforcement Powers

- Unlike the BC securities regulator, OSC lacks the power to, for example, issue "tickets" for less egregious violations, especially those committed by unregulated companies and individuals, that do not warrant a full-blown investigation by its Enforcement Branch.

RECOMMENDATIONS 7–10

OSC Cannot Enforce Collection of Monetary Sanctions	• Between 2011/12 and 2020/21, the OSC collected only 28% of $525 million of monetary sanctions it imposed. • Unlike the BC securities regulator, the OSC does not have power to make orders to seize assets to collect unpaid monetary sanctions or direct the refusal of driver's licence renewals. **RECOMMENDATION 11**
OSC Paid Minimal Amounts from Fund to Investors	• Of the $117 million collected and accumulated in the OSC's Designated Fund as of 2020/21, it only paid out between 6% and 11% each year, between 2016/17 and 2020/21, that could be used for the benefit of investors. • This excluded OSC orders for $208 million in sanctions to be paid by violators directly to investors. **RECOMMENDATIONS 12-13**
Limited Reviews of Potentially High-Risk Market Participants and Transactions	• The OSC conducts limited reviews of special purpose acquisition companies, capital pool companies (CPCs) and reverse takeovers. • For example, from 2016/17 to 2020/21, the OSC reviewed only seven CPCs out of 77 CPCs at the time of market entry after identifying issues with their promoters. • OSC's Corporate Finance Branch does not use key criteria, such as location of operations of reporting issuers, 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. **RECOMMENDATIONS 14-15**
OSC Needs Additional Powers to Better Protect Investors	• OSC's Corporate Finance Director lacks statutory authority to require companies using regulatory exemptions from issuing prospectuses to make adequate disclosures to investors following non-compliance. • The OSC has limited power to require audit information from the Canadian Public Accountability Board, the national, independent body responsible for the regulation and oversight of public accounting firms, which is responsible for the audits of Canadian reporting issuers. **RECOMMENDATIONS 16-19**
IT Systems are Outdated, Not Connected and IT Controls can be Further Strengthened	• Some of the OSC's information systems are outdated and/or operated in silos, hindering its ability to effectively use data gathered to operate more efficiently. • Staff access to IT systems and facilities, to manage system changes and administrator access controls can be further strengthened. **RECOMMENDATIONS 20-25**
Regulatory Strategies Needed in Some Areas of Interest	• During our audit, a number of emerging areas of interest were noted during our discussions with OSC and stakeholders, including alternative performance measures and tied selling. **RECOMMENDATION 26**

Conclusions

- The OSC plays a key role in regulating the largest capital markets sector in Canada. However, it has been impacted in certain of its regulatory activities to protect investors because of complexity of the sector and industry. This has caused significant delays in addressing current and emerging market issues.
- The OSC requires more legislative authority and tools to better enforce securities laws and to collect monetary sanctions imposed on unregulated companies and individuals.
- The OSC has not effectively used its accumulated Designated Fund, collected from its sanctions imposed through enforcement activities, for the benefit of the investor community as much as permitted within the existing securities laws in Ontario.

Read the report at www.auditor.on.ca