ONTARIO SECURITIES COMMISSION

FOR FISCAL

2011-12

Statement of Priorities

Introduction

The *Securities Act* (Ontario) requires the Ontario Securities Commission (OSC) to publish in its Bulletin and to deliver to the Minister by June 30 of each year a statement by the Chair setting out the proposed priorities for the Commission for the current financial year.

This Statement of Priorities sets out the OSC's strategic goals and specific initiatives that will be pursued in support of these goals in the fiscal year commencing April 1, 2011. It also discusses the environmental factors that the OSC considered in setting these goals.

The OSC fully supports the policy of the government of Ontario regarding the establishment of a national securities regulator for Canada. However, pending the establishment of a national regulator, the OSC remains committed to delivering its regulatory services with effectiveness and accountability. Consequently, the OSC will continue to work closely with its colleagues within the Canadian Securities Administrators (CSA) and with market participants to ensure that the regulatory system continues to function efficiently and remains responsive to changing market circumstances.

Our Vision

To be an effective and responsive securities regulator – fostering a culture of integrity and compliance and instilling investor confidence in the capital markets.

Our Mandate

The OSC's mandate is to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in capital markets. The mandate is established by statute.

Message from the Chair

The Ontario Securities Commission's top priority is to represent the best interests of the investors of this province. The OSC is a public service agency dedicated to protecting the interests of investors and fostering their confidence in Ontario's capital markets. We serve investors by being responsive, vigorous and accountable as we carry out our responsibilities and duties as a securities regulator.

The OSC Statement of Priorities features five broad regulatory priorities for the 2011-12 fiscal year, developed during the Commission's annual planning process. These regulatory priorities indicate where we will focus our attention and energy in the year ahead. We will address these priorities within the context of the rapidly unfolding developments in the capital markets, such as the proposed transaction involving TMX Group and the London Stock Exchange Group. As a new Chair of the OSC, I believe the organization must stay ahead of the important issues and anticipate risks that could affect investors and the capital markets in the future. Delivering risk-oriented regulatory responses is essential to fostering public confidence in the markets.

The OSC's strong support for the creation of a national securities regulator is reflected in our Statement of Priorities. We believe that a national regulator would serve the best interests of all Canadians by enhancing investor protection, strengthening securities law enforcement, allowing for more responsive policy development and giving this country a stronger voice in shaping international standards for securities regulation. The OSC intends to support the Ontario Government and our Minister during this important initiative.

Today's financial markets are dynamic and innovative. As a result, the OSC must constantly enhance its skills and knowledge in order to protect the interests of investors and foster their confidence in the fairness and integrity of the capital markets. The Commission, executive team and staff of the OSC are working together to build the OSC into one of the best regulatory models in North America. It is an honour to serve investors as a regulator of the capital markets of Ontario.

Yours very truly,

Howard I. Wetston, Q.C.
Chair and Chief Executive Officer

Our Environment

Each year, the OSC develops its business plan and sets goals and priorities to achieve its vision and its mandate. The OSC does this against a backdrop of current and forecast economic conditions, evolving market practices, developing trends and issues, as well as changes in public expectations. The main factors influencing this year's planning are:

- *Developments in the broader investment marketplace:* This includes changes in products and market structures, and issues related to transactions and the activities of market intermediaries.
- *Developments in the domestic and international regulatory arena:* As the globalization of economies and capital markets continues to evolve, so has the need to consider changes in the way financial services are regulated.
- *Responses to investor concerns about regulatory effectiveness:* Notwithstanding the efforts of regulators, there is a need to assess and demonstrate the effectiveness of regulatory programs in achieving regulatory objectives.

Market Developments/Evolution

The rapid pace of product and market innovation has led to the proliferation of complex exchange-traded funds (ETFs) and structured products, dark pools and algorithmic trading, portfolio account services that provide retail investors with access to the exempt market, greater importance of new trading platforms, developments in new order types, and evolving regulatory requirements for the clearing and reporting of over-the-counter (OTC) trades in derivatives.

The OSC must assess the impact of these developments on market transparency, stability, and investor access and fairness, to determine the needed changes to the regulatory framework. The OSC does this by constantly reviewing the regulatory capabilities and approaches used to assess the impacts and risks emerging in the areas it regulates. In some cases, existing tools may be insufficient to monitor and respond to new developments within the limits of current regulation, and the OSC must find new ways to respond effectively. Skilled staff, including specialists in market and product research and analysis, have become increasingly important resources that the OSC must consider using in these circumstances. In addition, developments in areas beyond the OSC's current regulatory jurisdiction may require an extension of the OSC's authority.

Evolving Global Regulatory Landscape

Recognizing the interconnectedness of Canadian financial markets domestically and internationally, and the importance of securities markets to broader financial activities, is fundamental to effective securities regulation. The appropriate regulatory response to market developments must ensure that opportunities for regulatory arbitrage are minimized and that local investors and market participants are protected.

Securities regulators, with their traditional focus on transparency and business conduct oversight, have an important role to play in promoting Canada's financial stability. However, addressing systemic risk is a shared responsibility and securities regulators must partner with other Canadian organizations, including the Office of the Superintendent of Financial Institutions Canada (OSFI), the Bank of Canada, and the federal and provincial Finance Ministries.

The recent financial crisis has resulted in the development of recommendations and principles internationally relating to the conduct and reporting of short selling activities, regulation of OTC derivatives trading and the role of securities regulators with respect to systemic risk in the capital markets. Keeping pace with these developments, while paying close attention to issues that matter to Ontario's investors and markets, is an ongoing challenge.

The OSC will consider G20 commitments, initiatives by other North American regulatory agencies, such as the U.S. Securities and Exchange Commission (SEC) and the U.S. Commodity Futures Trading Commission (CFTC) and developments at the International Organization of Securities Commissions (IOSCO).

Expectations of Regulatory Effectiveness

Confidence in capital markets depends on meeting public expectations of regulatory effectiveness. Public expectations are affected by personal financial losses (and associated public perceptions), the overall level of stability of the markets, the visibility of timely enforcement actions, and perceptions of fairness and access to the markets by investors. A regulatory focus on the "technical" correctness of a product must be balanced against public interest considerations.

Significant structural changes in the markets have occurred over the last few years. New challenges include the rise of alternative trading systems and new transaction types, complex financial engineering of new products, greater reliance on the exempt market for distribution, potential intermediary conflicts of interest in the distribution of products, and differing rules for similar products.

Changes in products and market structures challenge the ability of traditional securities regulation to protect investors. The OSC must be more sensitive to market activity that affects retail investors, such as dealing with harmful conduct by distributors or the provision of clear client reports, as well as business structure issues such as advisor incorporation or algorithmic trading. More effort is required to encourage input from investors, particularly retail investors, so that their views are represented as much as those of more formally organized market participants.

Traditional approaches to investor protection alone, such as setting disclosure requirements and business conduct rules, as well as enforcement, are no longer sufficient. Equally important for investor protection is the development of an educated and informed investing public.

Collecting and analysing comments from retail investors is needed to ensure the concerns of the retail investors are heard. The OSC will examine alternative ways to reach retail investors through its investor communications, including a greater use of social media. Using the Investor Education Fund and the recently established OSC Investor Advisory Panel, the OSC will improve the awareness and financial literacy of Ontario investors and ensure that their views and concerns are considered effectively.

Though the OSC's compliance and enforcement regime is vigorous and active, it must be visible and understood by market participants and the public in order to effectively deter illegal or undesirable conduct. This may require assuming a stronger investor education role.

Key Regulatory Priorities for 2011-12

The OSC has identified five broad priorities for 2011-12. These priorities are set out below. In addition, the OSC will carry out a number of other initiatives, as well as ongoing operational programs, in order to achieve its mandate.

1. Better Demonstrate our Commitment to Investor Protection

- In undertaking policy and rule development as well as compliance and enforcement programs, a foremost priority of the OSC will be the protection of investors.

The interests of investors are at the core of everything that the OSC does. The need to educate and protect investors is even more critical, given the increased availability of complex products, greater reliance on the exempt market for distribution and potential conflicts of interest in the distribution of products. The OSC will work to ensure investors get a fair deal. The OSC will:

- Build confidence in the investment process by ensuring that investors be provided with information that is timely, clear and useful. Better information, not just more information, will help investors make better choices. The OSC will:
  - Research the pros and cons of imposing a fiduciary duty on financial advisors and identify what problems we think that introducing a statutory fiduciary duty would resolve. At the same time, we will continue to identify specific standards against which advisors' conduct can be measured.
  - Work with the CSA, IIROC and the MFDA to develop harmonized standards for cost disclosure and performance reporting to investors. The proposed rules will apply to all dealers and advisers in relation to all securities and investment products they sell and will, if adopted, improve the account reporting clients currently receive. We expect that the proposed rules will address many of the securities-industry related recommendations of the recent Financial Literacy Task Force Report (December 2010).
  - Continue to implement the point of sale (POS) initiative and consider expanding POS delivery to other types of publicly offered investment fund products. (As work on the POS initiative continues, the OSC will monitor its impact on price competition in mutual funds).
- Work with the Ontario Government to explore a mechanism by which the OSC could award compensation to Ontario investors who suffer losses because of violations of the *Securities Act* (Ontario).

- Increase efforts to gather views of investors by conducting town hall meetings and investor round tables.
- Simplify its communication with retail investors by using a variety of tools, including social media and focus groups.
- Continue to focus on issues relevant to investors who own securities (shareholder rights).
- Continue to support investor education through the use of monies received through enforcement proceedings to support the Investor Education Fund.

2. Intensify Operational, Compliance and Enforcement Efforts to Promote Confidence in the Markets

The OSC's operational, compliance and enforcement regime is vigorous and active. However, it must be more visible and better understood by market participants and the public in order to achieve the desired deterrent effect. The OSC will step up its focus on compliance and enforcement by insisting on adherence to both the spirit and letter of regulatory requirements. To this end the OSC will:

- Focus compliance efforts on higher risk areas and potential abusive practices affecting investors.
- Strengthen the risk and results-based focus of its compliance work through better use of data and the refinement of risk assessment techniques.
- Identify through compliance efforts registrants and issuers whose operations or structures may pose risks to retail investors.
- Strive to modify market behaviour by using the full set of regulatory tools available to act against those who engage in activities adverse to investors' interests or to market integrity.
- Strive to reduce timelines for completing investigations and bringing regulatory proceedings forward.
- Improve the timeliness of adjudicative processes.
- Publicize the successful implementation of IFRS in our capital markets, specifically focusing compliance efforts on affected capital market participants.
- Improve communication and collaboration among domestic and international enforcement agencies.

3. Modernize our Regulatory Systems and Approaches

- Respond to emerging issues and trends in product development, distribution models, trading programs and market structures; and
- Monitor developments among international regulators while adapting their principles and programs as needed for Ontario and Canadian markets.

Market quality and investor confidence are key outcomes for the OSC. The OSC strives to identify the important issues and deal with them in a timely way. The OSC must continue to discourage or pre-empt regulatory arbitrage, maintain market confidence, reduce financial crime and safeguard investors.

The global financial environment is dynamic and will continue to evolve. The OSC needs to ensure that regulatory risks and consequences that arise as products and market structures change (e.g. new technology, new market participants), are assessed and mitigated. Key steps in this process will include:

- Re-assessing current regulatory approaches to determine any changes necessary to improve fairness and protection for investors.
- Continuing to develop regulatory approaches focussed on risk-based tools and measurable results.
- Focusing on systemic risk with greater participation in the international arena and more interaction with other Canadian financial services regulators in Canada, such as OSFI and the Bank of Canada.
- Continuing to work with international regulators to develop an international regulatory agenda that works for Canada.

Proactive regulatory responses that are “risk oriented” are needed to maintain confidence in the markets. As part of accomplishing this goal the OSC should:

- Implement a regulatory framework for OTC derivatives including new rules specifically designed to implement the G20 commitments. The framework should bring OTC derivatives within the scope of existing insider-trading offences.
- Develop rules to provide non-exempt investors with a risk disclosure document.
- Review and develop an appropriate regulatory approach, through recognition or exemption, for OTC derivative clearing houses operating in Ontario.

4. Pursue a Coordinated Approach to Securities Regulation

- By supporting the development of a Canadian Securities Regulator.
- By collaborating in the harmonization and modernization of regulation in Canada through the CSA while representing the interests of Ontario investors.

The evolution of the capital markets reinforces our belief that the OSC must improve its system of regulation by supporting the implementation of a Canadian Securities Regulator. Capital markets extend across provincial boundaries and are important to the economy of Canada. Their effective regulation demands a national approach to deal with national issues such as the regulation of derivatives and the coordination with other Canada-wide regulation in the broader financial services sector in addressing systemic risk. To reflect the reality of Canadian capital markets, the Canadian Securities Regulator should be based in Canada's financial capital, Toronto. This will recognize the importance of Ontario's markets in the context of Canada's capital markets and utilize the expertise of OSC staff.

The OSC will continue to support the Ontario Government, the Canadian Securities Transition Office (CSTO) and participating provincial regulators to make this happen. The OSC expects the CSTO to request more of its resources to support this initiative as it proceeds. The OSC remains committed to working with the CSA to promote the protection of retail investors and the quality and integrity of Canada's capital markets. The OSC will find a way to do this. In some instances this may mean encouraging its CSA colleagues to take on the development of initiatives that are not a priority for Ontario capital markets.

Through this transition period, the OSC will also coordinate with other Canadian regulators to monitor system-wide issues and ensure consistent regulatory coverage. The OSC will work with other sector regulators, such as the OSFI and the Bank of Canada, to create coordinated responses to address regulatory issues as they emerge.

5. Demonstrate Accountability for its Performance as a Leading Securities Regulator in Canada by:

- Identifying specific outcomes and related rationale;
- Developing clear reporting on its progress in achieving the results the OSC will pursue; and
- Prudently managing its limited resources.

As the CSTO works toward a national regulator the OSC will continue to pursue its mandate and will continue efforts to improve its organizational performance. As a leading regulator, the OSC will strive to protect Ontario's investors and capital markets as it moves towards creation of a national regulator and beyond. Throughout this period the OSC will become a more capable organization. The OSC will:

- Communicate its agenda and the results it expects to achieve more clearly.
- Improve its visibility by being more externally focused in its actions and communications.
- Increase its reliance on data and facts when developing policy and operational solutions to achieve measurable results that clearly support its actions.
- Monitor and improve the efficiency and effectiveness of its operations to provide cost-effective regulation.

2011-12 Outlook

OSC Revenues and Surplus

Overall, the OSC is forecasting revenues to increase by 10.1% from 2010-11 actual revenues, primarily due to the higher fee rates noted earlier. Even with these fee increases and consistent with its plan to reduce its surplus (as outlined earlier), the OSC expects to operate at a deficit in 2011-12.

2011-12 Budget Approach

In developing the 2011-12 budget, the OSC continued to balance the need for restraint with its need to move forward on initiatives which are necessary to achieve its mandate of providing protection to investors and fostering fair and efficient capital markets.

	2010-11	2010-11	2011-12	2011-12 Budget to 2010-11 Budget		2011-12 Budget to 2010-11 Actual	
($000's)	Budget	Actual	Budget	$$$ Change	% Change	$$$ Change	% Change
Revenues	69,496	72,955	80,287	10,791	**15.5**	7,332	**10.1**
Expenses	86,740	84,047	90,706	3,966	**4.6**	6,659	**7.9**
Deficiency of Revenue compared with Expenses	(17,244)	(11,092)	(10,419)	6,825		673	
Capital Expenditures	1,401	1,321	2,396	995	**71.0**	1,075	**81.4**

The 2011-12 budget increase includes investments in a number of strategic initiatives. While these initiatives will be staffed in part by a re-allocation of existing resources, the scope of the initiatives is such that more resources will be needed and are reflected in the budget.

The 2011-12 budget includes money for new staff and consulting resources to deal with market structure issues that are increasing both in number and complexity. Additional funding is also allocated to build out the new group focused on the regulation of OTC derivatives. These initiatives are consistent with the regulatory results the OSC is seeking.

The OSC is committed to becoming a 21st century regulator. As a first step consulting resources have been committed to complete a comprehensive strategic plan. The plan will provide a roadmap for future operational priorities and investments. To be a 21st century regulator, the OSC also needs to attract, retain and motivate staff with the required skills and experience. Skilled staff are increasingly important resources. The OSC believes that becoming a leading employer will help it attract skilled staff. Therefore, resources have been allocated to develop a talent strategy so as to create the appropriate organizational structure and development environment.

The budget reflects a projected increase of $6.6 million or 7.9% over 2010-11 spending and 4.6% above the 2010-11 budget. The level of the proposed increase is consistent with that being sought by regulators in other jurisdictions. Salaries and benefits, which comprise $69.9 million or 77.1% of the budget, reflect an increase of $4.0 million or 5.6% over 2010-11 spending. The average annual increase for staff was 1.9%. The increase in salaries and benefits cost reflects the full-year costs for staff hired during 2010-11 and higher health benefit costs. Eleven new positions were approved to achieve the strategic initiatives set out above. More resources were allocated to support OSC Commissioners and improve the timeliness of our adjudicative processes. Additional staff was added to support our new directions and approaches to enforcement and compliance. Our goal is to pursue meaningful cases that have a strong deterrent effect on those tempted to contravene securities legislation.

The significant increase in the capital budget reflects the replacement of personal computers and laptops as the bulk of the OSC's computer leases end in 2011-12 and must be replaced.

ONTARIO SECURITIES COMMISSION

Statement of Priorities

for fiscal 2011-2012

www.osc.gov.on.ca

Ontario

As the regulatory body responsible for overseeing the capital markets in Ontario, the Ontario Securities Commission administers and enforces the provincial Securities Act, the provincial Commodity Futures Act and administers certain provisions of the provincial Business Corporations Act. The OSC is a self-funded Crown corporation accountable to the Ontario Legislature through the Minister of Finance.