

**Objectives, Outcomes and
Performance Measures in Securities Regulation**

A Research Study for the
Expert Panel on Securities Regulation in Canada

Larry P. Schwartz

Objectives, Outcomes and Performance Measures in Securities Regulation

Biography

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Larry Schwartz is an economist and consultant specializing in financial-sector policy and regulatory issues and competition policy. He prepared the paper on cost-benefit analysis for the recent Investment Dealers Association of Canada Task Force on the Modernization of Canadian Securities Legislation.

With previous experience in corporate lending and securities underwriting, he was a policy advisor in the Chair's Office at the Ontario Securities Commission 1985-87, and has since consulted to Finance Canada (interdealer bond brokerage), the OSC (bought deals, soft-dollars), the Canadian Bankers Association, Bank-owned dealers (connected issuer rules), The Investment Funds Institute of Canada and The Toronto Stock Exchange. He participated in World Bank financial-sector development missions to Uganda, Tanzania and Pakistan.

As the full-time lay member of the federal Competition Tribunal 1998-2003, he adjudicated cases of merger and abuse of dominance under the Competition Act, and drafted the decision of the Tribunal in the landmark "Propane" merger case.

He teaches finance at the Schulich School of Business, York University and is a frequent writer and speaker on competition policy and capital markets issues. Mr. Schwartz earned the PhD, at the Wharton School, University of Pennsylvania and his B.A at the University of Toronto.

Executive Summary

The Expert Panel on Securities Regulation is charged with advising federal and provincial finance ministers on global best practices in securities regulation that advance the Government of Canada's plan for capital markets as set out in "Creating a Canadian Advantage in Global Capital Markets". This study for the Expert Panel concerns the development of a framework for establishing goals, objectives and performance measurement in securities regulation.

The approach taken here is to identify elements of a desirable framework and then to examine the practices of securities regulators in Canada and abroad and to suggest where these practices might be strengthened so as to advance the goals of securities regulation. By framework is meant the extent to which regulators articulate goals and objectives, measure their performance in achieving them, and disseminate their results. All securities regulators operate within such a framework to a greater or lesser extent.

The articulation of goals and objectives, whether in statute or in the regulator's own statement of its mission, is important because, while capital markets have changed very dramatically in recent years, the traditional goals of securities regulation have become diffuse and perhaps outdated. Thus, the classic focus on investor protection is now commonly viewed through the lens of market efficiency and proportionate regulation even if the basic securities laws have not changed. In addition, there is increasing interest in how securities regulation interacts with other elements of economic policy and regional development. An important question arises whether regulation ought to be more directly concerned with financial system stability.

Correspondingly, there is a question about how regulators assess their performance. The literature suggests that regulatory bodies typically measure their performance with reference to activity levels. However, the framework concern is with "output", the extent to which agencies are meeting and advancing their goals. This focus calls for the adoption of performance measures that are measurable and widely disseminated to policymakers, investors and the public at large.

The U.K. Financial Services Authority appears to be the leading financial regulator in terms of its fully-developed framework. As an integrated regulator with broad responsibility for the financial services sector, it has a statutory mandate that specifies market confidence, public awareness, consumer protection and the reduction of financial crime. It has also articulated "Principles of Good Regulation" that include economic efficiency, proportionality of restrictions on industry, and competition within the sector, inter alia.

To measure its attainment of these goals and objectives, FSA measures its performance in three areas: promoting efficient markets, helping consumers to get a fair deal, and improving its internal effectiveness. In its annual "Performance Account", FSA reports various measures of the extent of its performance in these areas. FSA has also developed

64 service standards and provides statistical account of its progress in meeting those standards.

A similar, but less well-developed approach has been adopted by the Australian Securities Commission, largely in response to government policy which seeks to improve the governance, transparency and accountability of independent agencies and to attain better balance between market efficiency and investor protection. Accordingly, the Commission has instituted service standards and identified key performance indicators, the latter appearing to focus on activity levels and input measures. It is also apparent that there is some conflict between the regulator and the government on fundamental issues of goals and performance measurement.

In Canada, the Office of the Superintendent of Financial Institutions faces specific Treasury Board reporting requirements as well as a modern statutory framework that recognizes the benefits of competition and risk-taking among regulated financial institutions. OSFI measures its effectiveness by means of regular surveys, but in other respects it is required to report progress against implementation priorities. Thus, it reports on the extent to which it has acquired the identified input capacity (i.e. in order to better assess risk) rather than the output capacity itself (measures of risk). Performance measurement within OSFI is conceptually difficult because its statute makes clear that its performance is not to be assessed in light of financial institution failure.

Among the three provincial securities regulators studied, the British Columbia Securities Commission has established the most comprehensive framework of performance measurement. Although recently instituted, it specifies clear goals and objectives and seeks to identify quantifiable measures of the results of its regulatory interventions.

The statutory framework in Ontario is specific, not only with respect to fundamental goals (investor protection, market efficiency), but also regarding principles including proportionate regulation. It is the only province with cost-benefit analysis requirements in rule-making. However, its performance measurement is quite limited.

The Québec regulator is responsible for securities, insurance, non-bank deposit-taking institutions and market intermediaries generally. It has undertaken enhanced monitoring in support of the detailed statutory expression of goals and objectives, but it tends to measure its level of activity (e.g. number of inspections and investigations) rather than the extent to which progress toward the attainment of those goals and objectives has been achieved. The Investment Industry Regulatory Organization, the self-regulatory body takes the same approach, although its measure of industry risk is an output measure.

The IOSCO framework is somewhat narrow when compared with the various goals pursued by Canadian securities regulators who, by and large, do not accord its focus on investor protection the same priority. However, none of the Canadian regulators have adopted the goal of financial system stability that is one of IOSCO's three "core principles".

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Introduction

The Expert Panel on Securities Regulation is charged with advising federal and provincial finance ministers on global best practices that advance the Government of Canada's plan for capital markets as set out in "Creating a Canadian Advantage in Global Capital Markets".

Among the areas of the Expert Panel's review and advice are the objectives, outcomes and performance measures that will best anchor securities regulation and the pursuit of a Canadian advantage in global capital markets. These may include

- Efficient and competitive capital markets that contribute to economic growth and prosperity
- Market integrity and the protection of investors
- The reduction of systemic risk

To assist the Expert Panel in this part of its mandate, this report examines the goals of securities regulation in Canada and abroad and the adoption of performance standards and measurement systems by securities regulators in order to identify a framework in which global best practices and opportunities to create a Canadian advantage can be identified.

1. Goals and Objectives: Why are they important?

It is apparent that securities market activity has grown significantly in all of the developed and emerging economies. This growth stems from fundamental changes in technology and in society at large and is reflected in the disintermediation of savings through traditional financial institutions such as banks and insurance companies.

For many years now, individual investors have been accessing capital markets directly through brokers and dealers and portfolio managers including mutual funds and (defined contribution) pension funds, rather than putting their savings in bank accounts or insurance policies to be invested by the financial intermediaries for their own, rather than for the individuals', accounts. Correspondingly, businesses have turned increasingly to short-term commercial paper and medium and long-term bond markets in preference to banks to fund their operations.

These well-established shifts in market activity have resulted from growing economic efficiencies brought about through communications and computer technology that allow the very rapid dissemination of information and transaction-processing. Indeed, innovation within securities markets has been very dramatic as witnessed, for example, by the development of alternative trading systems that have arisen to challenge the dominance of the traditional stock exchange.

However, the regulatory environments have been slower to change. Many of the goals and objectives that currently drive securities regulation were established in response to

the Great Crash in 1929 which gave rise to the creation in the 1930's of the United States Securities and Exchange Commission and the Ontario Securities Commission. Thus, as late as the 1990's, Instinet Corp. was denied a license to operate in Ontario because the Commission felt that the public interest required it to "protect" the Toronto Stock Exchange from competition from new trading technologies.

Accordingly, new financial services, products and technologies face a regulatory regime that retains some of the foci and constraints that were instituted decades ago. Of course, securities regulators are well-aware of these developments but they are required to view them through the lens of statutes and regulatory history that emphasize the goals and objectives of earlier periods. As securities regulation in the various jurisdictions modernizes slowly, it is not surprising that some regimes secure the economic advantages of efficiency and innovation earlier than others.

The study begins with the premise that the statutory provisions that guide securities regulation are important even if they express general statements of purpose or intent. However, securities laws in several provinces are silent with respect to goals and objectives. To determine what path the regulator is following, it will be necessary to consult other sources of information, such as the regulator's own description of its mission. Indeed, even when the statutory regime indicates goals and objectives, the discretion granted to securities regulators means that the statutory framework may not be the sole source of information.

2. Principles for Performance Measurement

The mere adoption of modern goals and objectives in securities regulation would be insufficient. Even when accepted as legitimate, a goal (such as "enhanced investor protection" or "capital market efficiency") may be expressed at a very high level of generality and, despite high levels of activity directed towards its attainment, it may be unclear whether the goal is achieved or not.

The OECD observes that, traditionally,

regulatory agencies' performance and cost-effectiveness are managed and evaluated largely by reference to their level of activity, rather than the outcomes they accomplish. Valid measures of compliance rates and outcomes will give governments the capacity to evaluate regulatory agency performance by outcomes (*vis-à-vis* cost and activity), and to target agency resources towards where they are likely to be most effective.¹

Effective securities regulation requires some form of performance measurement that goes beyond activity levels. Policymakers, the public and regulators themselves would like to know to what extent the interventions are achieving the accepted goals and objectives.

¹ Organization for Economic Co-operation and Development. Reducing the Risk of Policy Failure: Challenges for Regulatory Compliance. 2000, at p. 51.

Thus, while performance measurement is desirable, it is often difficult to put into practice. Often the goals do not lend themselves to measurement; there is, for example, no single index of market efficiency that might be consulted. Where measures are available, they may be uninformative, as the OECD notes with respect to activity levels.

The following questions suggest generic principles that might be used, inter alia, to evaluate the success of the regulatory process:

- a. Is the regulator adopting the least-costly approach?
- b. Does the regulator consider alternate means of achieving the objective?
- c. Is the impact of the regulatory intervention measurable?
- d. When the regulator evaluates its performance, does it measure inputs (such as activity levels) or outputs?
- e. Is the performance measure by which the regulation is evaluated disclosed publicly?
- f. Does the problem at hand require direct regulatory intervention, or might it be resolved by the market? (i.e. regulate only where demonstrably needed?)
- g. Is there accountability and transparency in decision-making? (Is someone held accountable for achieving the desired outcome? Are there rewards for achieving and consequences for failure?)
- h. Does the public understand what the regulator is doing in clear terms?
- i. Do the regulated firm and personnel understand what the regulator is doing in clear terms?
- j. Are rules applied consistently across the country?
- k. Are the direct and indirect costs of regulation roughly similar to those in other jurisdictions?

Accordingly, this study will examine the goals and objectives adopted by securities and financial regulators in Canada and abroad, and will attempt to ascertain what principles and measurement efforts are guiding their efforts.

3. Elements of a Framework

A framework begins with an articulation of the goal or goals of securities regulation. These goals, such as investor protection, are typically stated at a high level of generality and reflect the common understanding of why the proposed regulatory regime is necessary.

To meet these goals, securities regulators must propose specific objectives in the form of regulations or rule changes. Thus, under the goal of protecting investors, the regulator might propose to improve the disclosure of financial information by issuers. This objective gives specific content to the goal assigned to the regulator.

After implementing the rule-change, the regulator seeks, whether formally or informally, to evaluate its impact on investor protection. This evaluation requires the regulator to identify the relevant measure of performance. For example, the regulator might evaluate

the effectiveness of the rule-change by the change in the number of complaints it receives from the investing public. This measure may not be unique; indeed it may not be a particularly good measure, but it has the desirable property that it is attainable at low cost.

Having collected the appropriate performance data and drawn conclusions about the effectiveness of the rule-change, the regulator then decides whether to publish the number of complaints of inadequate disclosure on a regular basis.

These steps constitute a complete framework of performance measurement. At any given time, the securities regulatory body has such a system in place, even if the data collection is perhaps anecdotal, the performance measure(s) not completely informative, and the dissemination of results limited.

As the regulator identifies objectives over time, it may become apparent that other, perhaps previously unstated, goals are also important. While the objective of improved financial disclosure is undoubted, the rule-change may impose significant costs of compliance on issuers that the regulator also takes seriously. Thus, it may be modified in light of the goal of “proportionate regulation” that the securities regulator has been mandated to consider, and new measures of performance will be required.

Thus, the framework becomes somewhat complex. Relevant goals may not be the ones in the statute; objectives may be limited by implicit goals, and performance measurement may be difficult to design and costly to assess. Nevertheless, all regulatory agencies have an understanding of the framework under which they operate; opportunities for improving the framework can be gleaned from observing how the agencies fulfill their mission.

4. Organization of the Report

The first part of the report reviews and documents the statutory goals and objectives and related performance standards and measurement efforts by the U.K.’s Financial Services Authority and Australia’s Securities and Investment Commission. The FSA has gone the furthest in defining and implementing formal performance measurement systems.

The second part of the report reviews and documents goals, objectives and performance measurement by Canada’s Office of the Superintendent of Financial Institutions. As part of the federal government, this agency has extensive reporting requirements that include performance measurement.

The third part of the report presents information on provincial securities regulators’ goals in, Ontario and Quebec, and British Columbia and attempts to determine how well they achieve them. What performance measures do they use? Do they have systems that accurately measure their progress? How do their efforts compare with other jurisdictions? As markets have evolved, are there gaps in their mandates?

The final section of the report contains suggestions for the framework for performance measurement, including goals, objectives and performance indicators that securities regulation should target.

Chapter 1

U.K. Financial Services Authority

1. General

The Financial Services Authority (“FSA”) is the main regulator for the UK financial services industry, covering both prudential and conduct-of-business regulation for banking, insurance and securities. An independent *non-governmental* body, its statutory powers are given by the Financial Services and Markets Act, 2000 (the “2000 Act”). The statutory goals of FSA and the detailed specification of performance standards and measurement processes make it a good model for other regulators.

2. Statutory Mandate

The 2000 Act sets out four statutory objectives that are supported by a set of principles of good regulation to which the FSA must have regard when discharging its functions.

(a) Statutory objectives:

- (1) Market confidence: maintaining confidence in the financial system
- (2) Public Awareness: promoting public understanding of the financial system
- (3) Consumer protection: securing the appropriate degree of protection for consumers; and
- (4) The reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

(b) Principles of Good Regulation

Further to section 2(3) of the Financial Services and Markets Act 2000, the FSA has enunciated certain principles to which it has regard in fulfilling its statutory mandate. These principles form the core of the FSA’s approach to implementing principles-based regulation:

- *Efficiency and economy: the need to use resources in the most efficient and economic way.*

The non-executive committee of the Board is required to oversee the allocation of resources and report to the Treasury every year. The Treasury is able to commission value-for-money reviews of our operations.

- *Role of management: the responsibilities of those who manage the affairs of authorized persons.*

A regulated firm’s senior management is responsible for its activities and for ensuring that its business complies with regulatory requirements. This principle is

designed to guard against unnecessary intrusion by the regulator into firms' business and requires FSA to hold senior management responsible for risk management and controls within firms.

- *Proportionality: The restrictions that FSA imposes on industry must be proportionate to the benefits that are expected to result from those restrictions.*

In making judgments in this area, FSA takes into account the costs to firms and consumers. One of the main techniques is cost-benefit analysis of proposed regulatory requirements. This approach is shown in the different regulatory requirements that apply to wholesale and retail markets.

- *Innovation: the desirability of facilitating innovation in connection with regulated activities.*

This involves allowing scope for different means of compliance so as not to unduly restrict market participants from launching new financial products and services

- *International character: the international character of financial services and markets and the desirability of maintaining the competitive position of the UK.*

The FSA takes into account the international aspects of much financial business and the competitive position of the UK. This involves co-operating with overseas regulators, both to agree international standards and to monitor global firms and markets effectively.

- *Competition: the need to minimize the adverse effects on competition that may arise from FSA activities and the desirability of facilitating competition between the firms it regulates.*

These principles cover avoiding unnecessary regulatory barriers to entry or business expansion. Competition and innovation considerations play a key role in the FSA's cost-benefit analysis work. Under the 2000 Act, the Treasury, the Office of Fair Trading and the Competition Commission review the impact of FSA rules and practices on competition.

3. Performance Standards

Having regard to the statutory framework and the detailed principles of good regulation, the FSA describes its general mandate under three strategic aims:

- Promoting efficient, orderly and fair markets;
- Helping retail consumers achieve a fair deal; and
- Improving its business capability and effectiveness

The FSA has established the Performance Account through which it provides stakeholders with detailed information about its performance. The Performance Account sets out how FSA measures its performance against its strategic aims.

In 2007, FSA published the Outcomes Performance Report that clearly aligns the objectives and regulatory principles in the 2000 Act with its strategic aims. As shown in Exhibit 1-1, three outcomes are linked to each of the three aims. The Outcomes Performance Report is a key tool in the FSA's drive to become more outcome-focused and principles-based.

The FSA intends that each outcome be tracked and measured on a regular basis, recognizing that some outcomes will be difficult to measure. The indicated outcomes in Exhibit 1-1 will be assessed as follows:

1. *Consumers receive and use clear, simple and relevant information from the industry and from FSA*

To be assessed using the Consumer Outcome Study (first report Autumn 2007)

2. *Consumers are capable and confident in exercising responsibility when dealing with the financial services industry*

A long-term outcome, assessed by means of the Financial Capability Survey every four to five years

3. *Financial services firms treat their customers fairly and so help them to meet their needs*

Addresses whether firms treat their customers fairly and whether consumers end up with suitable financial products and services. Tracked through the ARROW supervision framework, complaints data, thematic work (i.e. special studies), performance against Treating Customer Fairly ("TCF") embedding and other inputs described in the annual TCF performance report (first published November 2007)

4. *Firms are financially sound and well managed*

Assessed by ARROW risk assessment and the internal Alert and Risk Indicator to understand financial soundness and management of smaller firms; informed by regulatory returns

5. *Firms and other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime and arising from market conduct*

This is assessed using the Financial Crime Survey of firms, the Consumer Awareness Survey, and market cleanliness measures. Market cleanliness is reflected in the

extent to which ‘informed price movements’ are observed ahead of significant regulatory announcements by issuers.

6. *Financial markets are efficient, resilient and internationally attractive*

Efficiency is measured through a series of wholesale and retail measures and the efficiency of the UK Listing Authority. Resilience is measured through the Resilience Benchmarking Project. International attractiveness is gauged through a number of surveys assessing London’s relative position as an international financial centre and through its share of financial activities such as initial public offerings.

7. *The FSA is professional, fair, efficient and easy to do business with*

Assessed by the two-yearly Practitioner Panel survey, external Service Standards, and internal customer satisfaction surveys of regulatory processes. Fairness tracked by feedback in the Enforcement Performance Account.

8. *The FSA is effective in identifying and managing risks to its statutory objectives*

Based on survey of what relationship-managed firms think about FSA supervision

9. *The costs and benefits of regulation are proportionate*

The “Cost of Regulation” study with Deloitte and the “Administrative Burdens” report have provided details on where FSA should focus its efforts to reduce costs. FSA is looking at more studies to improve its ability to track cost, benefit and proportionality

Two areas of the Performance Account that have been subject to well-defined statistical measurement are Service Standards and Enforcement Performance.

4. Service Standards

The Performance Account includes reports on FSA’s performance in meeting service standards that it has adopted. Most standards are voluntary commitments (e.g. dealing with inquiries from the public) but others are statutory deadlines (e.g. filing deadlines) that apply to all applications.

Standards have been established in the following service areas²:

- Authorization (licensing/registration)
e.g. A1.1 to process 100% of complete applications for corporate authorization within 6 or 12 months of receipt; 75% within 3 months of receipt
- Regulatory decisions

² FSA. “Currently applicable standards”, available at <http://www.fsa.gov.uk/Pages/About/Aims/Performance/standards/index.shtml>

- e.g. R2.1 to consider 100% of notices of a proposed alteration to a Collective Investment Scheme and, if appropriate, issue a warning notice, within 1 month
- Complaints about the FSA
e.g. C1.2 Stage 1: to acknowledge 100% of complaints and send a leaflet explaining how the Complaints Scheme works and the right to ask for a stage two investigation, within 5 working days
 - Listing
e.g. L1.1 to process 100% of applications for listing within 6 months of receipt
 - Notifications
e.g. N1.1 to process 100% of complete notifications for Appointed Representative status within 5 working days of receipt
 - Communications
e.g. CM1.1 to provide a substantive response to 90% of letters, emails, or faxes received by the Firm Contact Centre, FSA Relationship Manager, or relating to certain types of questions about fees, within 12 working days of receipt

The list of current standards is provided in Exhibit 1-2.

The Performance Account reviews the 64 service standards that were in place between October 1, 2007 and March 31, 2008.³ During this time, there were no transactions for four of the 64 standards.

For the 60 standards where transactions did occur, FSA met 49 (or 81.7%) and did not meet 11 (18.3%). FSA notes that of the eleven unmet standards, nine have targets of 100% meaning that a delay in any single case may result in a missed standard. FSA also notes that its performance was over 96% in such standards.

Exhibit 1-3 shows FSA's performance against prevailing service standards over the last four years. Note that because new standards are introduced and some are deleted over time, the year-to-year results are not completely comparable. The results in the latest reporting period, October 2007 to March 2008, show a decrease in performance compared to the previous period. However, there were no missed standards below 90% of the target.

FSA makes clear that, given a choice between meeting a standard and taking more time to make the right decision, it will take more time.

³ FSA. "Latest results", available at <http://www.fsa.gov.uk/Pages/About/Aims/Performance/standards/latest/index.shtml>

5. Enforcement Performance Account

FSA considers the effectiveness of enforcement on a regular basis through measurement and reporting on performance. It produces an annual performance account of the fairness and effectiveness of its enforcement activity and publishes statistics thereon in its annual report.

FSA views enforcement action as one of several instruments that it can use in achieving its statutory objectives:

Our approach is to achieve credible deterrence through our enforcement work. We focus on those cases where we think we can make a real difference to consumers and markets, using enforcement strategically as a tool to change behaviour in the industry. To achieve credible deterrence, wrongdoers must realise that they face a real and tangible risk of being held to account and expect a significant penalty. This applies across the spectrum, from our work to prevent market abuse, to our work helping to ensure that customers are treated fairly.⁴

FSA brings enforcement actions on violations of both its Principles and its rules, the former having the status of the latter. FSA views its enforcement policy as an important component in its move toward principles-based regulation:

Most enforcement actions in the last financial year were based on Principles only or a combination of Principles and rules. Of 48 disciplinary cases, 21 (44%) were based on Principles and almost all of the remaining cases were a combination of Principles and rules. This demonstrates the continued alignment of enforcement with the move towards principles-based regulation. Our Principles have the status of rules and we will continue to take action where they are breached. Our new Enforcement Guide, which was adopted on 28 August 2007, makes clear that we acknowledge that firms may comply with the Principles in different ways and that we will not take enforcement action unless it was possible to determine at the relevant time that the conduct fell short of our requirements. We will apply the standards required by the Principles at the time the conduct took place and not later, higher standards. However, where conduct falls below the standards we require, we may take action even if the conduct is widespread within the industry.⁵

The FSA's statistical report on enforcement activities for the period 2007/08 is contained in its annual report.⁶

In light of FSA's approach to enforcement, it is apparent that the statistics must be placed in context. Since, as FSA indicates, enforcement is a relatively small part of its work, a high number of cases opened need not be a good indicator of its effectiveness.

6. General Observations

⁴ Financial Services Authority. Enforcement annual performance account 2007/08, at para. 8.
http://www.fsa.gov.uk/pubs/annual/ar07_08/Enforcement_report.pdf

⁵ *ibid.* at para. 10.

⁶ Financial Services Authority. "Enforcement activity 2007/08". Appendix 5, Annual Report 2007/08. (available at http://www.fsa.gov.uk/pages/Library/corporate/Annual/ar07_08.shtml)

It is apparent that FSA has devoted considerable effort to translating its statutory directives into clearly-articulated operational objectives, strategic aims and outcomes. In addition, it has established a measurement system that enables it to assess the extent to which it has attained those outcomes.

As to goals and objectives, it is noteworthy that the traditional goal of “investor protection” is discussed in terms that are concrete: clear information provided to customers, confident customer capability, and fair treatment by firms. This attempt to “flesh out” what it means by investor protection may be a reaction to the tendency to justify all regulatory interventions on the basis of an ill-defined objective that, once invoked, cannot be challenged.

It is also noteworthy that the FSA’s “economic” objectives give effect, not only to the statutory objective of efficient markets, but also to competitive conditions in financial services. FSA clearly seeks to maintain London’s pre-eminent position as an international financial centre, even though it faces no explicit statutory requirement to do so. This concern with industry competitiveness is expressed in terms of “proportionate regulation”, service standards, and keeping U.K. markets “internationally attractive”. The significance of its competitiveness objective may be the reason why FSA has devoted so much effort to cost-benefit analysis in analyzing proposed regulatory interventions.

These broader economic objectives are likely related to the growth of the financial services sector in the European Union and to the competitive efforts among the Member States to attract companies to their own financial centres. In this regard, it should also be noted that as an integrated regulator, FSA is attractive to foreign firms operating in different financial industries. Such firms will face one regulator with similar policy objectives across the financial services that it regulates.

It may also be noted that neither FSA’s statute nor its various interpretations thereof make reference to international financial market stability. This omission is surprising in light of London’s stature as an international financial centre, and may result from the fact that FSA is a non-governmental body. Thus, there may be an implicit understanding that financial stability issues are beyond its capability to influence, and fall within the domains of the Bank of England and the Treasury.

From a measurement perspective, FSA accepts that its performance should be based on outputs that are measurable. While it maintains and reports statistics on its activities, these statistics relate less directly to its statutory and self-imposed goals and objectives.

It is also noteworthy that FSA publishes its performance measures. The “Performance Account” appears to be a unique development.

Although measurement is a clear concern for FSA, it is interesting that it makes use mainly of surveys. Apparently, FSA does not assess economic objectives directly. For example, one might have thought that FSA would undertake regular studies of the extent

to which stock prices reflect publicly available information. Such information could be extremely valuable in assessing concerns about capital market efficiency, “insider information” and discounts on initial public offerings.

Similarly, FSA does not explicitly report on the success of its efforts to enhance the international competitiveness of the London market. However, this may reflect a political sensitivity within the European Union.

It may also be pointed out that the FSA’s efforts in performance measurement appear to require a significant budgetary expense and claim on management time and resources.

Exhibit 1-1: Operational Performance Report

OPR summary

FSMA objectives and Principles of Good Regulation	Strategic Aim	Outcome
Consumer protection Public awareness	Help retail consumers achieve a fair deal	1. Consumers receive and use clear, simple and relevant information from the financial services industry and the FSA. 2. Consumers are capable and confident in dealing with the financial services industry. 3. Financial services firms treat their customers fairly and thereby help them meet their needs.
Market Confidence Financial Crime	Promote orderly, efficient and fair markets	4. Firms are financially sound and well managed. 5. Firms and other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime and arising from market conduct. 6. Financial markets are efficient, resilient, fair and easy to do business with.
Principles of Good Regulation: Economic and Efficient; Innovation; Proportionality; International character; Senior management responsibility; Competition (two principles)	Improve our business capability and effectiveness	7. The FSA is professional, efficient, fair and easy to do business with. 8. The FSA is effective at identifying and managing risk. 9. The costs and benefits of the regulatory regime are proportionate.

Exhibit 1-2: Current Performance Standards

We are constantly seeking to improve our performance so our service standards are regularly reviewed to ensure they are appropriate and challenging.

List of current standards

The following table lists all of the service standards that apply from 1 April 2008.

For a more detailed explanation of what a given standard means, click on its ID.

<u>Authorisation</u>		
	Standard	Target
A1.1	To process a complete application for corporate authorisation	100% within 6 or 12 months of receipt
		75% within 3 months of receipt
A1.2	To process Money Laundering registrations (2)	100% within 45 days of receipt of application or receipt of any further required information
A2.1	To process applications for the authorisation of new schemes under section 242 for Authorised Unit Trusts (AUT) and Regulation 12 for Open Ended Investment Companies (OEIC) (1)	100% within the earlier of 12 months from receipt or 6 months from being deemed complete
A3.1	To process applications under s242 for the authorisation of Unit Trust Schemes and under Regulation 12 of The Open Ended Investment Companies Regulations 2001 for authorisation of an OEIC	75% within 6 weeks of receipt
A5.1	To consider whether an EEA UCITS scheme that has given a notice to the FSA of its intention to invite UK persons to invest will be compliant with UK law and, where not, to issue a notice to that effect	100% within 2 months of receipt
A6.1	To consider notifications for recognition from schemes authorised in Table 5-2 (con't)	100% within 2 months of receipt
	designated countries or territories and, if appropriate, issue a warning notice	

A8.1	To process a complete registration application from a Mutual Society	90% within 15 working days of receipt
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Regulatory decisions

	Standard	Target
R1.1	To process an application for approved person status	100% within 3 months of receipt unless attached to an application for Part IV Permission 85% within 2, 4 or 7 working days
R2.1	To consider notice of a proposed alteration to a Collective Investment Scheme and, if appropriate, issue a warning notice	100% within 1 month
R5.1	To process an application from an authorised firm for Variation of Permission	100% within 6 months of becoming complete or 12 months of receipt
R5.2	To process a complete application from an authorised firm for Variation of Permission	70% within 2 months of application becoming complete
R6.1	To make a decision following receipt of a 'valid' notification to approve a change in control	100% within 3 months of receipt
R7.1	To give waiver decisions for an application which includes sufficient information	90% within 20 working days of receipt 100% within the earlier of 1) 6 months of application becoming complete (if an application is received complete) or 2) 12 months of the application first being received by the FSA
R8.1	To determine applications for Cancellation of Part IV Permission	80% within 3 months of receipt (2)
R9.1	To respond to requests from EEA or Swiss regulators in respect of insurance business	100% within 3 months of receipt

	transfers outside the UK	
R10.1	To consent to, or refuse, changes to branch details for a branch established by a UK firm exercising its EEA rights	100% within 1 month of notification
R10.2	To consent to, or refuse, changes to relevant details for a UK firm which is providing services in exercise of an EEA right	100% within 1 month of notification

Complaints about the FSA

	Standard	Target
C1.1	Fast Track: To complete the investigation and respond to the complainant and send a leaflet explaining how the Complaints Scheme works and the right to ask for a stage one investigation	100% within 5 working days
C1.2	Stage 1: To acknowledge a complaint and send a leaflet explaining how the Complaints Scheme works and the right to ask for a stage two investigation	100% within 5 working days
C1.3	Stage 1: To notify the complainant if the complaint will not be admitted to the Scheme at stage one	100% within 4 weeks
C1.4	Complete a stage one investigation and write to the complainant with results of the complaint or write to the complainant to set out a reasonable timescale within which the FSA plans to deal with the complaint	100% within 4 weeks

- Listing

	Standard	Target
L1.1	To process an application for listing	100% within 6 months of receipt
L2.1	To comment on the initial proof of a document submitted for pre-vetting by a new applicant for listing	95% within 10 days of receipt 100% within 10 days of receipt
L2.2	To comment on the initial proof of a document submitted for pre-vetting by an issuer already	95% within 5 days of receipt

	listed	100% within 5 days of receipt
L2.3	To comment on subsequent proofs of documents submitted for pre-vetting	95% within 5 days of receipt 100% within 5 days of receipt
L3.1	To reply to a complaint about a listed company	95% within 5 working days of receipt 100% within 5 working days of receipt

Notifications

	Standard	Target
N1.1	To process a complete notification for Appointed Representative status	100% within 5 working days of receipt
N2.1	To process a complete post-event notification to change the FSA's static data on a regulated firm	95% within 5 working days of receipt
N2.2	To process a complete pre-event notification to change the FSA's static data on a regulated firm	95% on or before the date requested by the firm
N3.1	To notify the firm of the applicable provisions if they are an EEA firm wanting to establish a branch in the UK	100% within 2 months of receipt
N3.2	To notify the firm of the applicable provisions if they are an EEA firm wanting to provide services in the UK	100% within 2 months of receipt
N4.1	To inform the firm if a consent notice will not be issued for a UK firm wanting to establish a branch in the EEA	100% within 3 months of receipt
N5.1	To provide a copy of the notice of intention to the host state regulator if a UK firm expresses the intention to provide cross-border services in an EEA country	100% within 1 month

Communications

	Standard	Target
<u>CM1.1</u>	To provide a substantive response to letters, emails or faxes received by the Firm Contact Centre, FSA Relationship Manager, or relating to certain types of questions about fees	90% within 12 working days of receipt
<u>CM1.2</u>	To provide a draft letter of our findings and recommendations following an "ARROW" discovery visit to a firm	70% within 10 weeks for a Full ARROW assessment/Light ARROW plus Capital assessment or 6 weeks for a Light ARROW assessment
<u>CM2.1</u>	To provide a substantive response to correspondence received by the Consumer Contact Centre	90% within 12 working days of receipt
<u>CM2.2</u>	To meet requests received through the automated consumer leaflet request telephone lines	95% within 5 working days of receipt
<u>CM2.3</u>	The telephone call abandonment rate for calls made directly to the Consumer Contact Centre	Not more than 5%
<u>CM2.4</u>	To answer telephone calls made directly to the Consumer Contact Centre	80% within 20 seconds
<u>CM3.1</u>	The telephone call abandonment rate for calls made directly to the Firm Contact Centre	Not more than 5%
<u>CM3.2</u>	To answer telephone calls made directly to the Firm Contact Centre	80% within 20 seconds
<u>CM4.1</u>	To process simple oral queries relating to the Code of Market Conduct	90% within 24 hours
<u>CM4.2</u>	To process complex queries relating to the Code of Market Conduct	100% within a timeframe consistent with the enquirer's requirements
<u>CM4.3</u>	To consult on relevant documentation	To inform the industry in 100% of cases where the consultation period is less than 3 months

CM5.1	To provide a substantive reply to MPs' letters	80% within 30 working days 100% within 60 working days
CM6.1	To reply to 'right to know' requests for information made under the Freedom of Information Act 2000	100% within 20 working days of receipt (unless public interest extension applies)
CM7.1	To reply to requests for information made under the Data Protection Act 1998	100% within 40 working days of receipt
CM10.1	To pay correct invoices received from suppliers	90% within 30 working days of receipt of a correct invoice
CM11.4	To ensure availability of customer facing IS systems (2)	98.5% availability of the systems (currently measured Monday to Friday, 7am to 8pm, UK time)

(1) This is a new definition that came into effect on 1 April 2008.

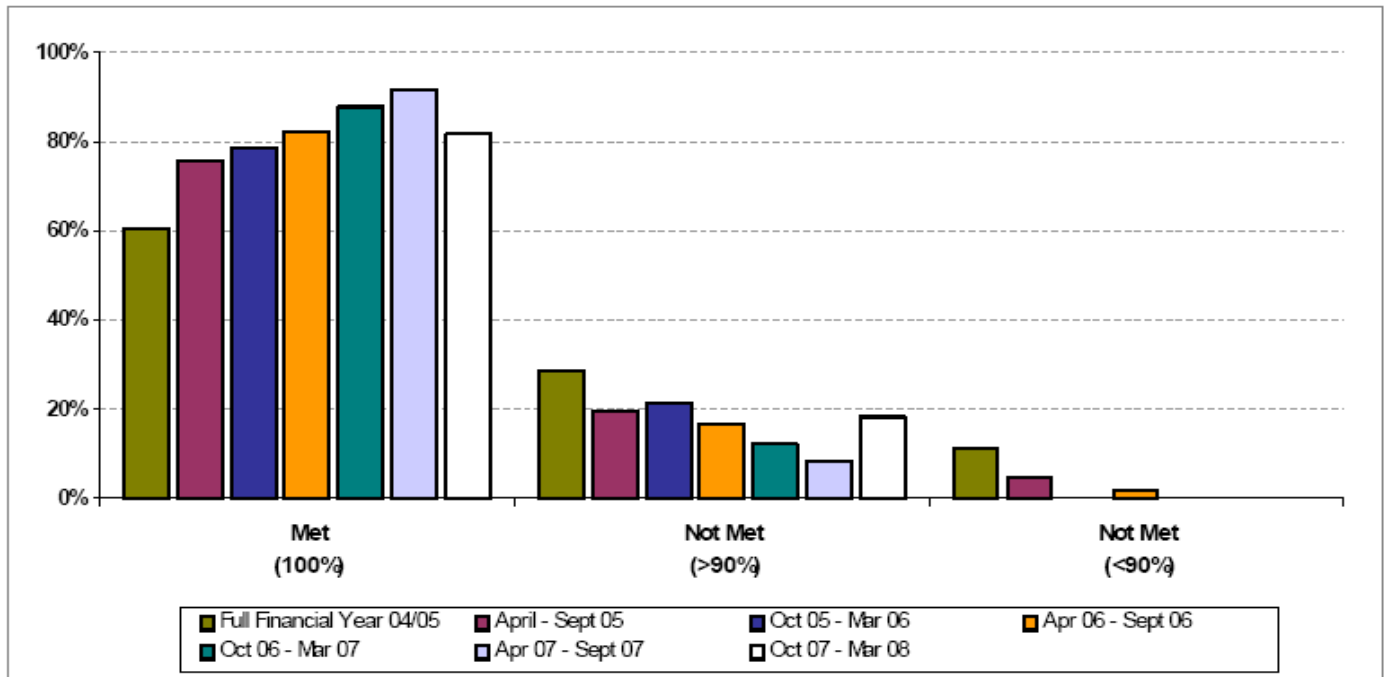
(2) This is a new standard that came into effect on 1 April 2008.

Exhibit 1-3: Service Performance over Time

Service Standards



Performance against our service standards



Chapter 2

Australian Securities and Investment Commission

1. General

The experience with goal, objectives and performance measurement in Australia is of interest to Canada because of similarities in the economies of the two countries, the federal structure, and the concern with economic aspects of securities regulation.

In addition, the Australian situation may be of interest because the national securities regulator began operating in 1991, replacing the National Companies and Securities Commission (NCSC) and the Corporate Affairs offices of the states and territories.

The Australian Securities and Investment Commission (“ASIC”), established on 1 July 1998, is now an integrated regulator, responsible for consumer protection in superannuation, insurance, deposit taking and credit, resulting from the recommendations of the Financial System Inquiry. The Inquiry had found that financial system regulation was piecemeal and varied, and was determined according to the particular industry and the product being provided. This was seen as inefficient, as giving rise to opportunities for regulatory arbitrage, and in some cases leading to regulatory overlap and confusion.

However, there has been some tension over basic goals and objectives of securities regulation between the ASIC and the government.

2. Statutory Mandate

The responsibilities of ASIC in performing its functions and exercising its powers are set out in the ASIC Act (2001)⁷, which provides that ASIC must “strive” to:

- (a) Maintain, facilitate and improve the performance of the financial system and the entities within that system in the interests of commercial certainty, reducing business costs, and the efficiency and development of the economy; and
- (b) Promote the confident and informed participation of investors and consumers in the financial system, and
- (c) Administer the laws that confer functions and powers on it effectively and with a minimum of procedural requirements, and
- (d) Receive, process and store, efficiently and quickly, the information given to ASIC under the laws that confer functions and powers on it; and

⁷ Source:

[http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/2C65E906B4D3CD17CA25747800145C48/\\$file/AusSecInvCom2001_WD02.pdf](http://www.comlaw.gov.au/ComLaw/Legislation/ActCompilation1.nsf/0/2C65E906B4D3CD17CA25747800145C48/$file/AusSecInvCom2001_WD02.pdf)

- (e) Ensure that information is available as soon as practicable for access by the public; and
- (f) Take whatever action it can take, and is necessary, in order to enforce and give effect to the laws of the Commonwealth that confer functions and powers on it.

It is noteworthy that the statutory objects of the ASIC give prominence to the economic objectives relating to financial system performance, reducing regulatory burden, and economic efficiency and development.

The second statutory object addresses the investor protection objective, but is limited to promoting participation by confident and informed investors.

3. Service Standards

The ASIC Service Charter sets out how the ASIC serves its clientele, what they can expect and how they may facilitate ASIC assistance in all matters save surveillance and enforcement.

Exhibit 2-1 identifies the various service dimensions for handling inquiries from the public, the goal for response time to each, and its record of meeting these services goals in the fiscal year 2006-2007.

4. Key Performance Indicators

On February 20, 2007, the Treasurer issued the Government's Statement of Expectations for the ASIC. The Statement results from a recommendation in the Review of Corporate Governance of Statutory Authorities and Office Holders that identified ways in which the governance of Commonwealth "portfolio bodies" may be improved, transparency and accountability increased, and clear relationships between different arms of Government be established.

The Government's Statement also forms part of the response to the Report of the Taskforce on Reducing Regulatory Burden on Business. That Report proposed that the Government provide specific guidance to ASIC about the appropriate balance between pursuing safety and investor protection, and market efficiency. As a result of the Report's recommendations, the Treasurer proposed that ASIC develop, inter alia, principles-based regulation, produce key performance indicators, pay greater attention to Government policy directions and objectives, and cooperate with other economic regulators.

The development of key performance indicators is noteworthy. The Report had recommended that ASIC develop indicators in addition to existing safety measures, having regard to all of its statutory objectives, including efficiency and business costs.

The Report also recommended that any indicators should be reported in the ASIC's annual report and should be accompanied by guidance in their interpretation, particularly where outcomes may be influenced by factors outside ASIC's control.

The Treasurer indicated that as an initial priority ASIC should develop indicators for:

- Costs for business of complying with ASIC's supervisory regimes
- Levels of stakeholder satisfaction with ASIC's services, and
- Time taken for provision of guidance by ASIC about regulatory obligations in areas where concerns have been raised.

The Treasurer further stated that indicators of the broader economic impact of ASIC's supervisory conduct should be developed over the longer term.

In its response to the Treasurer's Statement of Expectations, ASIC acknowledged the need for more comprehensive performance indicators covering all its statutory objectives, including efficiency and business costs. It cautioned that it would take some time to achieve this goal.

6. Performance Measurement

Exhibit 2-2, extracted from the ASIC's Annual Report, 2006-07, presents the performance indicators that ASIC uses to measure its "effectiveness" in attaining the four statutory objectives.

The information in Exhibit 2-2 makes it clear that the ASIC's associates "effectiveness" in achieving goals and objectives with its activity levels. Thus, its primary statutory obligation is to improve the performance of the financial system and to reduce business costs. However, ASIC does not attempt to measure the performance of the financial system or the costs of doing business. Instead, it measures the number of applications processed to reduce costs and the number of new financial services firms licensed.

The primary statutory obligation calls attention to improve the financial system in the interests of economic efficiency and development. Thus far, however, ASIC has not provided indicators of the impact of its activities on efficiency and development.

Similarly, the important statutory object of promoting the confident and informed participation of investors and consumers is not the subject of measurement. ASIC reports the number of visits to its website, the number of people it has assisted, etc. These measures are essentially measures of activity and are, at best, indirect indicators of whether investors and consumers are confident and informed.

7. General Observations

It should be noted that ASIC does not regulate the banking sector. This may account for the lack of emphasis on financial system stability.

The Australian experience indicates a degree of tension between the government and the regulatory authority. Whereas the statute clearly assigns economic objectives clear priority over investor protection, it is not entirely clear that the ASIC accepts the hierarchy of objects in the statute.

On its website, ASIC states: “The Australian Securities and Investment Commission Act (2001) requires us to

- Uphold the law uniformly, effectively and quickly
- Promote confident and informed participation by investors and consumers in the financial system
- Make information about companies and other bodies available to the public
- Improve the performance of the financial system and the entities within it.”⁸

This tension between the government’s concern with economic goals and the regulator’s focus on investor protection may be the reason that Australia has not moved more vigorously to establish formal systems of performance measurement.

⁸ <http://www.asic.gov.au/asic/asic.nsf/byheadline/Our+role?openDocument>

Exhibit 2-1: Service Charter Measurement

ASIC Service Charter: how we performed

On 30 June 2006, as part of our commitment to better and more transparent regulation, we published the *ASIC Service Charter*, which explained what Australian companies, financial services business and professional service providers could expect in their dealings with us.

In the charter, we set out our goals for processing the most common applications and requests we receive, and committed to reporting on performance against those goals. Below are the results of our performance from 1 July 2006 to 30 June 2007.

The processes we use to measure these results have been independently verified. The verification process uncovered some issues with the way we count some of our results. We are working to improve those aspects of our systems for reporting performance against the charter. We are also working to improve the areas where we are not meeting our service targets.

We will continue to report against the service charter indicators each year.

Service	Service charter target	2006–07 performance
General phone queries	We aim to answer your telephone queries on the spot.	94% of calls answered on the spot (630,856 of 670,755) 6% (39,899 calls) referred to specialist staff
General email queries	We aim to reply within 2 business days to email queries sent to: - info.enquiries@asic.gov.au - infoline@asic.gov.au - onlineaccess@asic.gov.au	80% replied to in 2 business days (23,091 of 29,057)
General correspondence	We aim to acknowledge receipt of general correspondence within 14 days of receiving it, and give a full response within 28 days:	
	General correspondence to Public Information Program about our public database and registers, including fee waivers.	95% fully responded to within 28 days (52,796 of 55,734)
	Correspondence received by our Correspondence Control Unit.	100% acknowledged within 14 days (656 letters) 71% responded to within 28 days (470 of 661 letters)
Registering a company	We aim to complete company incorporations within 1 business day of receiving a complete application.	97% (156,522 of 161,673) 87% of paper forms completed in 1 day (21,959 of 25,320) 99% of electronic forms completed in 1 day (134,563 of 136,353)
Updating company information and status	We aim to enter critical changes to company information in the corporate register within 2 business days.	92% (960,636 of 1,050,260) 72% of paper forms (214,296 of 299,908) entered in 2 business days 99.5% of electronic forms entered in 2 business days (746,340 of 750,352)

Exhibit 2-1 (con't)

Service	Service charter target	2006–07 performance
Registering as an auditor	We aim to decide whether to register a person as an auditor within 28 days of receiving a complete application.	100% registered within 28 days (112 individual applications and 18 authorised audit companies)
Registering as a liquidator	We aim to decide whether to register a person as a liquidator or official liquidator within 28 days of receiving a complete application.	Liquidators: 83% decided within 28 days (15 of 18 applications) Official liquidators: 83% decided within 28 days (24 of 29 applications)
Registering a managed investment scheme	By law, we must register a managed investment scheme within 14 days of receiving an application (unless incomplete in various ways).	95% registered in 14 days (583 of 616)
Applying for or varying an AFS licence	We aim to decide whether to grant or vary an Australian financial services licence within 28 days of receiving a complete application.	Granting a licence: 65% decided in 28 days (310 of 474 applications) Varying a licence: 71% decided in 28 days (503 of 709 applications) This result is for all applications, including those where we did not initially receive all the information we needed to make a decision.
Applying for an Australian market licence	We aim to give the Minister our recommendation about simple applications to operate financial markets within 12 weeks of receiving an application.	100% to Minister within 12 weeks (3 applications)
Applying for relief	If you lodge an application for relief from the Corporations Act that does not raise new policy issues, we aim to give you an in principle decision within 21 days of receiving all necessary information and fees.	74% of in principle decisions made within 21 days (2278 of 3062 applications) This result is for all applications, including those where we did not initially receive all the information we needed to make a decision.
Complaints about misconduct by a company or an individual	If you make a complaint about the activities of a company or individual, we aim to respond to you within 28 days of receiving all relevant information.	81% finalised within 28 days (8,620 of 10,681)

Exhibit 2-2: Key Performance Indicators

Effectiveness

Key statistics about advancing the aims set out in our legislation*

	2006–07	2005–06	2004–05
Upholding the law uniformly, effectively and quickly			
• % total litigation successful	97%	94%	94%
• % criminal litigation successful	88%	72%	87%
• % civil litigation successful†	98%	98%	95%
• Civil orders against people or companies	256	230	121
• Criminals jailed	21	17	27
• Additional disclosures achieved for investors	371	125	161
Promoting confident and informed consumers			
• Public complaints about misconduct assessed	10,681	12,075‡	10,752
• Visits to our consumer website FIDO	1,050,000	785,000	615,000
• People assisted through our call centre	707,000	770,000	784,000
• Recoveries, costs, compensation, fines and assets frozen (million)	\$140m	\$215m	\$123m
• Company fundraisings where ASIC achieved better disclosure for investors (billion)	\$17bn	\$10bn	\$6bn
Making company information available quickly and efficiently			
• Total requests (free and paid) from ASIC databases (million)	55m	45m	36m
• % company data lodged on time	95%	94%	94%
Improving the performance of the financial system and the entities within it			
• Applications granted that reduced costs to business	2,287	2,489	2,939
• Applications granted for innovative transactions or products	72	76	54
• New Australian financial services licences issued	369	428	401

* Based on ASIC Act, see page 32.

† Civil litigation includes civil injunctions, freezing orders and civil penalty proceedings.

‡ Included 1,818 questionnaires ASIC sought from Westpoint investors.

Chapter 3

Canada Office of the Superintendent of Financial Institutions

1. General

The Office of the Superintendent of Financial Institutions (“OSFI”) was established by Parliament on July 2, 1987 by the OSFI Act. It is an integrated financial regulator, responsible for the regulation and supervision of all federally chartered, licensed or regulated banks, insurance companies, trust and loan companies, cooperative credit associations, fraternal benefit societies and pension plans. The Office of the Chief Actuary conducts actuarial services for the Government of Canada. While OSFI does not regulate securities markets, it has statutory responsibility for the securities business activities conducted internally by federal financial institutions.

OSFI’s performance standards and measurement approaches are of interest because, as an industry-funded, integrated financial regulator that operates at arm’s length from the Minister, it bears certain similarities to Canadian securities regulators.

However, as an agency of the federal government, OSFI is subject to reporting requirements of the federal Treasury Board Secretariat. These requirements can be evaluated by the extent to which they focus on measurable outcomes.

2. Statutory Mandate

The OSFI Act creates the Office and establishes its goals and objectives. Section 3 of the Act emphasizes that the goal of the OSFI is public confidence in the financial system:

3.1 The purpose of this Act is to ensure that financial institutions and pension plans are regulated by an office of the Government of Canada so as to contribute to public confidence in the Canadian financial system.

Section 4 of the Act specifies OSFI’s objectives. In regard to financial institutions, s.4(2) emphasizes the objective of safety and soundness:

- (2) The objects of the Office, in respect of financial institutions, are
- (a) to supervise financial institutions in order to determine whether they are in sound financial condition and are complying with their governing statute law and supervisory requirements under that law;
 - (b) to promptly advise the management and board of directors of a financial institution in the event the institution is not in sound financial condition or is not complying with its governing statute law or supervisory requirements under that law and, in such a case, to take, or require the management or board to take, the necessary corrective measures or series of measures to deal with the situation in an expeditious manner;
 - (c) to promote the adoption by management and boards of directors of financial institutions of policies and procedures designed to control and manage risk; and
 - (d) to monitor and evaluate system-wide or sectoral events or issues that may have a negative impact on the financial condition of financial institutions.

Section 4(3) provides objectives regarding depositors, policyholders and creditors:

- (3) In pursuing its objects, the Office shall strive
- (a) in respect of financial institutions, to protect the rights and interests of depositors, policyholders and creditors of financial institutions, having due regard to the need to allow financial institutions to compete effectively and take reasonable risks;

It is noteworthy that, unlike the direct objectives given to OSFI for financial institutions, OSFI is here required to “strive” to protect depositors, policyholders and creditors. The consideration of the interests of creditors is also noteworthy, as is the overall objective in depositor protection of requiring consideration of competition and reasonable risk-taking.

It is also noteworthy that section 4(4) of the Act does not assign sole responsibility to OSFI:

- (4) Notwithstanding that the regulation and supervision of financial institutions by the Office and the Superintendent can reduce the risk that financial institutions will fail, regulation and supervision must be carried out having regard to the fact that boards of directors are responsible for the management of financial institutions, financial institutions carry on business in a competitive environment that necessitates the management of risk and financial institutions can experience financial difficulties that can lead to their failure.

Thus, the Act recognizes that boards of directors have management responsibilities; that financial institutions operate in a competitive environment; and that failure is always a possibility.

3. Strategic Outcomes

OSFI identifies two strategic outcomes that are primary to its mission and central to its contribution to Canada’s financial system:

- To regulate and supervise to contribute to public confidence in Canada’s financial system and safeguard from loss. OSFI safeguards depositors, policyholders and private pension plan members by enhancing the safety and soundness of federally regulated financial institutions and private pension plans.
- To contribute to public confidence in Canada’s public retirement income system. This is achieved through the activities of the Office of the Chief Actuary, which provides accurate, timely advice on the state of various public pension plans and on the financial implications of options being considered by policy makers

4. Performance Reporting

As with federal government departments and agencies generally, OSFI is required to submit a Departmental Performance Report (“DPR”) annually.

As noted therein, OSFI does not measure its performance on the basis of financial-institution closures and pension plan terminations because, as indicated in the OSFI Act, such failures do not necessarily indicate OSFI's performance. When a failure occurs, OSFI assesses how it performed relative to its early intervention mandate in identifying the situation and intervening appropriately.

In the most recent DPR, OSFI measures its performance according to eight Program Priorities and two Program Support Activities:

Program Priorities

- (1) Accurate risk assessment of financial institutions and timely, effective intervention and feedback
- (2) A balanced, relevant regulatory framework of guidance and rules that meets or exceeds international minimums
- (3) A prudentially effective, balanced and responsive approvals process
- (4) Accurate risk assessments of pension plans, timely and effective intervention and feedback, a balanced relevant regulatory framework, and a prudentially effective and responsive approvals process
- (5) Contribute to awareness and improvement of supervisory and regulatory practices for selected foreign regulators through the operations of an International Assistance Program
- (6) Contribute to financially sound federal government pension and other programs through the provision of expert actuarial valuation and advice
- (7) Participate in and monitor international work on conceptual changes to accounting standards
- (8) Ensure that OSFI is in a position to review and approve applications that are submitted for approval under the Basel II capital framework

Program Support Priorities

- (9) High-quality internal governance and related reporting resources and
- (10) Resources and infrastructure necessary to support supervisory and regulatory activities

Exhibit 3-1, from the DPR for the period ending March 31, 2007, provides OSFI's report on its performance against the first priority. Here, OSFI measures its performance by an independent survey of knowledgeable observers, and reports 92% satisfaction with its supervisory process (for the most recent survey in 2005-05) and 78% satisfaction for early intervention for life insurance companies (in 2006-07 survey).

5. Service Standards

In July 2005, OSFI published service standards for those approval-related services to federally regulated financial institutions for which a fee is charged. These service standards comply with the Government's "Policy on Service Standards for External Fees".⁹ OSFI has developed seven service standards for application to 51 service fees in effect at the time, although it has since stopped charging the full set of fees.

Service Standard 4 covers twenty Ministerial approvals. As shown for twelve thereof in Exhibit 3-2, OSFI's standard is that 80% of requests will be processed in less than 90 calendar days of receipt.

OSFI reported its success in meeting these service standards for the seven categories of services in its 2005-06 annual report. As shown in Exhibit 3-3, the performance standard for Ministerial approvals was 80% of requests handled in 90 days, and OSFI handled over 95% of requests within that period.^{10,11}

6. General Observations

As a prudential regulator, OSFI is concerned mainly with solvency issues. Its role in regulating market conduct of federal financial institutions is limited, and for this reason, its goals and objectives with respect to investor/consumer protection are limited. In this regard, it does not serve as a model for securities regulation.

However, OSFI is significantly concerned with promoting competition within the financial sector and with the burden of compliance. It is also noteworthy that OSFI applies internationally-developed financial regulations in Canada, most notably the various Basel Accords. It has limited ability to control the significant compliance costs that these regulations impose, as they are held to be justified by the requirements for international financial stability. Thus, OSFI regulates and supervises federal financial institutions with regard to this goal.

In financial regulation, the absence of failures is often taken as the key indicator of soundness and, indeed, of regulatory success. However, OSFI's mandate does not preclude failures and the occurrence of failure says nothing about OSFI's performance.

⁹ http://www.tbs-sct.gc.ca/Pubs_pol/opepubs/TB_H/CRP_e.asp.

¹⁰ OSFI. Striking a Balance: OSFI Annual Report 2005-2006 (http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/reports/osfi/ar0506_e.pdf)

¹¹ Since the service standards were introduced, OSFI has reviewed its fees for service and no longer charges fees for approvals requested by existing entities. Its 2006-07 annual report did not report on achievement of service standards.

Section 4 of the OSFI Act refers to the need to promote a competitive environment in which financial institutions take risks in the normal course of business; accordingly, OSFI's mandate does not include such stringent regulation that no failures can occur.

OSFI's statutory framework is of particular interest for its explicit consideration of competition. A similar view of competition is found, if not always articulated, among provincial securities regulators, who take the view that the regulatory regime is there to protect investors in the event of dealer failure, rather than to ensure that dealers do not fail.

In terms of performance measurement, OSFI seeks to measure outputs where possible. Its use of independent surveys of knowledgeable industry observers to assess its "accurate risk assessment of financial institutions and timely, effective intervention and feedback" provides relevant information on this dimension of its performance.

However, it is clear that when OSFI, in compliance with the requirements set down by Treasury Board, measures its performance against its priorities, its formal performance measurement systems generally measure *inputs* rather than outputs. Thus, if OSFI makes it a priority to improve its ability to assess risk-taking by banks, then OSFI's performance report documents the improvements it has put in place to monitor and assess risk.

The Treasury Board performance-reporting requirement emphasizes accountability for expenditures, and like other government departments and agencies, OSFI must prepare detailed accounts of its plans and priorities that require funding. While such accountability is important in itself, it does not identify the appropriate output measure, which for OSFI would be the level of risk in the banking system.

In this regard, OSFI does not publish its risk assessments for individual institutions. While there may be good reason for this, it may be possible to develop aggregate risk measures that would enable it, and the public, to determine whether the financial system is becoming more or less risky over time.

In light of OSFI's objective relating to competition, entry and exit may be good indicators of success. A regulatory regime in which entry and exit are infrequent may be one in which regulatory barriers to entry are too high, with resulting implications for the efficiency of the sector and the economy as a whole. In addition, OSFI might examine market shares by product line and the extent of changes in rankings of firms by market share as indicators of competition. A sector with a relatively small number of firms might still be highly competitive in this regard.

Exhibit 3–1: Performance Measurement for Risk Assessment

PRIORITY 1

Strategic Outcome: Regulate and Supervise to Contribute to Public Confidence in Canada's Financial System and Safeguard from Undue Loss	
Program Activity: Regulation and Supervision of Federally Regulated Financial Institutions	
Program Sub-Activity: Risk Assessment and Intervention	
Priority 1: Accurate risk assessments of financial institutions and timely, effective intervention and feedback.	
Description <ul style="list-style-type: none"> Operate an effective prudential supervisory system by allocating resources to higher risk/impact institutions/activities. Conduct timely risk assessments and interventions and provide clear reports and recommendations to Federally Regulated Financial Institutions (FRFIs). Recommend appropriate changes in FRFI practices and processes. 	
Key Expected Results <ul style="list-style-type: none"> OSFI uses a modern supervisory process that is effective and leads to an accurate overall assessment of the risk profile and control functions of the financial institutions it regulates and supervises. In exercising its early intervention mandate, OSFI is proactive in intervening in problem cases in an effective and appropriate manner. 	
Key Performance Measures / Achieved Results <p>1. Knowledgeable observers² are of the view that OSFI uses a modern supervisory process that is effective and leads to an accurate overall assessment of the risk profile and control functions of the financial institutions it regulates and supervises.</p> <p>NOTE: This measure was not assessed in the year under review, but a link is provided to the most recent assessment obtained through independent consultation with knowledgeable observers about OSFI's performance.</p> <ul style="list-style-type: none"> In 2004-2005, results of consultations with a cross section of financial institutions regulated by OSFI showed that satisfaction with OSFI as the principal regulator and supervisor of Canada's financial services sector was high. The majority of 	Ratings <p>2006-2007 – N/A</p> <p>2005-2006 – N/A</p> <p>2004-2005 – 92% satisfaction</p>

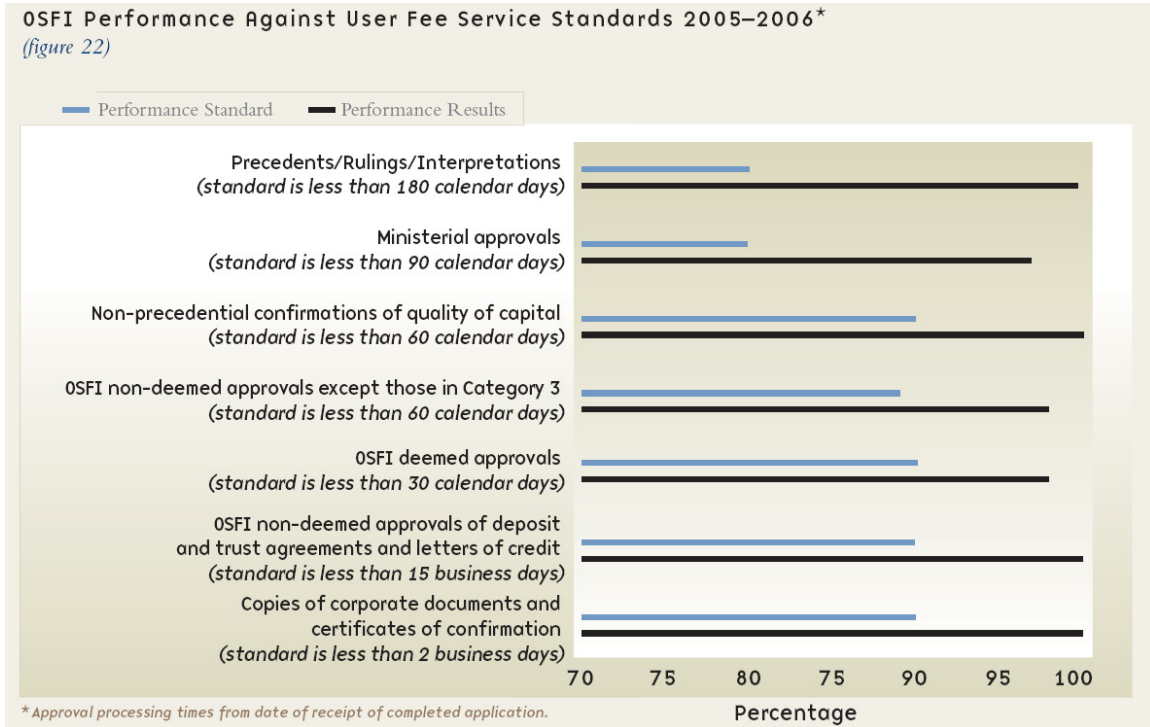
Exhibit 3–1 (con't)

<p>respondents were "very" or "somewhat" satisfied with OSFI's performance as a prudential regulator. Source: 2004 Industry Consultation Findings³.</p> <p>2. Knowledgeable observers are of the view that, in exercising its early intervention mandate, OSFI is proactive in intervening in problem cases regarding the financial institutions it regulates and supervises.</p> <ul style="list-style-type: none"> In 2006-2007, results of consultations with a cross section of life and property and casualty insurance companies regulated by OSFI showed that 78% of knowledgeable observers consider OSFI's treatment of companies of concern as appropriate; recommendations are clear and understandable. Source: 2007 Report on Actuarial Consultations⁴. In 2004-2005, results of consultations with a cross section of financial institutions regulated by OSFI showed that 85% of knowledgeable observers consider OSFI's treatment of companies experiencing financial difficulties as appropriate; recommendations are clear and understandable. Source: 2004 Industry Consultation Findings. 	<p>2006-2007 – 78% appropriate for insurance companies</p> <p>2005-2006 – N/A</p> <p>2004-2005 – 85% appropriate for financial institutions</p>
<p>Performance Discussion</p> <p><i>Steps taken during the year in support of this objective include:</i></p> <ul style="list-style-type: none"> Intervened with a number of institutions to improve risk management and governance practices and to enhance safety and soundness. Reduced the number of "staged" (problem) institutions, mainly as a result of the continued improved health of the Property and Casualty (P&C) insurance industry, as well as effective intervention by OSFI. The number of staged institutions declined to 25 at the end of 2006-2007 from 36 a year earlier. Assigned a low or moderate Composite Risk Rating (CRR) to 95% of all rated institutions as at March 31, 2007. No institution was assessed as high risk. The percentage of institutions with a low or moderate risk rating has been improving steadily since 2002-2003, when OSFI started sharing risk ratings with institutions. Enhanced risk assessment and intervention activities on emerging areas of risk. For example, OSFI increased the focus on risks arising from Canadian institutions' offshore operations and their ability to manage those risks. Continued to develop and maintain effective working relationships with foreign regulators to optimize supervisory efforts. Monitored institutions' ability to manage the adoption of international accounting standards and the implementation of Basel II. Reviewed institutions' crisis response and preparedness. Continued to assess institutions' ability to detect and deter terrorist financing and money laundering. Increased focus on a potential deterioration in asset quality at smaller deposit-taking institutions. 	

Exhibit 3-2: Service Standards

SERVICE STANDARD 4 Ministerial Approvals 80% will be processed in less than 90 calendar days of receipt						
<p>This service standard is more lenient than the Superintendent Approvals (Categories 1 to 3) because Ministerial Approvals typically involve more complex cases that demand additional time. For the purpose of measuring performance against the service standard, the first day of the process will be the day that OSFI receives all material information relevant to the approval requirements. Regardless of the number of days it takes OSFI to complete this review, OSFI will issue an "application receipt" to the applicant effective on the date of actual receipt. If information is incomplete, OSFI will issue a "deficiency letter" to the applicant. For the purposes of measuring performance against the service standard, the final day of the process is the day that a <i>Recommendation Memorandum</i> has been sent to the Minister to approve or deny the application or the day that the applicant decides to withdraw the application or place it on hold.</p> <p>This service standard will apply to the following user pay codes:</p>						
User Pay Code	Description of Document or Service	Bank Act	T&LC	ICA	CCAA	Service Fee
S1-01	Letters patent of incorporation	22 671	21	22 708	23	32,000
S1-02	Letters patent of continuance	33 682	31	32 719	N/A	32,000
S1-03	Order permitting a foreign bank to carry on business in Canada	524(1)	N/A	N/A	N/A	32,000
S1-04	Order approving the insuring in Canada of risks by a foreign body corporate	N/A	N/A	574	N/A	32,000
S1-05	Letters patent of amalgamation	228 808	233	251 862	231	16,000
S1-06	Approval of an agreement respecting the sale of all or substantially all assets	236	241	N/A	N/A	16,000
S1-07	Approval of the acquisition or increase of a significant interest	373 875	375	407 927	354	16,000
S1-08	Approval of a purchase, reinsurance or transfer of policies, a reinsurance against risks undertaken by the company, or a sale of assets	N/A	N/A	254 587.1	N/A	8,000
S1-09	Approval of the acquisition of control of, or the acquisition or increase of a substantial investment in, an entity (Ministerial Approval)	468(5) 930(5)	453(5)	495(7) 554(5) 971(5)	390(5)	8,000
S1-10	Approval to retain control of, or to continue to hold a substantial investment in, an entity for longer than 90 days	471(4) 522.14(4) 933(3)	456(4)	498(4) 557(4) 974(3)	393(4)	8,000
S1-12	Approval, for an indeterminate period, to retain control of, or to hold a substantial investment in, an entity that was acquired by way of a loan workout or realization of a security interest	472(7) 473(5) 522.15(3) 934(6) 935(4)	457(7) 458(5)	499(7) 500(5) 558(7) 559(5) 975(6) 976(4)	394(7) 395(5)	8,000
S1-14	Order exempting a foreign bank from certain provisions of Part XII of the <i>Bank Act</i>	509(1)	N/A	N/A	N/A	8,000

Exhibit 3-3: Meeting Service Standards



Chapter 4

Ontario Securities Commission

1. General

The Ontario Securities Commission (“OSC”) is the regulatory body responsible for administering and enforcing securities legislation in Ontario. It is an administrative tribunal with quasi-judicial powers.

The Commission’s approach to goals, objectives and performance measurement is of interest for several reasons, including its role as regulator of the largest capital market in the country. Although it has typically viewed regulation through the lens of investor protection, it has increasingly recognized the importance of capital market efficiency and issues relating to the costs of regulation.

2. Statutory Mandate

The Securities Act creates the Commission and instructs the Commission in several parts of the statute. The OSC must interpret its mandate from these various provisions.

a. Purpose

Section 1.1 of the Securities Act provides the “purposes” of the Act:

The purposes of this Act are,

- (a) to provide protection to investors from unfair, improper or fraudulent practices; and
- (b) to foster fair and efficient capital markets and confidence in capital markets. 1994, c. 33, s. 2.

While this purpose clause is not specifically hierarchical, it is noteworthy that the first purpose is investor protection and that market efficiency and confidence are listed second. It might be inferred that the Securities Act accords the former purpose greater importance or significance than the latter.

The reference to fairness in the second principle is oblique. It could be taken to indicate “fair” competition and the acceptability of market outcomes only when they are deemed “fair”. Alternately, it could mean fairness in the sense that all participants face the same rules and that the outcomes of such competition are not the policy concern.

Market efficiency and confidence are clearly economic considerations. The Securities Act is thus concerned with the economic consequences of inefficiency and the lack of confidence on the part of issuers and investors.

b. Principles

Section 2.1 of the Act provides “fundamental principles” for the Commission in pursuit of the statutory purposes:

In pursuing the purposes of this Act, the Commission shall have regard to the following fundamental principles:

1. Balancing the importance to be given to each of the purposes of this Act may be required in specific cases.
2. The primary means for achieving the purposes of this Act are,
 - i. requirements for timely, accurate and efficient disclosure of information,
 - ii. restrictions on fraudulent and unfair market practices and procedures, and
 - iii. requirements for the maintenance of high standards of fitness and business conduct to ensure honest and responsible conduct by market participants.
3. Effective and responsive securities regulation requires timely, open and efficient administration and enforcement of this Act by the Commission.
4. The Commission should, subject to an appropriate system of supervision, use the enforcement capability and regulatory expertise of recognized self-regulatory organizations.
5. The integration of capital markets is supported and promoted by the sound and responsible harmonization and co-ordination of securities regulation regimes.
6. Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized. 1994, c. 33, s. 2.

The first of these principles to which the Commission is required to have regard is “balance” with respect to the two statutory purposes. This principle seems to suggest that there is, or could be, a conflict between protecting investors and fostering market efficiency and confidence.

The third principle indicates that the Commission should have regard to effective and responsive regulation, achieved by open and efficient administration and enforcement.

The “integration of capital markets” is a fundamental principle for which the Commission is to have regard. This principle suggests that capital markets are more efficient when regulation is coordinated and harmonized. This principle supports the statutory direction to foster fair and efficient markets and market confidence.

The last principle calls attention to “business and regulatory costs”. Thus, the Commission is instructed that such costs should be “proportionate” to the regulatory objectives.

c. Economic efficiency in rule-making authority

Section 143 of the Securities Act gives the Commission the authority to make rules; such rules have the status of regulations. With respect to every rule that the Commission proposes to make under this provision, s.143.2 requires the Commission to publish a notice and s.143.2 (2) requires that the notice contain, among other things,

- A discussion of all alternatives to the proposed rule that were considered by the Commission and the reasons for not proposing the adoption of the alternatives considered.
- A reference to any significant unpublished study, report or other written materials on which the Commission relies in proposing the rule.
- A description of the anticipated costs and benefits of the proposed rule.¹²

The requirement for cost-benefit analysis in rule-making authority emphasizes the goal of economic efficiency, i.e. that proposed rules should be shown to have benefits that exceed the costs they impose. Notably, the Commission is not required to demonstrate this, but it is required to consider the costs and benefits.

3. Performance Measurement

The Commission tracks and reports a variety of statistics, such as the number of registrants, salespeople, hearings, regulated entities' by-laws reviewed or approved, etc. As discussed above, such statistics are measures of activity; they do not necessarily measure the progress of the agency toward achieving the statutory goals and objectives.

One activity indicator, complaints from the public, does suggest a measure of service that the Commission seeks to attain. Exhibit 5-1 shows how complaints were received and disposed of in the past few years¹³. However, the Commission has not formulated a service standard in this regard, nor has it indicated its success in achieving a prescribed level of response to complaints.

One area where the Commission has established a service standard is with respect to its review of offering documents and applications for exemptive relief. When the OSC is the principal regulator in regard to an issuer of securities, the Commission's Corporate Finance Branch is charged with reviewing offering documents and applications for exemptive relief from that issuer.

The Corporate Finance Branch has set standards for responding to these filings¹⁴. For offering documents, it aims to complete the review within 30 working days of receipt.

¹² S. 143.2(5) provides exceptions to the notice requirement.

¹³ OSC. "Complaint Data", available at http://www.osc.gov.on.ca/About/ComplaintData/cd_index.jsp

¹⁴ OSC. Report of the Corporate Finance Branch. Staff Notice 51-706. November 1, 2007, at p.41.

For fiscal 2007, the Branch met this standard 92% of the time, unchanged from the previous year.

For exemptive relief applications, the Branch's standard is 40 working days. During the 2007 fiscal year, the standard was met for 85% of applications completed, versus 80% in the previous year.

It appears that these two areas are the only ones for which service standards have been established.

4. General Observations

Similarly, the Act gives some precision to the objective of investor protection, i.e. unfair, improper, fraudulent practices. Yet, despite the apparent primacy of investor protection in the Ontario Securities Act, there is no indication of how the OSC views its performance in this area. The available statistics focus on activity levels rather than outputs.

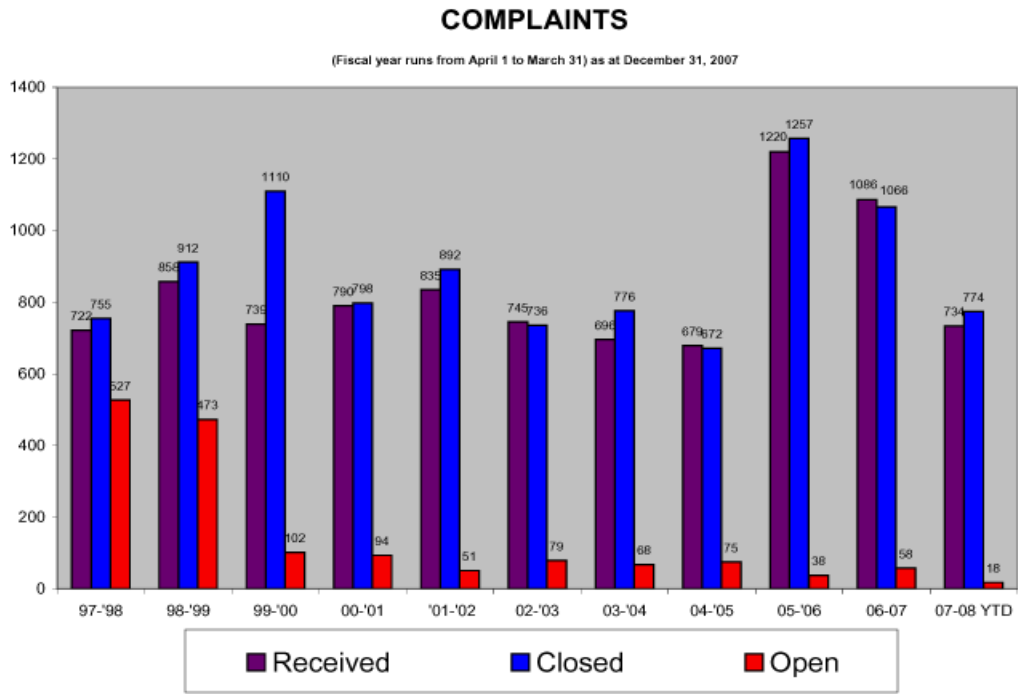
In 2000, the Commission established the Investor Education Fund. This innovative step to promote investor education complements the Commission's efforts to protect investors through enforcement actions, and indicates that the Commission pursuing the goal of well-informed investors. This initiative is similar to those established in other provinces and is potentially measurable through properly-designed surveys.

In recent years, the Commission has become more focused on competition and efficiency issues with, for example, the elimination of entry barriers through dealer ownership restrictions, the de-mutualization of the Toronto Stock Exchange, and the establishment of a framework for alternative trading systems. The Commission is a leader in the adoption of requirements for cost-benefit analysis in rule-making.

These regulatory innovations evidence a clear and growing concern with capital market efficiency, competition, and the proportionality of costs of regulation. There is, however, no framework in place for the regular assessment of these goals and objectives as yet.

The introduction of service standards in the Corporate Finance Branch is likely to be followed by similar developments in other parts of the Commission. This may lead to further discussion of the goals and objectives of securities regulation in Ontario. Doubtless, the contribution of securities market regulation to financial system stability is a concern of provincial regulators, and concern with this objective will likely increase.

Exhibit 4-1: OSC Complaint Reporting



Chapter 5

Québec Autorité des Marchés Financiers

1. General

The Autorité des marchés financiers (“AMF”) is the body mandated by the government of Québec to regulate the province's financial markets and provide assistance to consumers of financial products and services.¹⁵

Established under An Act respecting the Autorité des marchés financiers on February 1, 2004, the AMF is unique among Canadian regulatory bodies by virtue of its integrated regulation of the Québec financial sector, notably in the areas of insurance, securities, deposit institutions (other than banks) and the distribution of financial products and services. In addition to the powers and responsibilities conferred on it by its incorporating legislation, the AMF oversees the enforcement of laws in each of the areas it regulates.

2. Statutory Mandate

Securities regulation in Québec is guided by two statutes, the Securities Act and An Act Respecting the Autorité Des Marchés Financiers, R.S.Q., chapter A-33.2.

S.4 of the Autorité’s governing act specifies the Statutory Mission:

4. The mission of the Authority is to

- 1) provide assistance to consumers of financial products and services, in particular by setting up consumer-oriented educational programs on financial products and services, processing complaints filed by consumers and giving consumers access to dispute-resolution services;
- 2) ensure that the financial institutions and other regulated entities of the financial sector comply with the solvency standards applicable to them as well as with the obligations imposed on them by law with a view to protecting the interests of consumers of financial products and services, and take any measure provided by law for those purposes;
- 3) supervise the activities connected with the distribution of financial products and services, administer the rules governing eligibility for and the carrying on of those activities, and take any measure provided by law for those purposes;
- 4) supervise stock market and clearing house activities and monitor the securities market, in particular, by administering the controls provided by law as regards access to the public capital market, ensuring that the issuers and other practitioners involved in the financial sector comply with the obligations imposed on them by law and taking any measure provided by law for those purposes;

¹⁵ <http://www.lautorite.qc.ca/autorite/a-propos.en.html#>

5) see to the implementation of protection and compensation programs for consumers of financial products and services and administer the compensation funds set up by law.

2002, c. 45, s. 4; 2004, c. 37, s. 90.

In s.8 the Act instructs the AMF in regard to its functions and powers:

8. The Authority shall perform its functions and exercise its powers in a way as to:

1) foster the confidence of the public and of the business community as regards financial institutions and practitioners in the financial sector as regards solvency and the competence of agents, advisers, brokers, representatives and other practitioners in the financial sector;

2) promote the availability of high-quality, competitively priced financial products and services for individuals and enterprises in all regions of Québec;

3) see to the establishment of an effective and efficient regulatory framework that promotes the development of the financial sector and facilitates innovative management and commercial practices;

4) grant the public and the business community access to reliable, accurate and complete information on the financial institutions and practitioners in the financial sector and on the financial products and services offered;

5) protect consumers against unethical, abusive or fraudulent practices and give individuals and enterprises access to various dispute resolution mechanisms.

2002, c. 45, s. 8; 2004, c. 37, s. 90.

In respect of securities markets, the Securities Act refers to both market efficiency and investor protection, but appears to give prominence to the former:

Administration of the Act.

276. The Autorité des marchés financiers established under section 1 of the Act respecting the Autorité des marchés financiers (chapter A-33.2) is responsible for the administration of this Act and shall discharge the functions and exercise the powers specified thereunder.

Mission.

In addition, the Authority's mission is

1) to promote efficiency in the securities market;

2) to protect investors against unfair, improper or fraudulent practices;

3) to regulate the information that must be disclosed to security holders and to the public in respect of persons engaging in the distribution of securities and in respect of the securities issued by these persons;

4) to define a framework for the activities of the professionals of the securities market and organizations responsible for the operation of a stock market.

3. Performance Measurement

AMF regularly collects and publishes a variety statistics that describe its activities. For example, under its mandate to assist consumers, AMF has undertaken to improve the delivery of services to consumers. In this regard, it collects and publishes statistics in a variety of areas including the number of requests for information and complaints received. The majority of calls from consumers focused on insurance and securities matters and the confirmation of licenses of service providers.¹⁶

Under its regulatory mandate, AMF has undertaken enhanced monitoring in order to protect the public. In this regard, it publishes statistics on the number of inspections and investigations and reports the number of files opened, completed and pending. In addition, it reports on the number of legal proceedings commenced.¹⁷

These measures of activity are those generally undertaken by regulatory agencies. Although undertaken in support of the statutory goals and objectives, they are not designed to measurable indicators of the extent to which progress toward the attainment of those goals and objectives has been achieved.

However, AMF does have a broader conception of the performance outcomes that it seeks to obtain. For example, the Fund for Investor Education and the Promotion of Good Governance financially supports various initiatives related to investor protection, investor education, promotion of good governance and improving knowledge of the financial sector.¹⁸ Such outcomes are potentially measurable by properly-designed survey instruments.

4. General Observations

Québec has perhaps the most detailed specification of statutory goals and objectives for securities regulation among the provinces. The goals clearly indicate that the AMF is to regulate in such manner as to promote the development of the financial sector in the province.

¹⁶ AMF. 2006-2007 Annual Report, Tables 5-6, at p.32

¹⁷ AMF. 2006-2007 Annual Report. Tables 2-4, at p. 26-27

¹⁸ AMF. Regulation and oversight of Québec's financial sector, 2006 at p. 6.

It is noteworthy that securities market efficiency is the first-listed goal of the Securities Act. Similarly, the manner in which the Autorité is to perform its functions has a decidedly economic focus; investor protection against abusive and fraudulent practices is the last of the five statutory concerns indicated. In this regard, the regulatory approach in Québec is decidedly different from that in Ontario.

Although Québec has articulated a detailed set of goals and objectives for securities regulation, the Autorité has not developed performance standards or measurement systems that would allow it to assess its progress in achieving the statutory mandates in measurable terms.

Chapter 6

British Columbia Securities Commission

1. General

The British Columbia Securities Commission is the independent provincial government agency responsible for administering the provincial Securities Act.

The Commission has recently developed a formal system of performance measurement and is in various stages of implementation.

2. Statutory Mandate

The provincial Securities Act makes no mention of goals or objectives of the Commission. However, the Commission indicates that it “protects and promotes the public interest by fostering

- a securities market that is fair and warrants public confidence
- a dynamic and competitive securities industry that provides investment opportunities and access to capital”¹⁹

3. Performance Measurement

The Commission implements its mission in four specific areas²⁰:

- (i) Promote a culture of compliance
- (ii) Act decisively against misconduct
- (iii) Educate investors
- (iv) Advance cost-effective regulation

It proposes long-term measures in order that progress toward these objectives can be assessed by stakeholders. Measurements are to be selected based on the following criteria:

- Connection to goals. Measurements will assess progress in achieving goals and, through them, the mission.
- Longevity. Measurements will be chosen that the Commission will be able to track over several years, and whose trends will provide valuable information for improving the Commission’s performance.
- Cost-effectiveness. Measures that can be executed within the measurement budget.
- Measurability. Measurements will be chosen for which accurate data can be collected and used to form baselines in a timely way.

¹⁹ British Columbia Securities Commission. Service Plan, 2008-2011 at p. iii

²⁰ British Columbia Securities Commission. 2008/2009 Service Plan Performance Measures, at p.1

Three examples illustrate the developing performance measurement system.

Promote a Culture of Compliance:

The Commission proposes to measure compliance in the mining industry²¹. Each year it engages a mining specialist to review a random sample of mining issuers to determine whether they meet the minimum standards for technical disclosure in news releases, annual information forms, websites and management discussion and analysis.

Goal 1: Promote a culture of compliance

PERFORMANCE MEASUREMENTS	TARGETS				
	06/07 Actuals /Baseline	07/08 Estimate	08/09 Target	09/10 Target	10/11 Target
1.1 Percentage of reviewed issuers that reduce deficiencies in their continuous disclosure a) Improved disclosure subsequent to a continuous disclosure review b) Improved disclosure to minimum standards	a) 100% b) 81%	Data will be available in 07/08 Annual Report	a) ≥ 94% ⁽¹⁾ b) ≥ 85%	a) ≥ 94% b) ≥ 90%	New measure planned for new reporting standard ⁽²⁾
	Our corporate finance division reviews issuer disclosure for non-compliance. At the end of each fiscal year, we retain an outside auditor to analyze the subsequent continuous disclosure of a statistically significant random sample of issuers that received comment letters from us during that year. The results of this review will show the extent to which our detailed CD review work motivated non-compliant issuers to improve their disclosure voluntarily.				
1.2 Percentage of randomly sampled mining issuers that meet the minimum standards for technical disclosure in: a) News releases b) Annual information forms c) Issuer websites d) Management discussion and analysis	a) 71% b) 70% c) 47% d) 42%	Data will be available in 07/08 Annual Report	a) 70% b) 70% c) 55% d) 50%	a) 70% b) 70% c) 70% d) 70%	a) 75% b) 75% c) 75% d) 75%
	BC is home to many mining issuers. We will give a list of BC-based mining issuers to an external mining specialist, who will select randomly from that list and analyze whether those issuers' most recent technical filings were compliant with NI 43-101 <i>Standards of Disclosure for Mineral Projects</i> . This review will show the extent to which a sample of BC-based mining issuers is compliant in specific areas of their technical disclosure.				

Notes: (1) This target is lower than the 2006/07 actual to allow for our small sample size (around 30 reviews). (2) We expect that Canada will adopt international financial reporting standards (IFRS) by January 1, 2011.

Thus, in 2006-07, 71% of randomly selected mining issuers met the minimum standards for technical disclosure in news releases. The Commission's target is 70% for 2008-09, rising to 75% in 2010-11.

²¹ See fn. 21 supra, at p.17 available at http://www.bccsc.bc.ca/uploadedFiles/ServicePlan_2008-2011.pdf

Act Decisively Against Misconduct

This area of measurement concerns the critically-important enforcement efforts of the Commission. In developing its performance measurement system, the commission recognizes that activity levels, budgets, number of cases, etc. often fail to identify the effectiveness of these efforts.

Goal 2: Act decisively against misconduct

PERFORMANCE MEASUREMENTS			TARGETS		
	06/07 Actuals /Baseline	07/08 Estimate	08/09 Target	09/10 Target	10/11 Target
2.1 Percentage of new cases with active misconduct where we intervened	20%	55%	55%	60%	65%
Detecting active misconduct and then preventing, stopping, or disrupting it early benefits investors, especially since the amount of money investors lose in illegal distributions tends to increase exponentially over the life of the distribution. We will track the cases accepted each year for enforcement action where the misconduct was ongoing when the BCSC learned of it. We will calculate the percentage of those cases in which we issued a freeze order, a temporary order, or took some other step to formally or informally disrupt the distribution. This will show how often we take early action to stop misconduct.					

Advance Cost-Effective Regulation²²:

The Commission proposes to create a scorecard to projects initiated locally and by the Canadian Securities Administrators.

²² See fn. 21 supra, at p.20 (available at http://www.bsc.bc.ca/uploadedFiles/ServicePlan_2008-2011.pdf)

Goal 4: Advance cost-effective regulation

PERFORMANCE MEASUREMENTS			TARGETS		
	06/07 Actuals /Baseline	07/08 Estimate	08/09 Target	09/10 Target	09/11 Target
4.1 Average score on cost-effective regulation scorecard	New measure	Data will be available in 07/08 Annual Report	Improve on 07/08	Improve on 08/09	Improve on 09/10
	To measure cost-effective regulation, we will create a scorecard that tracks the important steps and outcomes in responding to market problems. We will apply the scorecard to all CSA and local projects. For CSA projects, the scorecard will report on the extent to which we took steps to advocate our cost-effective regulation principles. For all projects, the scorecard will give credit for outcomes-focused results. We will report the average score of all the projects completed each year.				
4.2 Average approved project post-implementation score	New measure	Data will be available in 07/08 Annual Report	Improve on 07/08	Improve on 08/09	Improve on 09/10
	We will assess each local IT project at a predetermined time after the project's completion (as documented in the project proposal) and score the project's success relative to its proposed benefits.				

At this time, it is not clear what projects the Commission intends to evaluate or how the score will be established. The Plan refers to information technology projects, but may perhaps include rule-making generally. There may be a role for cost-benefit analysis in scoring potential regulatory interventions as the percentage of benefits over costs.

4. General Observations

It is noteworthy that the British Columbia Securities Commission has described its mission in terms of protecting and promoting the “public interest” by fostering a fair market that warrants public confidence and a competitive securities industry. The “public interest” formulation of the goal of securities policy is common and is open to the criticism that it gives inordinate discretion to the regulators. In some respects, the development of performance measurement in securities policy in various jurisdictions is a reaction to the breadth of interpretation that this formulation allows.

Perhaps because of this breadth, the Commission has found it necessary to be more precise about what actions it is to take. Here, the Commission sees its mandate as ensuring compliance, acting against misconduct, educating investors, and promoting proportionate regulation. The first two actions simply recognize the enforcement role of the Commission in respect of statute requirements.

Notably, however, “educating investors” and “advancing cost-effective regulation” are not statutory requirements but are goals that the Commission has identified within its discretion. Other such goals and objectives, such as capital market efficiency, financial system stability, and economic development in the province are, presumably, also

considered as relevant by the Commission and might be included in its performance measurement system.

It is also noteworthy that the Commission is attempting to identify and measure outputs and to institute targets in its performance measurement system, whether in respect to statutory or discretionary goals. Whereas other commissions and financial regulators often evaluate their performance against input priorities and activity levels, the British Columbia Commission seeks quantitative measures of the extent to which its performance targets are being met.

One area that the performance measurement system has not yet addressed is the “competitive securities industry” that the Commission includes in its mission statement. Since this area is part of that statement, it might be expected that the Commission would want to identify quantitative measures of the extent of competition in the industry and measure changes thereto over time.

Although the development of the Commission’s performance measurement system is at an early stage, its approach will likely be the model for further development by other provincial regulators. It will be of particular interest to see how the Commission measures cost-effectiveness generally and the effectiveness of enforcement in particular.

Chapter 7

Investment Industry Regulatory Organization of Canada

1. General

The Investment Industry Regulatory Organization of Canada (“IIROC”) is the national self-regulatory organization that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada. It was created in 2008 through the consolidation of the Investment Dealers Association of Canada and Market Regulation Services Inc.

It is relevant to consider IIROC’s goals, objectives and performance measurement systems because so much of the regulatory and supervisory activity in the Canadian regulatory scheme has devolved to self-regulatory organizations.

2. Statutory Authority

IIROC operates under a Recognition Order from the Canadian Securities Administrators (Canada’s provincial and territorial securities regulators). IIROC is subject to oversight and regular operational reviews by the CSA.

Under this mandate, IIROC sets regulatory and investment industry standards, protects investors and strengthens market integrity while maintaining efficient and competitive capital markets.

3. Mandated Functions

IIROC has three main functions: compliance, enforcement and regulatory policy development.

- a. Compliance/Surveillance of Member Firms and Marketplaces
 - Screens all investment advisors employed by IIROC- regulated firms to ensure they are of good character and have successfully completed all the required educational courses and programs.
 - Conducts financial compliance reviews to ensure that firms have enough capital for the specific nature and volume of their business. IIROC- regulated firms also participate in the Canadian Investor Protection Fund which protects individual investors in the unlikely event that a firm should go bankrupt.
 - Conducts business conduct compliance reviews to check that firms have procedures in place to properly supervise the handling of client accounts

and that advice and transactions appropriately reflect the client's directions.

- Monitors the trading activity on Canadian equity markets for compliance with market integrity rules, on both a real time and post-trade basis
- b. Enforcement
- Investigates complaints against a dealer firm, approved person, access person, participant or applicant.
 - Conducts disciplinary actions where there is evidence that misconduct has taken place

IIROC and its predecessor organizations have established a set of “benchmarks” for assessing the internal performance of its divisions. As discussed below, these benchmarks measure and set targets for the efficient functioning of the divisions, i.e. they are directly concerned with the measurement and assessment of activity levels.²³

As discussed below, however, IIROC has made considerable progress in one particularly critical area, the identification and measurement of industry risk. It also publishes a report on marketplace statistics but has not, to date, used these data to measure performance.²⁴

4. Operational Goals-Financial Compliance

The role of Financial Compliance (FC) is to monitor the financial status of its Member firms and enforce compliance with IIROC rules. The main elements of the department's work are:

- a. **Review of financial regulatory filings** – FC staff review monthly financial reports and year-end audited joint regulatory financial questionnaires and reports to identify changes in trends, financial status, and profitability. When necessary, IIROC can take preventive measures to preserve the capital position of a firm and protect client money and securities. Any Member firm that does not meet minimum capital requirements is referred to as capital-deficient. The firm must immediately rectify its capital position or face possible suspension or termination of membership.
- b. **Annual and biennial "surprise" field examinations** – FC staff conducts "surprise" examinations of each Member's books and records to ensure the reliability of their unaudited regulatory filings.

²³ The following discussion is presented for readers who may be unfamiliar with what IIROC does. For a discussion of the performance measurement issues, the reader may wish to skip to section 9.

²⁴ IIROC. Market Share by Marketplace (for the four quarters ending June 30, 2008).

- c. **Review of audit working papers** – Each Member firm is subject to a year-end audit by an approved panel auditor to validate the information filed by the firm with IIROC. To ensure the quality of the audit, FC staff review the panel auditor's working paper files within three months of the filing date of the firm's joint regulatory financial questionnaire and report.

The following benchmarks for FC are monitored and reviewed at least annually.

- Attain an average examiner project utilization rate of 70%, meaning 70% of available staff time is to be spent directly on Member firm reviews
- Examine every Member annually (except for firms approved for biennial review) within a calendar year
- Complete and issue 60% of field examination reports within 8 weeks to a maximum of 6 months for all examination reports
- Perform an audit working paper review within 3 months of the filing date for high risk firms
- Complete all other audit working paper reviews within 6 months of the filing date
- Complete and issue preliminary reports for new Member applicants within 2 weeks

Information on the results of monitoring and review of performance is not available.

5. Operational Goals-Business Conduct

The role of Business Conduct staff is to ensure that Member firms implement policies and procedures to ensure their compliance with all non-financial regulatory requirements, including those of IIROC, provincial securities acts and federal legislation such as the Proceeds of Crime (Money Laundering) and Terrorist Financing Act 2001.

BC staff conducts regular reviews and on-site examinations of Member firms, focusing on issues of suitability, anti-money laundering due diligence, supervision, corporate finance and research, employee activities and internal controls.

Providing best practice guidance and rule interpretations is also part of BC's work, as well as providing feedback on policy development to the Regulatory Policy Department.

Businesses Conduct benchmarks are monitored and reviewed at least annually.

- Attain a project utilization rate of 70%, meaning 70% of available staff time is to be spent directly on Member firm reviews
- Complete all mandated reviews (including scheduled branch reviews) as established at beginning of year
- Complete and issue final examination reports:
 - within 15 weeks of completion of fieldwork for 60% of reports
 - within 26 weeks for all reports

- complete and issue preliminary reports for new Member applicants within 2 weeks

Information on the results of monitoring and review of performance is not available.

6. Operational Goals-Trade Desk Compliance

IIROC regularly reviews trading firms' trade-desk procedures. The reviews are intended to assess whether trade desk procedures comply with the Universal Market Integrity Rules (UMIR) and appropriate provincial securities requirements.

Our Trade Desk Compliance staff also assists in the development, introduction and education of users on new rules and policies, such as the Supervision of Trading Policy. This policy requires all applicable market participants to proactively monitor their compliance by completing internal reviews and addressing deficiencies. An IIROC Trade Desk Compliance Officer will examine the results of these reviews when a field review is conducted at the trading firm's office.

No operational goals or benchmarks are available.

7. Operational Goals-Market Surveillance

IIROC's market surveillance functions include:

- Real-time monitoring of trading activity on the Canadian equity markets, including the TSX, TSX V, CNQ, Bloomberg and Market Securities Inc.
- Ensuring compliance with timely disclosure of information by publicly traded companies
- Carrying out trading analysis
- Ensuring trade desk compliance with the Universal Market Integrity Rules (UMIR)

No operational goals or benchmarks are available.

8. Risk Assessment

Business Conduct, Financial Compliance and Enforcement use risk assessment models to assign risk scores to firms and track the performance, in terms of compliance, of each firm, group of firms involved in similar lines of business (peer group), and the industry as a whole. ComSet, the Complaints and Settlements Database of the Enforcement Department, is used to track trends at each level.

The risk scores are available only to the Member Firms and regulators. However, IIROC produces an Industry Risk Score that identifies trends in the risk assessments. As seen in Exhibit 7-1, the assessed risk level was declining in the period 2001-2006.

9. General Observations

As indicated above, most of IIROC's measurement activity concerns benchmarking, i.e. the establishment of desired levels of activity and the monitoring of the attainment of those levels. This "benchmarking" has a different purpose than performance measurement in relation to goals and objectives of securities policy, which is more focused on the establishment and assessment of broader policy outcomes.

Thus, while IIROC sets regulatory and investment industry standards, protects investors and strengthens market integrity while maintaining efficient and competitive capital markets, it does not, for the most part, measure its performance against these objectives. An exception to this is IIROC's concern with industry risk, a key "output" that it has attempted to measure.

In addition, IIROC's financial compliance and business conduct departments have formulated detailed service standards. Such standards find their place under the principle or objective of effective business management by a regulatory organization.

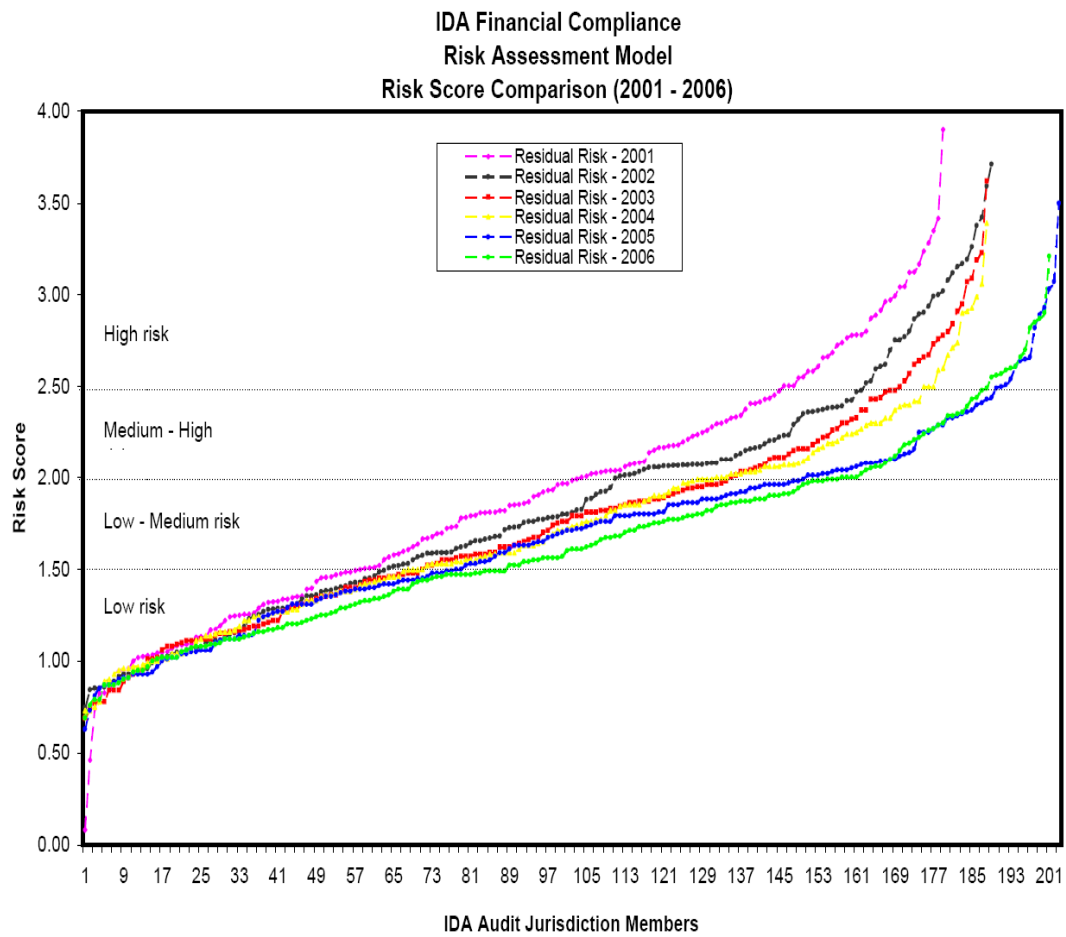
Unlike the Ontario Securities Commission, it does not face an explicit statutory obligation to consider the costs and benefits of its rules. The efficiency objective may be especially important in regard to IIROC's regulation of marketplaces. It is now widely accepted from a competitive perspective that alternative trading systems should be allowed to operate in Canadian capital markets, subject to regulation.

In this area, IIROC has developed detailed "market integrity rules" under which these marketplaces operate. However, there are no performance standards or measures that measure the market efficiency and investor protection objectives that these rules seek. As the market integrity rules deal with fundamental issues of transparency and market fragmentation and because it is difficult to identify the optimal market structure in advance, there is considerable value in developing "output" performance measures and assessing them over time. Its marketplace statistics may be used to draw conclusions regarding the impact of its rules on competition; at present, there is no dissemination of such evaluations.

IIROC also publishes information on "highly liquid securities" which could be the basis for analysis and measurement of market liquidity, and the impact of its rules thereon²⁵.

²⁵ Investment Industry Regulatory Organization. "Highly Liquid Stocks", available at <http://www.iiroc.ca/English/ComplianceSurveillance/MarketSurveillance/Pages/HighlyLiquidStocks.aspx>

Exhibit 7-1: Industry Risk Score



Chapter 8

Elements of a Framework for a Common Securities Policy

1. Introduction

In developing a common approach to performance measurement for the regulation of Canadian securities markets, it is important to recognize that these markets are a critical component of the economy and that the effective and efficient regulation of the market is fundamental to Canada's financial and economic development and integration into the global market.

It is instructive therefore to look first at the objectives and principles of securities regulation developed by the International Organization of Securities Commissions ("IOSCO"), both for suggestions in regard to a desirable performance measurement system, and to understand the differences between that approach and the various approaches that characterize current Canadian securities regulation.

In terms of a framework for a common securities policy, much can be gained from distilling lessons from the previous chapters. What have these organizations done well, and perhaps what might be done better? The chapter concludes with a discussion of goals, objectives and performance indicators.

2. IOSCO Principles²⁶

IOSCO's "*Objectives and Principles of Securities Regulation*" is an internationally-agreed upon statement for strengthening securities markets by strengthening the regulatory framework. The statement sets out three core objectives on which securities regulation is based:

- Promoting investor protection
- Ensuring that markets are fair, efficient and transparent
- Reducing systemic risk

The *Objectives and Principles of Securities Regulation* provides thirty principles that are designed to give effect to these objectives.

While each of the three core objectives is equally important, the *Objectives and Principles* emphasizes that IOSCO members should be guided at all times by their concern for investor protection. Investors are to be protected from misleading, manipulative and fraudulent practices; the most important means for achieving this end is full disclosure.

²⁶ International Organization of Securities Commissions. "Objectives and Principles of Securities Regulation", Madrid, Spain: IOSCO. (available at <http://www.iosco.org/pubdocs/pdf/IOSCOPD154.pdf>)

IOSCO's core objectives provide that regulation should also promote fair and efficient markets with the highest level of transparency, defined to include pre-trade and post-trade transparency.

Finally, the core objectives call for regulators to reduce systemic risk. While regulators cannot prevent securities firms from failing, securities regulation should enable the containment of risks and mitigate the impact of any such failures.

This overview of IOSCO's core objectives serves as a starting point for discussing the goals and objectives of a common Canadian approach to performance measurement. As a performance measurement system for securities regulation, IOSCO's approach is silent on key issues.

3. Canadian Perspective on Goals and Objectives

It is important to keep in mind that the IOSCO core principles are the product of informed discussion by securities regulators in the leading jurisdictions. Securities regulation is a highly specialized field and, accordingly, the IOSCO principles are properly accorded a high degree of respect. Indeed, as indicated in the previous chapters, there is growing recognition in Canada and abroad that financial regulators should give increased attention to systemic and market efficiency goals.

While IOSCO's core objectives are highly relevant to the development of a common securities policy for Canada, there is some reason to think that it may be too narrow.

(a) Economic Goals and Objectives

There can be little doubt that governments at all levels in Canada regard capital markets as vital elements of public policy. As the previous chapters have shown, securities regulation in Canada has changed in some measure, from its historic principal focus on investor protection to a regime that balances those concerns with more broadly economic objectives. The IOSCO core principles do not address broader issues of competition in the securities industry, the significance of the sector itself in regional and national economic development and as a source of employment, technical innovation and venture capital, or the barriers to international competition and access to foreign securities markets.

In these respects, a common Canadian system for performance measurement finds the IOSCO principles somewhat limited.

(b) Investor Protection

Similarly, the evolving Canadian approach to investor protection also diverges from IOSCO's formulation. First, it is not clear that regulators in Canada or abroad regard investor protection as their overriding goal. As previous chapters indicate, some

jurisdictions have attempted to specify the objective of investor protection with greater precision.

For example, the FSA's statutory mandate includes the reduction of "financial crime". The Australian regulator is given the statutory duty of promoting the confident and informed participation of investors and consumers in the financial system. The Ontario Securities Commission is required, first and foremost, to protect investors, but the statute makes clear that this protection extends to unfair, improper or fraudulent practices. The AMF in Québec is instructed that consumer protection is the fifth priority²⁷. The British Columbia Securities Commission's mission statement refers to "fair" markets, but does not mention investor protection.

Second, while all regulators accept that disclosure is an important tool for protecting investors, the growing emphasis on proportionate regulation in Canada makes it clear that disclosure requirements must themselves be cost-effective. Third, and perhaps because of the apparent limits of a disclosure-based policy, Canadian regulators are turning to other ways, such as investor education, of protecting investors.

The problem with the IOSCO approach is that the concept of investor protection is not as well-defined as it perhaps was in earlier periods when markets were generally less regulated and less efficient, disintermediation through capital markets less well established, common pools such as pension funds and mutual funds less relied upon by individual investors, and investors less educated. If given priority over other goals, investor protection may be pursued at the expense of those goals.

In general, measures to enhance investor protection should, like all other rules and regulations, be subject to a cost-benefit analysis. Such an approach respects the broadly economic goals of domestic securities regulation, advances proportionate regulation and enhances the competitiveness of the Canadian economy.

(c) Systemic Risk

There is a view that systemic risk issues are within the purview of the central bank and the federal bank regulator, and that securities regulators participate on an informal basis. There are, however, two areas in which a common securities policy should be directly involved in assessing systemic risk: the regular assessment of market liquidity, and clearing and settlements. These areas are of clear importance to securities regulators even if they do not appear in explicit statements of regulatory goals and objectives.

Although a common securities policy will not be concerned with preventing dealer failure, the financial soundness of the securities industry will be a prime concern. As increasingly seen in the leading jurisdictions, a common securities policy should actively promote the stability of domestic securities markets.

²⁷ Although, as noted above, the Quebec Securities Act makes investor protection the second priority, after efficiency of the securities markets.

Market Liquidity

The stability of securities markets can be assessed using the traditional quantitative indicators of market liquidity. Market liquidity is defined as the volume of securities that can be sold in a short period of time without having a significant effect on their price. The relevant output measures include:

- Depth: ability to absorb large trade volumes, measured by market turnover (gross average daily value of securities traded relative to outstanding shares of the security)
- Tightness: ability to match supply and demand at low cost, measured by bid-ask spreads; narrower spreads reflecting larger numbers of buyers and sellers providing liquidity
- Resiliency: the speed with which price fluctuations resulting from trading are dissipated; alternately, the speed with which imbalances in order flow are adjusted, measured by the bid-ask spread and order volumes after large trades

Clearing and Settlement Systems

There is a particular role for a common securities policy in measuring the soundness and effectiveness of securities settlement systems. IOSCO has enunciated 19 recommendations intended to reduce risks, increase efficiency, provide adequate safeguards for investors and enhance international financial stability.²⁸

The principal risk in settlement activities is credit risk, the possibility that a counterparty to a trade may fail to settle its obligations when due or at any time thereafter. Liquidity risk, the possibility that a counterparty may not be able to meet its obligations when due but may settle at a later stage, is also relevant. Other risks involve the legal, custodial, and operational aspects of settlement.

Following IOSCO's recommendations, the national regulator should reduce pre-settlement risks by introducing and enforcing rules for trade confirmation, settlement cycles, central counterparties and securities lending. The principal output measures will be the volume of trades that do (and do not) settle within the required time, typically three days after execution.

It is noteworthy that IOSCO recommendation 6 discusses the central securities depository that immobilizes securities and effects transfers by book entry rather than settlement by the physical exchange of paper. In Canada, the Canadian Depository for Securities provides this capacity.

²⁸ Committee on Payment and Settlement Systems and Technical Committee of the IOSCO. "Recommendations for Securities Settlement Systems", Consultative Report, CPSS Publications No. 42, Bank for International Settlements, Basel, Switzerland (available at <http://www.bis.org/publ/cpss42.pdf>)

(d) Transparency

The IOSCO requirement that regulation promote the “highest level of transparency” is very unclear because no trading system meets that objective. Trading systems differ in the level of pre-trade and post-trade transparency because different traders adopt strategies that may require anonymity.

Accordingly, the IOSCO requirement for transparency presumably means the highest level of transparency consistent with other objectives such as competition among trading systems and attracting order flow. Thus, a common securities policy can follow the IOSCO transparency objectives and, with some modification of emphasis, continue to pursue the economic goals while reducing systemic risk and providing an appropriate degree of investor.

An important efficiency concern is the extent to which different marketplaces should be allowed to operate with different degrees of transactional transparency. This issue has proven to be highly divisive in the European context as some major market centres (e.g. the London Stock Exchange) are organized as “dealer markets” with low transparency and little regulatory intervention, while certain Continental marketplaces have been required by regulators to operate as “central auction markets” with consolidated order flow and high price transparency.

The same issues recur in environments where the central trading exchange has demutualized in order to better compete with alternative trading systems that offer lower trading costs and better execution to traders seeking anonymity, albeit at the cost of higher market fragmentation and reduced transparency (e.g. “dark pools”)

To date, there is little agreement as to which “market microstructure” is the more efficient, but it is clear that certain classes of investors strongly prefer less transparent structures and if prevented from doing accessing such markets may reduce their trading or divert to such markets in other jurisdictions. Accordingly, the regulator should measure the performance of different marketplaces and draw conclusions about the desirability of achieving greater transparency in light of all relevant policy objectives.

The principal “output” measure of rules establishing a particular market’s microstructure is the bid-ask spread, the difference between prices at which participants are willing to buy and sell securities; the more efficient market will exhibit a narrower spread.

(e) Internationally competitive securities industry

Competition among dealers and brokers is desirable because it normally leads to increased institutional efficiency, lower costs for clients, and improvements in the quality and range of financial services provided. Whereas the competition authority will be concerned about the anti-competitive effects of mergers and abuse of dominant position in the securities industry, the securities regulator will be concerned that anti-competitive

market structures may be the result of regulatory measures, such as licensing and capital requirements, that raise barriers to entry.

Accordingly, a common securities policy regulator will measure:

- (i) Dealer (foreign as well as domestic) market shares by line of Canadian business
- (ii) Changes in market shares over time
- (iii) Number of new entrants
- (iv) Innovation in products and services

(f) Market Efficiency

IOSCO'S emphasis on capital market efficiency is well-accepted, although perhaps not well-defined. Well-developed securities markets offer an alternate source of intermediation, thus enhancing efficiency in the financial sector through competition with other financial institutions. Well-functioning securities markets provide a mechanism for the efficient valuation of assets and diversification of risks; create liquidity in financial claims; and efficiently allocate risks. Markets help reduce the cost of capital, thereby raising economy-wide savings and investment. They also foster market discipline by providing incentives to corporations and financial institutions to use sound management and governance practices.

Thus, while regulatory objectives may emphasize that efficiency capital markets provide funds for investment, the informational efficiency of markets contributes significantly to living standards and economic growth in ways that go well beyond the provision of financing.

A securities market is informationally efficient when price movements are unpredictable. Because informationally efficient markets incorporate new information quickly into securities prices, observed price movements are unpredictable because the arrival of new information is unpredictable. Accordingly, a regulator will be concerned about departures from random price movements, as such departures may indicate the ineffectiveness or under-enforcement of regulations.

Tests of regulatory "output" would measure how markets react to information. For example, there is some indication that underpricing of initial public stock offerings in Canada is less than in other jurisdictions with less developed markets. Thus, efficiency tests could include:

- (i) Tests of randomness of day-to-day trading
- (ii) Measures of security-price reactions to announcements of new information (e.g. stock splits; share issues, takeover bids)
- (iii) The extent of discounts on initial public offerings
- (iv) Profitability of insider trading
- (v) Trading activity before major corporate announcements

(g) Regulatory Efficiency

Proportionate Costs of Regulation

Regulators are increasingly concerned with the costs of compliance that their rules and regulations create. The Ontario statute makes proportionate regulatory costs a principle to which the Commission shall have regard. The British Columbia Securities Commission indicates that advancing cost-effective regulation is one of its four areas of action. A common securities policy should have a similar requirement.

At present, Ontario is the only Canadian jurisdiction with a requirement to consider the costs and benefits of proposed rules. Cost-benefit analysis raises issues of measurement and organizational acceptance. However, it is an accepted part of regulatory impact analysis in many areas, such as health, safety and transportation and has been found to be applicable. Accordingly, a common securities policy should seek to measure the costs and benefits of regulatory proposals and to report the results of analyses to the public, without being specifically bound by the conclusions of those analyses.

Service Standards

Securities regulators are increasingly concerned with their internal efficiency through the development of service standards and measurement systems. This may be especially true where the regulator recovers its costs through fees and charges to market participants rather than through government funding.

As discussed in Chapter 1, the U.K. Financial Services Authority has established standards in 64 service areas and publishes performance statistics annually; Canadian efforts are thus far at an early stage. A common securities policy will seek to provide equally efficient service to issuers (e.g. clearing prospectuses), industry participants (e.g. registration times) and the public at large (e.g. complaint handling) across the country.

(h) Market Integrity

A key element in a scheme of investor protection is the development of regulations to fight financial crimes, in particular, money-laundering and terrorist financing. Noting that the U.K. Financial Services Authority is mandated by statute to reduce financial crime, a common securities policy will pay particular attention to this objective.

It may be questioned whether the securities regulator is better able to deal with these criminal activities than are police forces. Obviously, cooperation is required in enforcement matters; the regulatory role would focus on suitability, “know-your-client” and recordkeeping requirements.

As with most aspects of investor protection, performance standards and measurement are not easily defined. The national regulator’s success in reducing financial crime depends

on several factors, including the resources available to the enforcement agency. As these resources can be put to alternative uses, the regulator will necessarily allocate funds among activities with equally high priorities.

Note, however, the FSA's attempt to specify the objective in measurable terms in its Performance Account:

Firms and other stakeholders understand their respective responsibilities and mitigate risks relating to financial crime and arising from market conduct, measured by using the Financial Crime Survey of firms, the Consumer Awareness Survey, and market cleanliness measures. Market cleanliness is reflected in the extent to which 'informed price movements' are observed ahead of significant regulatory announcements by issuers.

The development of corresponding measurable output measures will be a prime concern in a common securities policy. Given its national scope, such a policy will contribute to the reduction of financial crime in conjunction with other national criminal enforcement bodies.

4. Framework Issues in Securities Regulation

In light of the framework issues presented in the introduction to this paper, it is easily concluded that the IOSCO approach of delineating principles of regulation is lacking in key respects. It says nothing about key performance indicators, the issues that attend performance measurement or the issues involved in public disclosure of regulatory performance.

When the individual Canadian regulatory organizations are studied, it becomes clear that while efforts are being made to specify goals and objectives, the performance measurement issues remain to be undertaken. The discussion in the previous chapters highlights that:

- In several provinces, performance measurement is not a priority, with the result that regulators do not obtain good feedback on the impact of rule-changes
- Where performance measurement is attempted, securities regulators primarily measure inputs and activity levels
- While the high-level statement of statutory goals may give the impression that measurement is not necessary or valuable, the reluctance to measure performance may have more to do with conflicts among goals
- It is desirable that performance measurements be widely disseminated

The efforts by the British Columbia Securities Commission, while at an early stage, are encouraging and may well serve as the model for regulators in other provinces.

There are clear benefits to Canada of a common set of goals and objectives for securities regulation. It is apparent that capital markets have national and international dimensions, and that Canada is best served by a capital market that is efficient, stable, domestically and internationally competitive, and supportive of national and regional economic development while ensuring that investors have the information necessary to evaluate investment risks and potential returns accurately and are protected against fraud and financial crime. A framework of agreed goals and objectives, together with effective performance measurement is an important ingredient in achieving these benefits.

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