The Final Report of the Capital Markets Modernization Taskforce: What Securities Litigators Need to Know

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Much has changed in capital markets in the last seventeen years. Ontario's securities regulatory framework, however, has not been comprehensively reviewed – until now. The Final Report of the Capital Markets Modernization Taskforce, delivered in January 2021, recommends significant amendments to update Ontario's regulatory framework. The Report is the product of nearly a year of consulting with stakeholders.

The Report's 74 recommendations primarily focus on enhancing the growth and competitiveness of Ontario's capital markets. Among other things, these recommendations aim to reverse the decline in new issuers and initial public offerings, and to spur the growth of independent dealers. The Taskforce proposes that these recommendations be implemented by introducing an Ontario version of the *Capital Markets Act* currently under development by the provinces, which would replace Ontario's *Securities Act* and *Commodity Futures Act*.

Much of the Report proposes broader regulatory changes, which are the focus of five of the six key recommendations:

- improving regulatory structure (by reforming governance under OSC and Self-Regulatory Organizations (SROs) – IIROC and the MFDA);
- making regulation a competitive advantage (through reduced regulatory burden and streamlined regulations);
- ensuring a level playing field (including for independent dealers and manufacturers of financial products);
- reforming the proxy system, corporate governance and rules for M&A transactions; and
- fostering innovation (including for new business models such as FinTech start-ups).

The sixth key recommendation is to modernize enforcement and enhance investor protection. Securities litigators should take note of important changes proposed in the Report, which are set out in full in the table below. While some changes will be enacted through legislation, others involve changes to existing policies that could be implemented immediately.

The Report's proposals focus on regulatory investigations and proceedings, both enhancing the powers of OSC Enforcement Staff and procedural protections for respondents. These recommendations confer significant new powers for Staff to:

- investigate breaches of securities law, such as: the ability to obtain quasi-criminal production orders (59), warrants for day-time searches of residences (60), and the ability to obtain orders to take-down websites (64);
- collect penalties and other funds from respondents, including: higher monetary penalties (58), expanded powers to freeze assets during an investigation (55), a statutory lien over all of a respondents' assets (62), and withholding driver's licenses for respondents who fail to pay (56);
- prosecute new statutory offences for: making misleading statements about issuers (to target "short and distort" campaigns) (57), aiding and abetting securities violations (66), and front-running their customers' orders (67).

At the same time, respondents and subjects of investigations will receive greater procedural rights. Some amendments confirm or enhance existing rights, such as: protections for those who produce documents when compelled by a summons (65), confirming that privileged communications are protected (70), and broadening rules to allow a respondent to disclose a summons to their employer and to other regulators in appropriate circumstances (69).

Most of the Report's investor protection recommendations involve legislative amendments, the details of which will be set out in forthcoming draft legislation. Expect wide-ranging discussions about the substance of these proposals in the coming years. In the meantime, we address below three of the most important proposals for securities litigators.

1. New OSC Enforcement Processes and Procedures

A number of the proposed reforms set out in the Report are based on competing objectives. On one hand, the Report seeks to create a more rigorous enforcement framework by expanding the scope and severity of sanctions that can be imposed, the types of offences that can be charged, and the tools that regulators have available to investigate and enforce securities laws. On the other, it suggests that the province "must ensure that investigations are conducted in a manner that does not place an undue burden on market participants".

While tougher enforcement can theoretically be done with a softer touch, this is often difficult to achieve in practice.

Some respondent-friendly reforms are proposed at the governance level. Currently, OSC Commissioners may serve as members of the Commission's board of directors as well as adjudicators. The Report proposes to separate these roles in keeping with best governance practices, by creating an independent dispute resolution tribunal with specialized Commissioners serving a five-year term.

In addition, the Report also proposes greater transparency for respondents and targets of investigations and proceedings, including the issuance of public guidance on processes and procedures adopted by Enforcement Staff, the codification of certain deadlines, and creating a process to adjudicate concerns about proportionality in investigations. The latter would include the ability to escalate concerns to the CEO, for example, to resolve disagreements between Staff and a target or witness over privilege, relevance or proportionality. The current regime makes adjudication of these issues difficult, as a contempt proceeding in Superior Court is the main place where such disputes can be litigated. As a practical matter, at present participants in investigations are required to either concede to Staff's position – bowing under pressure – or proceed forward at their peril.

2. Towards a Single SRO

The Report also proposes simplifying and updating the framework for regulation of investment and mutual fund dealers through a single SRO.

The drafters of the report do not pull any punches, describing the current IIROC and the MFDA regimes as "anachronistic and confusing to investors". Many firms face dual regulation, which adds to compliance costs and overhead. While the regulatory and enforcement processes followed by each of IIROC and the MFDA are similar, there are important and sometimes subtle differences between the two that can be confusing.

The Report notes that a single SRO would reduce regulatory complexity and cost while harmonizing regulation. The report states: "An underlying principle of moving to the new SRO is that regulatory oversight must be commensurate with the market participant's size and sophistication." While for smaller corporate and individual participants in the securities industry this will be welcome, the key question is how it will work in practice, which is based not only on the rules themselves but in the exercise of discretion as to how they are considered and enforced.

The Report proposes a phased introduction for a single new SRO, and contemplates that over time that SRO might take on additional authority and responsibility, and also take jurisdiction over additional categories of firms regulated directly by the OSC (Exempt Market

Dealers, Portfolio Managers, and RESP Dealers). If these more sweeping changes are made, they would have the potential to greatly simplify the processes for registration and carrying out certain types of investigations under securities legislation.

3. Replacing OBSI and Creating a Binding Dispute Resolution Service

The Ombudsman for Banking Services and Investments (OBSI) currently offers a non-binding dispute resolution service for certain types of losses suffered by investors up to a current damages cap of $350,000. There has long been discussion of reforming the OBSI process. From the perspective of dealers and firms, OBSI's process can be opaque and frustrating. For harmed investors, the non-binding nature of OBSI's dispute resolution process can involve a lot of time and effort for an uncertain benefit, as the firm may simply refuse to follow OBSI's recommendation.

The Report proposes to provide the OSC with the power to designate a dispute resolution service (DRS) that can make binding decisions and issue awards up to a $500,000 limit, to be periodically raised based on a cost of living calculation. It contemplates a framework for dispute resolution that includes procedural fairness and an express power to distribute disgorgement to investors. The devil may be in the details, but these reforms have the potential to result in a streamlined and more efficient dispute resolution process for smaller investor loss claims and to provide greater access to justice for harmed investors.

In summary, the Taskforce Report offers much for securities litigators to take in. Even before any of these proposed amendments come into force, some prospective changes ought to be flagged for clients that are or may be subject to an investigation. Defence counsel may be able to take advantage of the Report's articulation of some of their oft-stated concerns about proportionality and fairness in the context of discussions or negotiations with Staff. Securities litigators should watch closely for the further developments on the horizon.

Capital Markets Modernization Taskforce –
Key Recommendations Relevant to Securities Litigators

Topic	#	Select Recommendation in the Report
Independent OSC tribunal	4.	Separate regulatory and adjudicative functions at the OSC

Topic	#	Select Recommendation in the Report
Creation of a single SRO	9.	Move to a single SRO that covers all advisory firms, including investment dealers, mutual fund dealers, portfolio managers, exempt market dealers, and scholarship plan dealers
Expanded freeze powers	55.	Provide the OSC with more effective powers to freeze, seize or otherwise preserve property, including property transferred to family members or third parties below fair market value
No driver's licenses for debtors	56.	Limit access to drivers' licences and licence plates for failure to pay amounts ordered by the OSC or the Courts
"Short and distort" offence	57.	Create a prohibition to effectively deter and prosecute misleading or untrue statements about public companies and attempts to make such statements
$10 million monetary penalty	58.	Increase the maximum for administrative monetary penalties to $5 million and increase the maximum fine for offences to $10 million
Production orders in quasi-criminal proceedings	59.	Modernize investigative tools by empowering the provincial Court to issue capital markets production orders
Service by email and day-time residential searches	60.	Amend legislation to permit substituted and broader service provisions and remove the search exemption for private residences such that they can be searched during daylight hours with a warrant
Data delivery and privilege protocols	61.	Codify certain OSC requirements relating to data delivery standards to ensure the preservation of evidence and address assertions of privilege
Statutory lien for OSC orders	62.	Provide that, once a finding of wrongdoing has been made, any disgorgement amount owing to the OSC forms a lien that the OSC may register over the entire property of the persons named in the OSC order
Tolling agreements	63.	Allow tolling agreements to enable the OSC and respondents to mutually agree to extend the limitation period to commence proceedings, and expand the limitation period for collections-related actions
Website take-down orders	64.	Strengthen investigative tools by empowering the OSC to obtain orders to block or remove websites and social media sites
Protections for producing under a summons	65.	Confirm that persons or companies who comply with a summons will not be in breach of any contracts they are a party to and that compliance with an OSC summons will not be a basis of contractual liability against them by third parties
Aiding and abetting offence	66.	Create prohibitions to effectively prosecute those who facilitate contraventions of Ontario securities law
Front-running offence	67.	Create a prohibition to prosecute front-running effectively

Topic	#	Select Recommendation in the Report
Greater procedural rights for respondents	68.	Greater rights for persons or companies directly affected by an OSC investigation or examination and ensuring proportionality for responses to OSC investigations
Disclosure of summons to employers and other regulators	69.	Broaden the confidentiality exceptions available for disclosing an investigation and examination order or a summons
No compelling privileged information	70.	Clarify that the OSC may not require production of privileged documentation
Binding dispute resolution for investor claims	71.	Provide the OSC with the authority to designate a dispute resolution services (DRS) organization that would have the power to issue binding decisions
Statutory obligation to distribute disgorged funds to investors where appropriate	72.	Require, in cases where there is sufficient evidence to establish that investors suffered direct financial losses, that amounts collected by the OSC pursuant to disgorgement orders be distributed to harmed investors through a Court-supervised process
Automatic reciprocation of orders from other Canadian securities regulators	73.	Provide for automatically reciprocating sanction orders, cease trade orders and settlements from other Canadian securities regulators and granting the OSC a streamlined power to make reciprocation orders in response to criminal Court, foreign regulator, SRO, and exchange orders
Whistleblower protection from FIPPA requests	74.	Explicit exemption from freedom of information disclosures for whistleblower-identifying Information