

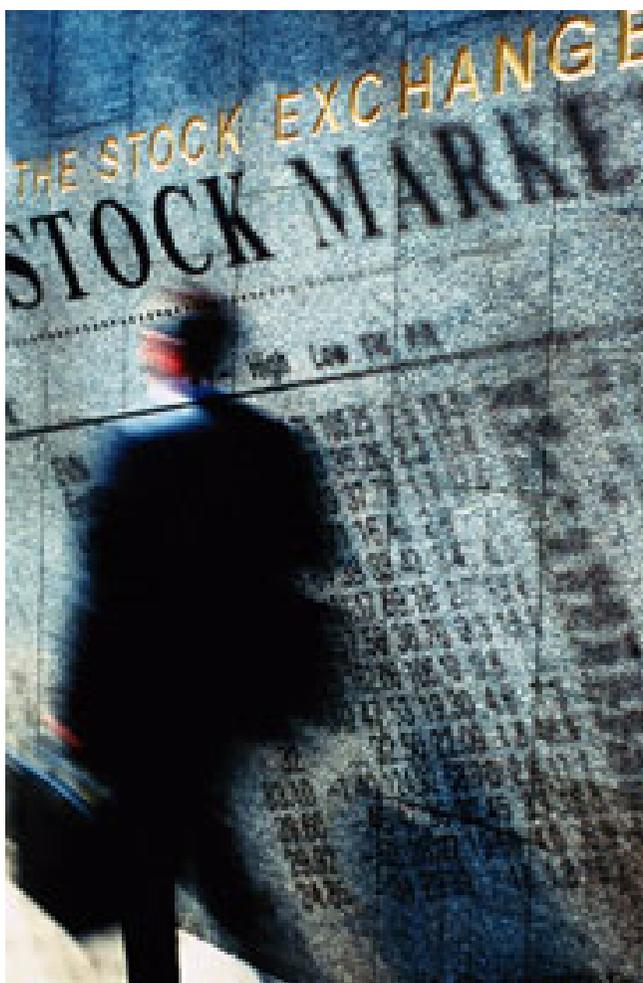
2001 FRASER INSTITUTE

# CRITICAL ISSUES

*bulletin*

## Commissions Unbound

The Changed  
Status of  
Securities  
Regulators  
in Canada



*John F. Chant and Neil Mohindra*

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**Critical Issues Bulletins**

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## Executive summary

Prior to 1995, the budgets of the securities commissions of Alberta and British Columbia were set by their provincial governments through the appropriation process commonly used for nearly all government spending. That year, the Alberta Securities Commission (ASC) and the British Columbia Securities Commission (BCSC) were given Crown Corporation status, which gave the commissions the ability to control the fee revenue generated from their activities and determine their own budgets. The Ontario Securities Commission (OSC), the Quebec Securities Commission (QSC) and the Manitoba Securities Commission (MSC) have since converted as well.

There were calls for the change in the status of the commissions because it would insulate them from the vagaries of negotiating appropriations with governments for financing their activities. In effect, they would be assured the resources necessary to do an effective job in maintaining the credibility of the securities markets.

As it is now more than five years since the first of these conversions took place, it is appropriate to assess the consequences of these changes. Has the removal of a budget constraint affected the levels of spending undertaken by the commissions in carrying out their duties? Has it affected the ways in which they spend their money? The purpose of this study is to examine these and other questions about the consequences of the changed status of the commissions through a review of the behaviour of the ASC, BCSC, and OSC.

Evidence suggests the reduced financial accountability inherent in the commissions' changed status appears to have worked to the detriment of low-cost, efficient regulation of the securities industry. In our assessment, we have found that since conversion in 1995, the ASC and BCSC have increased spending on average by almost 20% and 14% a year. Since its conversion in 1997, spending by the OSC has more than doubled.

A major reason for this explosion in spending is staff increases. The BCBS and ASC have increased their staff by approximately 50% in the five years since conversion while the OSC increased theirs by 67%. Salary growth was another

factor. Average salaries have been increasing at the BCSC by an average of over 5% per year while at the ASC they have been increasing 13.5% per year. Between 1996 and 2000, these two commissions beat private-sector counterparts in investment intermediaries, accounting, and law in salary growth. In 1996, the executive director was the only staff member to receive a salary greater than \$100,000 at the OSC. In 2000, 64 surpassed this mark.

Senior management at the commissions are beneficiaries of the salary growth. In 2000, the salaries of the Chair of the OSC and the Vice Chairs and Executive Directors at the OSC and ASC were more than double 1996 levels. Comparisons with positions of similar responsibility suggest salaries at the commissions are excessive. The OSC Chair now earns 2.6 times the salary of the Chair of the US Securities and Exchange Commission (SEC).

Despite the higher spending, fees were set at excessive levels that generated large surpluses. By the end of 2000, the three commissions combined held over \$60 million in reserves despite transfers to their provincial governments of over \$60 million by the OSC and \$12 million by the BCSC.

Overall, the conversion of the commissions into crown corporations was not a success but a lesson on why bureaucrats should not have independence in setting budget and salary levels. Little was achieved in that the commissions had adequate policy independence before the conversion. The change came clearly at the cost of financial accountability.

Measures are needed to restore financial accountability. The budget of the securities commissions should be subject to arm's length review and approval. The salaries and benefits of the commission's senior management should be based upon clearly stated benchmarks of positions of similar responsibility and authority. The fee levels of the securities commissions should be set to cover commissions' legitimate expenses over a medium-term horizon. Provincial auditors should periodically conduct performance (Value-for-Money) audits on securities commissions.



# 1 Introduction

## 1.1 Removing the bonds from the commissions

The 1990s saw the dawning of a new era for the securities regulators in Alberta, British Columbia, Manitoba, Ontario and Quebec as the securities commissions in these provinces—the Alberta Securities Commission (ASC), the British Columbia Securities Commission (BCSC), the Manitoba Securities Commission (MSC), the Ontario Securities Commission (OSC), and the Quebec Securities Commission (QSC)—were transformed from government agencies into crown corporations. While these changes affected neither their responsibilities nor their powers to fulfill them, they did give the commissions far greater independence with respect to their spending. Prior to the change, the Commissions’ fee revenues flowed directly into their provinces’ general revenues while the commissions depended on government appropriations to fund their activities. The change effectively transferred control over the fee revenues from the provincial treasuries to the commissions themselves. As the Chair of the OSC described the change: “We can set our own budgets, hire our own personnel, determine our own priorities, with confidence that, within reason, funding will be available” (Ontario Securities Commission 1998a: 2). The commissions would no longer be dependent on the vagaries of appropriations negotiated with governments for financing their activities. In a sense, the commissions had achieved something about which most bureaucrats can only dream.

As it is now more than five years since the first of these conversions took place, it is appropriate to assess the consequences of these changes. Has the removal of a budget constraint affected the levels of spending undertaken by the commissions in carrying out their duties? Has it affected the ways in which they spend their money? There are also questions that need to be answered about the way in which spending grew. How much of the increased salaries and wages went for increased staff and how much for increased rates of compensation? Were higher compensation levels required to attract the calibre

of staff required to meet the commissions’ responsibilities? The purpose of this study is to examine these and other questions about the consequences of the changed status of the commissions by reviewing the behavior of three of the commissions—the ASC, the BCSC and the OSC.

This Critical Issues Bulletin is a study of securities regulators and their behaviour, and is not a study of securities regulation itself. It examines the behaviour of securities regulators as they react to changes in their environment. Nevertheless, it does have a bearing on the relationship between securities regulators and the industry that they regulate. The supervision and enforcement activities of securities commissions are financed through fees on corporate issuers and other participants in the securities business. The spending of securities commissions affects the expenses of participants in securities markets because it is financed by the fees these participants pay for registration, prospectuses and annual reporting.

It is not easy to judge the appropriateness of the changes in the budgets of the securities commissions after they became crown corporations. Some argued for the changed status of the commissions because it would give them the resources necessary after years of austerity to do an effective job in maintaining the credibility of the securities markets. Still this argument has limits: should the resources to these commissions be increased 10%, 20% or 50%? Or do they need to be increased at all?

These questions would be easier to answer if we could identify an “ideal” level of regulatory and enforcement activity for securities markets. If the budget increases moved the commissions toward this ideal, then the conversion of the commissions to crown corporations has been worthwhile: the extra costs of operating the commissions may have generated more than equal benefits. On the other hand, if it has moved activity beyond this ideal, the extra activity beyond the ideal has not justified its extra expenses. Still, identifying the ideal provides only part of the answer. Even if the ideal level could be identified, we would still need to ask whether this ideal has been supplied at minimum costs and, if not, how much beyond the minimum costs.

Resolving these issues in this way is beyond the scope of the present study. Rather, we will attempt to use benchmarks of various sorts to judge the consequences of the changes. Among the benchmarks will be practices of other securities regulators elsewhere and similar bodies in the same jurisdiction. In addition, some of the changes will be judged on the reasonableness of the ratio of benefits to costs.

We begin this study with an overview of how the securities commissions operate. Next, we examine how the conversions to crown corporations affected their budgetary powers, followed by a review of the effects of the change in budgetary powers on the operations of the commissions. We continue with an assessment of these changes, draw lessons for ensuring future accountability.

## 1.2 The commissions— an overview

### The activities of securities commissions

Securities commissions combine together in one institution a variety of different functions related to the supervision of securities markets and their participants. Securities commissions administer the enforcement of securities laws; oversee the activities of participants in securities markets including exchanges, self regulatory organizations, dealers and advisers; regulate disclosure by public corporations and mutual funds; and develop rules, policies and legislation that govern securities markets.

This combination of different functions of the administration of securities law is a most curious part of our legal system. Securities law shares with the rest of the legal system the need for investigation, prosecution, judgment and rule making. Unlike other areas of justice where a clear separation is maintained among these activities, in the area of securities law these activities are all blended together into one institution, the securities commission. In contrast to criminal law, where investigation is performed by the police, prosecution by crown attorneys, judgment by the courts and rule making by the legislatures, a person may be investigated, prosecuted and judged by a securities commission for transgressions under rules developed and promulgated by that same commission. Even though commissions may in some cases have their investigations assisted by the police, prosecutions handled by crown attorneys and judgment referred to the courts, nowhere else in our legal system is such range of functions concentrated in one institution.

The commissions perform one further activity vital to their operations by serving as the agency through which participants in the securities market register their activities and make their mandated disclosures. Among the filings that are processed by commissions are the prospectuses for public companies and mutual funds; the annual information forms of public companies; and the registrations of companies as dealers, advisers and underwriters and of their sales people. As we will see in more detail below, the commissions' registration and filing activities provide the revenues that support the commissions' activities in the administration of securities law.

### The administration of the commissions

At the core of each securities commission are the chair and its other directors who determine how the commissions are run and what they will do. In British Columbia, for example, these commissioners have three basic functions:

- (1) to serve as the board of directors of the BCSC and oversee its management;
- (2) to provide policy direction to the BCSC staff and to enact legally binding rules; and
- (3) to conduct hearings and make decisions under the Securities Act (*BCSC Annual Report, 1999–2000: 7*).

In effect, the granting of these functions to the commissioners places the administration of much securities law in their hands. They set rules governing players in securities markets; decide the amount of resources to be devoted to enforcement through investigation and prosecution, determine the directions these enforcement activities should take, and preside over hearings to make decisions under the *Act*.

## 1.3 The revenues and expenses of the commissions

### Revenues

The major source of revenues for securities commissions consists of fees charged on the filings of information required for a variety of securities market activities. These fees include the following.

*Distribution fees* are paid for making the filings required for making securities distributions including new and renewal prospectus filings and private placement filings, and

also for take-over bid circulars, director circulars and notices of variation. These fees can be expected to fluctuate from year to year with changes in issuance and take-over activity that lead to these filings.

*Registration fees* are charged for the registration of advisors, dealers and salespersons. These fees can also be expected to fluctuate with the level of securities market activities. Experience, for example, shows that the registration of mutual-fund sales people tends to follow trends in mutual fund sales.

*Annual financial statements* must be filed annually by all reporting issuers. The fee revenues based on these filings tends to be stable in as much as the number of already existing issuers required to report does not fluctuate from year to year. The predominance of December 31 year ends together with a 140-day filing period means that these filings can straddle the commissions' March 31 year ends, contributing to some fluctuation in year-to-year revenues despite stability in the number of reporting issuers.

The patterns of revenue for the three provincial securities commissions shown in table 1.1 are very similar with over 85% of revenues in each case coming from fees. Of these fees, those for prospectus filings related to new issues were the most important, accounting for over 40% of revenues, followed by registration revenues from industry participants providing over 20% of revenues and corporate disclosure generating over 10% of revenues. The only significant source of revenues other than fees consisted of investment revenues that accounted for from 2.3% (Ontario) to 7.8% (Alberta) of total revenue.

The provincial commissions do differ with respect to the share of fees from prospectus filings, recoveries and investment income. Of these, only the prospectus filings are persistently different, accounting for the highest proportion in Ontario, a difference that reflects the concentration of institutional investors in Ontario. Differences in the levels of recoveries across the provinces are more transitory as the results depend on the settlement of particular cases. Finally, the higher level of investment income earned by the ASC reflects the lower level of BCSC's and the OSC's reserves because of required transfers to their provincial governments and, in the case of the OSC, the shorter time that it has had to develop reserves since it became a crown corporation.

### Revenues over time

A concern over the adequacy of reserves was one of the concerns that precipitated the conversion of the commissions. The same concern also appears to have motivated the commissions to build up reserves since their conversion to protect against drops in revenues from changes in securities market activities.

The movements over time in the three commissions' major sources of revenues show that their experience have been quite different over the period for which comparable data are available. The BCSC has experienced continual growth in all its sources of revenue from 1994 to 2001 with two exceptions: decreases in prospectus fees in 1996 and in exemption and order fees in 2001. In neither case was the change sufficient to reduce total revenues. Ontario faced a similar decline in revenue from prospectus fees together with a fall in registration-fee revenue in 1996. Ontario also suffered a drop in data-filing fees and a sharp drop in recoveries in 1995, the latter being a reflection of unusually large recovery the year before. It is interesting to note that the OSC's 10% across-the-board fee reduction in 1999 decreased only registration fees and was offset by increases in revenue from other fees. The ASC, in contrast, has experienced substantial declines in the components of its fee revenues: fees from distribution declined over 23% in the two years to 1999; revenue from registration fees declined in both 1995 and 2000; and annual filing revenues dropped 23% from 1995 to 1997.

Overall, total revenue and its components have been generally stable from 1994 onward for both the BCSC and the OSC.<sup>1</sup> The ASC has experienced both greater fluctuations in various types of revenues together with a recent downward trend in total revenue.

### Expenses

The allocation of the expenses of the ASC, BCSC and the OSC among different categories are shown in charts 1.1(a), 1.1(b) and 1.1(c). Overall, the allocations are generally similar. In each case, salaries and benefits are by far the largest expense, accounting for 60% to 69% of the total. Professional and contract services are next in importance and range from 4% in British Columbia to 19% in Ontario. The differences between the provinces in these two categories tend to offset each other. When professional services are combined with salaries and wages, this combined category accounts for between 74% and 79% of total expenditures. This high proportion of expenses directed to these two categories reflects the dependence of the commissions on labour resources in producing their regulatory services.

Table 1.1: Revenue sources of securities commissions: 2000 (\$thousands)

Source of Revenue	Commission		
	ASC	BCSC	OSC
<b>Fees</b>			
<i>Prospectus Filings</i>	\$5,281 (40.6%)	\$11,851 (43.4%)	\$46,326 (56.2%)
<i>Registration</i>	\$4,115 (31.6%)	\$6,147 (22.5%)	\$23,866 (29.0%)
<i>Disclosure</i>	\$1,777 (13.6%)	\$3,641 (13.3%)	\$8,802 (10.7%)
<i>Application</i>		\$2,755 (10.1%)	\$1,270 (1.5%)
<i>Other fees</i>	\$455 (3.5%)		
<b>Total fees</b>	\$11,628 (89.3%)	\$24,394 (89.3%)	\$80,264 (97.4%)
<b>Recoveries</b>	\$62 (0.5%)	\$1,235 (4.5%)	\$63 (0.1%)
<b>Administrative penalties</b>	\$186 (1.4%)	\$269 (1.0%)	
<b>Investment income</b>	\$1018 (7.8%)	\$1,254 (4.6%)	\$1,910 (2.3%)
<b>Other</b>	\$127 (1.0%)	\$179 (0.7%)	\$143 (0.2%)
<b>Total</b>	\$13,021 (100%)	\$27,331 (100%)	\$82,380 (100%)

Sources: Annual Reports

## 1.4 The status of securities commissions

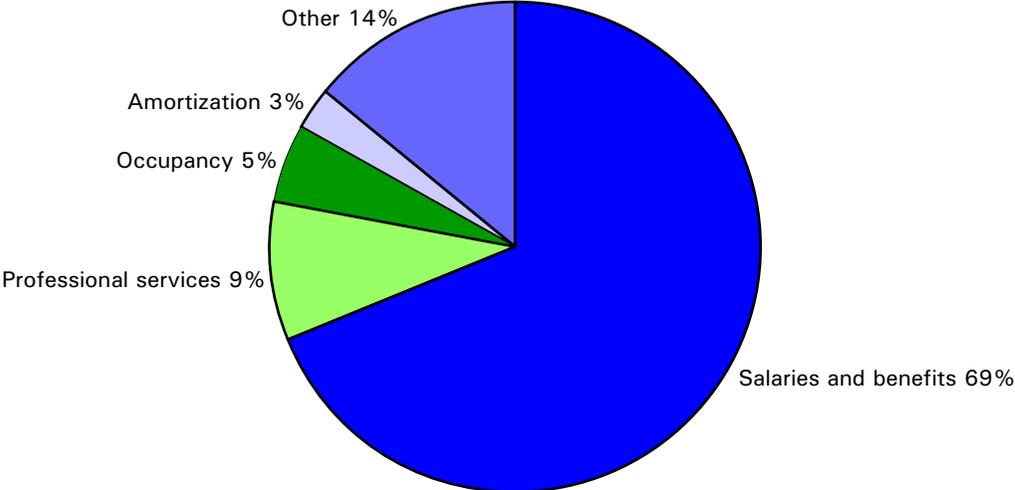
The analysis of securities commissions must take into account how the status of securities commissions differs from that of other crown corporations because of the nature of their activities. Most crown corporations sell goods or services to the public or manage assets on behalf of a provincial government. Even though many Crown Corporations have been either legal or natural monopolies, most deal with their customers as peers in carrying out voluntary transactions, albeit not always at competitive price levels. Their ability to sell their services depends on the quality of the service and its price. Securities commissions, in contrast, are regulatory agencies with quasi-judicial powers. The commissions as regulators deal with their “customers” as subjects of their regulation. Individuals and corporations falling under their jurisdiction use required quantities of their services specified by regulatory fiat. While customers buying hydroelectric power can choose the amount they purchase and are able to substitute other energy sources, any corporate issuers must pay fees for its mandatory reporting.

The quasi-judicial character of securities commissions means that they will need a different, more inde-

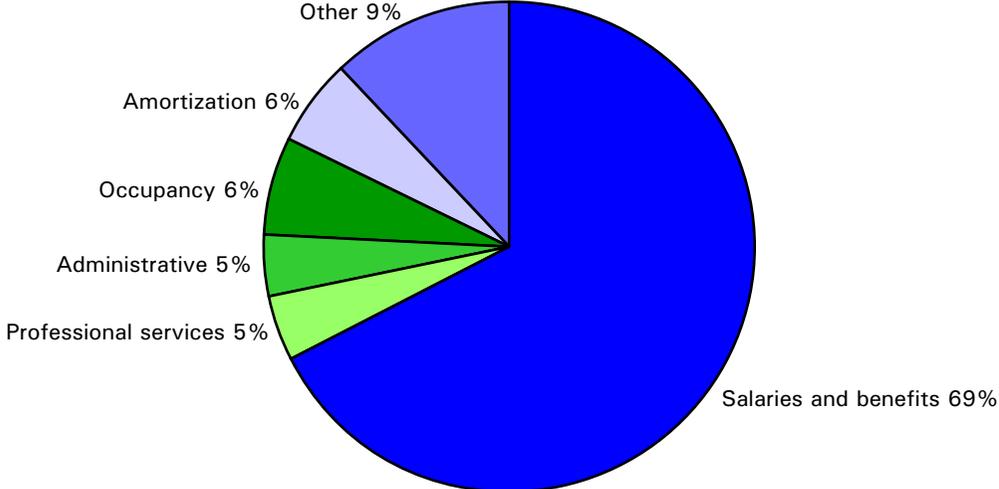
pendent status relative to their parent governments than typical crown corporations in order to carry out their responsibilities. The arguments for the independence of securities commissions are familiar; they are similar to those for the independence of the judiciary, prosecution and the policing arms of the legal system. Independence in both these cases is a basic tenet of democratic government to protect citizens from arbitrary actions from those having political power. The enforcement of laws should be carried out on the basis of evidence and the penalties for infractions should be determined on the seriousness of the offences involved.

The status of securities commissions will reflect a balancing of “policy independence” and “budgetary independence.” Policy independence refers to a commission’s ability to operate without the interference of others, especially political authorities, in the implementation of securities policy and the administration of securities law. Budgetary independence, in contrast, refers to the ability of a commission to determine its level and composition of expenditures on its own. Policy independence is absolutely vital for the credibility of security commissions in carrying out their mandate. We will see, however, that budgetary independence is less necessary and may even be detrimental to a commission’s performance.

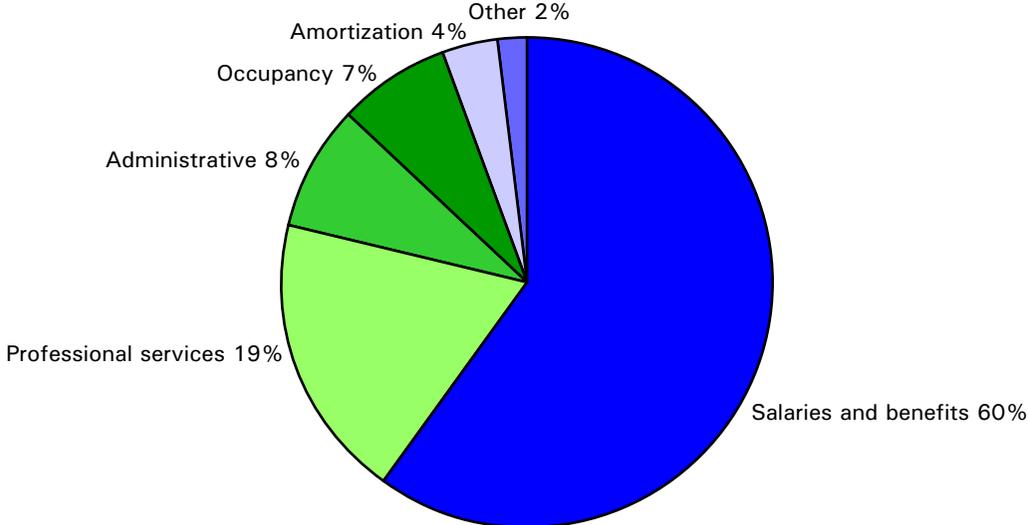
**Chart 1.1a: Alberta Securities Commission—expenses 1999/2000**



**Chart 1.1b: British Columbia Securities Commission—expenses 1999/2000**



**Chart 1.1c: Ontario Securities Commission—expenses 1999/2000**





# 2 The conversion to crown corporations — the status before and after

In response to the concerns expressed by their securities commissions, the governments of Alberta and British Columbia both converted these securities commissions from agencies within government to independent crown corporations in 1995 and the Ontario government followed their example in 1997. In this chapter, we will consider the ways in which this conversion altered the powers of the securities commissions over their own affairs.

## 2.1 The commissions before conversion

Prior to their conversions to crown corporations, the securities commissions had the status of agencies within the government. From a policy perspective, these agencies had their investigative, prosecutorial and judicial powers set out in the respective provincial Securities Acts. The conversion into crown corporations did nothing direct to alter their degree of policy independence.

From a budgetary perspective, the commissions were totally dependent on the government for their finances in the same way as any department or program within a ministry. From the mid-1980s onward, the commissions developed increasing revenues from their registration fees but their status as a government agency meant that these revenues were treated as part of the general revenues of their province. The commissions' expenditures, in turn, were totally determined by the appropriations made for them in their governments' budgets. Like other departments, the commissions were subject to the budget austerity measures undertaken by the provinces in the early 1990s. Finally, the commissions' staffs were members of the civil service with their terms of employment, including salaries, subject to the rules that governed other government employees. While the terms of their status as agencies appears to have provided the policy independence necessary for the commissions to do

their job, the commissions appear to have had very little budget independence prior to their conversions into crown corporations.

A significant feature of the commissions' arrangements prior to conversion was the government's financial benefit from their activities in the form of a transfer to their budgets. Even though they covered the commissions' expenditures through budget appropriations, the governments gained the revenues from the commissions' fees. The governments' gain from the commissions' activities equaled the surplus of the receipts of the general revenue fund less the appropriations to the commissions. In some cases, these funds were immediately available to the governments whereas in others, the funds built up as the commissions' reserves and were subsequently transferred to the province.

Table 2.1 shows that the governments' net revenues grew substantially in the period up to the change in status. The province of Ontario, for example, experienced a net loss from the OSC's activities in 1990/1991. The highest level of surplus prior to 1992/1993 was \$3.4 million in 1989/1990. The government's revenues increased dramatically in 1992/1993, increasing sevenfold, and continued increasing with one exception right up to the conversion. The net revenues to Ontario had reached \$38.2 million in 1996/1997, the year of the conversion, and exceeded \$25 million in each of the final four years.

The net benefits to the British Columbia government from the operations of the BCSC were much smaller than those generated by the OSC. Table 2.1 shows that these revenues averaged over \$2.7 million over the five years immediately prior to conversion, the only years for which data were available.

The Alberta government gained the least from the operations of its security commission. In only two years—1993/1994 and 1994/1995 did it gain substantial revenues, almost \$8 million over the two years.

There are two ways to look at these net surpluses: as a revenue source to governments and as a cost of reg-

**Table 2.1: Net surpluses of commissions before conversion**

	ASC		BCSC		OSC	
	Surplus (\$000)	% of revenue	Surplus (\$000)	% of revenue	Surplus (\$000)	% of revenue
1997/1998					Converted 1997	
1996/1997					38,209	65.4
1995/1996	Converted 1995		Converted 1995		27,910	60.1
1994/1995	5,223	56.5	4,138	28.4	30,737	66.4
1993/1994	2,702	35.5	3,549	26.9	29,856	61.1
1992/1993	349	7.8	3,000	27.3	12,529	39.2
1991/1992	-778	-21.2	2,500	25.0	1,802	8.6
1990/1991			200	2.5	-122	-0.7
1989/1990					3,361	19.9
1988/1989					1,734	12.9

Source: Annual reports of commissions and public accounts of British Columbia

ulation to the securities industry. There is little question that this source of funds was of minor significance in the overall scheme of provincial finances at the time. On the other hand, these surpluses are very substantial relative to the filing fees paid to the commissions by participants in the securities industry. As shown in Table 2.1, these transfers reached almost two thirds of the fees paid to the OSC in 1995/1996 and had exceeded 60% of revenues for each of four years preceding the OSC's conversion. In each of these years, the surpluses contributed over \$25 million to the Ontario government. These transfers were less significant both absolutely and relatively for the other provinces. In Alberta, the surplus exceeded one-half the ASC's revenues in one year, 1994/1995, the year when they also reached their maximum level of \$5.2 million. The surpluses were more moderate relatively in British Columbia, where they never exceeded 30% of commission revenues. Nevertheless, they provided at least \$3 million annually to provincial revenues in each of the three years preceding the BCSC's changed status.

## 2.2 The commissions after conversion

The conversion of the commissions into crown corporations meant little in itself because crown corporations come in all shapes and sizes. The commissions differed from other crown corporations that offer commercial products or services to the public (e.g. Alberta Treasury

Branches, AECL Limited, Export Development Bank, BC Hydro, BC Ferries) or to the government itself. The major activities of the securities commissions consist of the supply of regulatory services, an activity usually taken on by government agencies and departments such as the British Columbia Forest Practices Board, the Canadian Radio-television and Telecommunications Commission (CRTC), or the Ontario Labour Relations Board.

The meaning of the conversion can be assessed only through examining the framework that governs the commissions' powers as crown corporations. Among the most important provisions governing the commissions are those related to budgetary independence, the rights to revenues, control over and disposal of surplus, and the setting of remuneration.

While the motives for, and the general thrust of, the changes were similar in each case, the details of the conversion of the securities commissions into crown corporations differed from province to province. In particular, the significance attached to establishing accountability appears to have differed substantially. The revision of provincial securities legislation provided the primary mechanism for carrying out the changes in all three provinces, and was supplemented in Ontario by the adoption of by-laws by the commission close to the time it became a crown corporation.<sup>2</sup>

### Budgetary independence

The position of securities commissions within government meant that they suffered like other government departments and programs from the pressures during

the 1990s on provincial budgets arising from the weak economy and the federal government's downloading. The primary motive for the conversion of the securities commissions appears to have been a desire to establish their budgetary independence to insulate them from these pressures and to make their budgets more in keeping with their perceived needs to carry out their responsibilities.

Nevertheless, the securities commissions, like other public bodies, require some form of public accountability with respect to the levels and the patterns of their expenditures. All the Acts, as shown in table 2.2, made it clear that the commissions were in the first instance responsible for setting their budgets.

Beyond this, the mechanisms for accountability and their extent differed from province to province after conversion. At one extreme, Alberta's securities law had no provisions for review of the ASC's budget. Ontario's law did include some framework for budgetary review. The minister and the Commission were expected every five years to agree to a comprehensive memorandum of understanding regarding the activities of the commission. Among matters to be considered in the memorandum are the respective roles of the minister and the commission's chair, the commission's accountability to the minister, and its responsibility to provide business plans, operational budgets and plans for significant changes in operations and activities to the minister. The act also stipulated that the commission comply with the memorandum in exercising its powers and performing its duties. The memorandum of understanding was to be made public upon the acceptance of both the parties. Finally, British Columbia adopted the most comprehensive terms for accountability: it required the commission to submit annually to the Treasury Board for review and approval a business plan that included a budget and a statement of management objectives for the following three fiscal years. While the law also provided for the appointment of a British Columbia Securities Commission Policy Advisory Committee, this committee was not primarily a mechanism for accountability. It only provided advice to the commission and its mandate dealt with matters relating to trading of securities and the securities industry as distinct from the management and administration of the commission.

### **Control of revenues**

The change of the status of the commissions was accompanied by provisions that substantially altered the "ownership" of the revenues accruing from fees and other

charges related to the commission's activities. While these funds had been raised from charges for the commissions' activities, they were treated as part of the general revenues of the respective provinces. After the change in the commission's status, control of the fees revenues was shifted to the commissions themselves. The terms in which this transfer was expressed were emphatic and unambiguous (see table 2.3). British Columbia stated that the revenues are to be "paid" to the Commission; Ontario that "[the revenues] do not form part of the Consolidated revenue fund and . . . shall be applied to carrying out the powers conferred and the duties imposed on the Commission"; and Alberta, most emphatically, that "all fees, costs, administrative penalties . . . settlement money and other revenue arising with respect to the administration of the Alberta securities laws . . . are revenues of the Commission" and "all [such] money . . . belongs to the Commission."

### **Rights to surplus**

For some time prior to the change-over of the Commissions, the revenues resulting from their operations had exceeded their expenditures by a substantial margin. The surplus of revenues over expenses in the year preceding the conversion had alone been \$4.1 million in British Columbia, \$5.2 million in Alberta and \$38.2 million in Ontario.<sup>3</sup> In absence of any measures to reduce fees or raise costs, the commissions would have accumulated substantial surpluses over time. Placing these surpluses under the control of the commissions would mean that provincial governments could no longer be assured of the flow of these surpluses either at all, or not with any certainty.

Table 2.4 shows that the provinces adopted quite different approaches to the payment of any surpluses to the government. The Alberta government made no mention of the disposal of the ASC's surplus, apparently leaving the issue to be settled through the granting of ownership of these revenues to the ASC. While the British Columbia Act does mention the way in which the commission must hold any funds not immediately required for carrying out its responsibilities, it does not reflect any consideration of dealing with surplus funds beyond those needed for the commission to carry out its responsibilities in the long run. The Ontario Act takes an entirely different approach by declaring that surplus funds be paid into the province's consolidated revenue fund at times and in amounts to be determined by the minister after taking account of the OSC's need to build up a reserve for future requirements.

**Table 2.2: Provisions with respect to budgetary independence****Alberta Securities Act****By-laws**

## 10.1

(1) The Commission may make by-laws governing the administration and management of the business and affairs of the Commission.

**British Columbia Securities Act****British Columbia Securities Commission Policy Advisory Committee**

## Section 12

(1) the Minister may establish a British Columbia Securities Commission Policy Advisory Committee consisting of members appointed by the Minister.

(2) The purpose of the advisory committee is to provide to the commission advice on administrative, regulatory and legislative matters relating to trading in securities and to the securities industry.

**Revenues and Expenditures**

## Section 15

(2) Subject to subsection (3), money received by the commission may be expended for any costs involved in the administration and enforcement of this Act and for any costs in operating the Commission

**Business Plan**

## Section 21

At least once in every fiscal year of the commission and as directed by the Treasury Board, the commission must submit to the Treasury board, for review and approval, a business plan that includes

- (a) a proposed budget for the subsequent 3 fiscal years,
- (b) management objectives for the next 3 years, and
- (c) other information that the Treasury may specify.

**Ontario Securities Act****Board of Directors**

## 3.1

(2) The board of directors shall oversee the management of the financial and other affairs of the commission.

**Memorandum of understanding**

## 3.7

(1) Every five years beginning with the Commission's 1998–99 fiscal year, the Commission and the Minister shall enter into a memorandum of understanding setting out,

- (a) the respective roles and responsibilities of the Minister and the chair;
- (b) the accountability relationship between the Commission and the Minister;
- (c) the responsibility of the Commission to provide to the Minister business plans, operational budgets and plans for proposed significant changes in the operations or activities of the Commission; and
- (d) other matters that the minister may require.

(2) The commission shall comply with the memorandum of understanding in exercising its powers and performing its duties under this Act, but failure to do so does not affect the validity of any action taken by the Commission or give rise to any rights or remedies by any person.

(3) The Commission shall publish the memorandum of understanding in its bulletin as soon as practicable after the memorandum is entered into.

**Minister's request for information**

## 3.8

(1) The Commission shall promptly give the Minister such information about its activities, operations and financial affairs as the minister requests.

(2) The Minister shall designate a person to examine any financial or accounting procedures, activities or practices of the Commission. The person designated shall do so and report the results to the examination to the Minister.

**Table 2.3: Authority with respect to income****Alberta Securities Act****Financial matters re Commission**

13.3

(1) All fees, costs, administrative penalties under Section 165.1, settlement money and other revenue arising with respect to the administration of the Alberta securities laws or any other enactments administered by the Commission are revenues of the Commission.

(2) All money from any source that is received by and all money that is payable to the Commission belongs to the Commission.

(3) Any income earned from money of the Commission accrues to and belongs to the Commission.

(5) Notwithstanding subsections (1) and (2), money received by the Commission from administrative penalties under section 165.1 shall not be used for normal operating expenditures of the Commission and must only be used for endeavours or activities that in the opinion of the Commission enhance or may enhance the capital market in Alberta.

**British Columbia Securities Act****Revenues and Expenditures**

15

(1) Revenue received under this Act, including but not limited to revenue from administrative penalties under section 162 and any cost recoveries under this Act, but not including revenue from (a) fines referred to in section 155, or (b) from any payments to the minister under an order referred to in section 157 (1) (b), must be paid to the commission.

**Ontario Securities Act****Authority re Income**

3.4

(1) Despite the Financial Administration Act, the fees payable to the Commission under this or any other Act, the revenue from the exercise of a power conferred or the discharge of a duty imposed on the Commission under this or any other Act, and the investments held by the Commission do not form part of the Consolidated revenue fund and, subject to this section, shall be applied to carrying out the powers conferred and the duties imposed on the Commission under this or any other Act.

**Exception**

(2) The Commission shall pay into the Consolidated Revenue Fund money received by it as a payment to settle enforcement proceedings commenced by the Commission but not money received by the Commission,  
 (a) to reimburse it for costs incurred or to be incurred by it: or  
 (b) that is designated under the terms of the settlement for allocation to or for the benefit of third parties.

**Table 2.4: Disposal of surplus****Alberta: Not dealt with****British Columbia Securities Act****Financial Administration**

Investment 18

(1) The commission must place with the Minister of Finance and Corporate relations, for investment, any money the commission receives but does not immediately require for carrying out the purpose of this Act.

**Ontario Securities Act****Surplus**

(3) When ordered to do so by the minister, the Commission shall pay into the Consolidated Revenue Fund such of its surplus funds as are determined by the Minister.

(4) In determining the amount of a payment to be made under subsection (3) the Minister shall allow such reserves for the future needs of the Commission as he or she considers appropriate, and shall ensure that the payment will not impair the Commission's ability to pay its liabilities, to meet all its obligations as they become due or to fulfill its contractual obligations.

**Remuneration of commission members and staff**

The provinces all took the same approach to the mechanism for determining the remuneration of the Commissioners. As shown in table 2.5, Alberta and British Columbia both granted their commissions absolute powers to determine their own remuneration. Ontario differed only by making the OSC's power to make by-laws governing the remuneration and benefits of the members of the Commission subject to ministerial approval. In the event, the OSC adopted by-laws that limited its salary levels to be no more than the levels recommended by a committee nominated jointly by the Minister and the Commission's chair.

**Borrowing and reserves**

Prior to the change, the commissions' budgets were determined by appropriations from government and the government's general revenue absorbed the fluctuations in the revenues from their fees that arise year to year from changes in securities-market activity. In effect, the commissions were totally insulated from fluctuations in revenues.

The shift of the commissions to crown corporation status linked the level of their expenditures more directly to their revenues. The revised Securities Acts provided two types of provisions for the commissions to carry on their activities in the face of a revenue shortfall. All were granted borrowing powers to enable them to continue

their activities in face of such shortfalls. In addition, the commissions were allowed to build up of reserve funds to provide for future expenditures. In each case, as table 2.6 shows, the authority to do so differed from province to province

**2.3 The conversion—  
an overview**

The conversion of the securities commissions into crown corporations could have meant many different things depending on the powers granted to the corporations and the restrictions placed upon them. In fact, the particular terms accompanying the conversion substantially altered the commission's autonomy with respect to financial and budgetary matters. The increase in financial autonomy also varied across the commissions. The ASC gained almost complete autonomy with respect to budgetary and financial matters. The terms governing the BCSC and the OSC both incorporated requirements in principle for ministerial review and approval of their financial operations. The consequences of the autonomy in these cases will, in practice, depend upon the scrutiny of the commissions' affairs and the management initiatives undertaken by their ministries.

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**Table 2.5: Remuneration of commission and staff**

**Alberta Securities Act****Remuneration:**

11.1 The remuneration payable to the Chair, Vice-chair and members of the Commission shall be set by the Commission.

**British Columbia Securities Act****Salary powers**

9 The Commission may (c) determine the remuneration of its members and the remuneration and classification of the officers and employees.

**Ontario Securities Act:****Board of Directors**

3.2 (3) Subject to the approval of the Minister, the Commission may make by-laws, (e) governing the remuneration and benefits of the Chair, each Vice-Chair and the other members of the Commission.

**OSC By-law 1 (Ontario Securities Commission, Bulletin (1998) 21, pp.564-73):****3.8: Remuneration and Expenses**

Unless otherwise fixed in the manner provided for in this By-Law, the remuneration and benefits of Members shall continue to be those in effect on October 31, 1997. Except as aforesaid, the Members shall from time to time be paid such remuneration for their services, and shall be entitled to such benefits, as shall be fixed by the Board at or below the recommendations of a committee jointly nominated by the Minister and the Chair.

**Table 2.6: Reserves****Alberta:**

Provision for the Commission “to invest money for the purposes of carrying out its business [13.3(4)].”

**British Columbia**

Provision under *Investment* [18(1)] that “money the commission receives but does not immediately require for carrying out the purposes of [the] Act” must be placed with the Minister of finance.

**Ontario:**

Authority re income [3.4(1)] provides that “investments of the Commission do not form part of the Consolidated Revenue fund and, subject to this section, shall be applied to carrying out the powers conferred and duties imposed on the Commission....”

With approval of self-funded status, ...Commission was allowed to establish a \$10.0 million reserve to be used as an operating contingency against revenue shortfalls or unexpected expenditures. In April 1999, the Commission obtained approval to increase the reserve to \$20.0 million over a three year period.



## 3 Removing the bonds

Section 2 reviewed the ways in which the commissions gained greater autonomy with respect to the budgets. What have been the effects of the changes in the budgetary autonomy of the securities commissions? Have the differences in such things as the changes in spending authority, the powers to set salaries and their control over surpluses affected the commissions' behaviour? Section 3 examines the difference these changes have made by reviewing their consequences for overall costs, spending on salaries, commission revenues and the accumulation of surpluses.

We focus our analysis on both the general responses of the commissions and the commission-by-commission responses for several reasons. The different approaches taken by the provinces means the responses of the different commissions are unlikely to be uniform. In addition, the data available for tracking the changes differ by province and over time. As a result, we often are able to look at the evidence on some issues for only some of the provincial commissions.

### 3.1 Overall costs

Part of the motive for converting the commissions to crown corporations was to deal with their complaint that funding through government ministries failed to provide sufficient resources to meet the commissions' responsibilities. It should not be surprising, then, that spending rose once the budget constraint imposed by appropriations was replaced by the looser constraint of the commissions' revenues. Table 3.1 and chart 3.1 document the changed spending for each of the commissions.

#### Alberta

The level of spending of the ASC grew rapidly through the late 1980s but contracted sharply on three occasions in the early 1990s so that in 1994, the year prior to its change in status, its spending was barely above the peak realized in 1990. The pattern of spending was sharply altered by the change in status. Spending increased moder-

ately by 7% in the fiscal year immediately following the change but still remained well short of the previous peaks. Spending accelerated greatly over the next three years, increasing by 37% in 1997, 26% in 1998 and 39% in 1999. While the rate of increase of spending had slowed, the commission's spending still grew by 15% in 2000.

The short period after the commission's conversion to a crown corporation has been marked by four straight years of more than double digit spending increases. Over the period from 1990 to 1995, immediately prior to the conversion, the commission's expenditure had remained essentially constant. Over the next five year period, its spending increased almost three-fold from \$4 million to \$11.8 million, an average increase of almost 20% per year.

#### British Columbia

British Columbia's commission, unlike Alberta's, had received increasing appropriations from the government in the years prior to the change, allowing it to increase its spending by 8% in 1993, 19% in 1994, and a further 8% in 1995. Nevertheless, the increase in spending accelerated with the change in the commission's status, exceeding 10% in four and 15% in three of the five succeeding years. Over the five years after the conversion, spending by the British Columbia commission grew to almost twice its level immediately prior to the change. This represented an average annual growth rate of 13.7% over the five years.

#### Ontario

The evidence is more limited for Ontario than for the other two provinces because the conversion to a crown corporation took place only in late 1997. The Ontario experience prior to the change resembled Alberta's more than British Columbia's: the commission's appropriation decreased or grew only marginally in four of the six preceding years. In the other two years, however, the commission's spending grew substantially, increasing by 29% in 1996 and 15% in 1992.

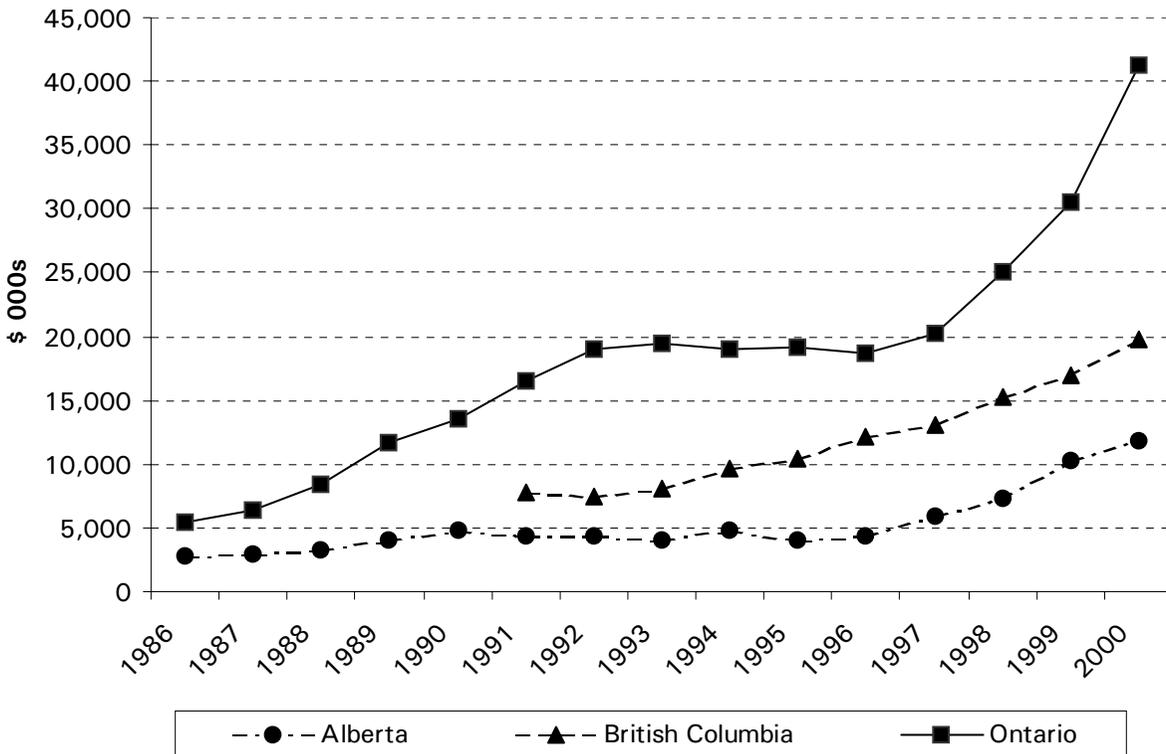
The spending of the OSC showed the same large increases after its conversion as the spending of the ASC.

Table 3.1: Commission Expenditures (\$000), 1986–2000

	Alberta	British Columbia	Ontario
1986	2,741		5,462
1987	2,927		6,392
1988	3,216		8,357
1989	4,097		11,672
1990	4,839		13,534
1991	4,296	7,776	16,583
1992	4,412	7,519	19,072
1993	4,123	8,109	19,442
1994	4,899	9,641	19,011
1995	4,026	10,413	19,145
1996	4,304	12,079	18,716
1997	5,876	13,138	20,174
1998	7,385	15,260	25,142
1999	10,235	16,963	30,455
2000	11,776	19,805	41,300

Source: Annual reports of commissions.

Chart 3.1: Commission expenditures, 1986–2000



Spending increased by 25% between 1997 and 1998 even though the change in the commission's status took place more than halfway through the year. The growth continued in the next two years with increases of 21% in 1999 and almost 35% in 2000. Overall, the spending by the OSC has more than doubled in the three years since it became a self-financing agency with an average growth of 28% over the period.

### Spending overall

The experience of the three provincial commissions has been qualitatively similar over the period since they became self-financing agencies. Spending growth has accelerated in all three cases, though at a faster rate in Alberta and Ontario. Each commissions' spending has at least doubled since the change. In the case of Alberta, expenditures have almost tripled over five years and in the case of Ontario the doubling took just over three years.

To a degree, the budget increases of the commissions after conversion reflected their prior experiences. The budgets of the OSC and the ASC, neither of which had experienced growth in their years as a government agency, both experienced growth rates of over 20% after the change. In contrast, the BCSC's budget, which had increased quite steadily prior to the change, grew at a slower rate of 13% afterwards.

Part of the argument for the changed status of the commissions and the resulting increases in budget had been based on the need for a catching up to offset the stagnation in their budgets during a period of general government austerity. Some perspective on this argument can be gained from examining the commissions' budgets over a longer period that includes both the austerity period and the period of greater budgetary autonomy. Table 3.2 shows longer-run comparisons of growth rates for each of the commissions. Overall, these comparisons show quite rapid rates of growth over these longer time periods and suggest that the growth in spending over longer periods has been more than the amount needed to catch up for the periods with small increases or decreases. The financial capacity of securities commis-

sions has increased substantially over the entire period since the mid 1980s. This does not, however, rule out the possibilities that the commissions were under-funded at the start of the comparison period or that the commissions may have taken on additional responsibilities over the period.

## 3.2 Salaries and benefits

As we saw in Section 1, salaries and benefits have accounted for the majority of the commission's spending throughout most of the period covered by the data. Nevertheless, the shares of spending on salaries and wages have differed substantially, reaching a peak of over 80% of total expenditures in 1988 in Ontario and a low of 48% in British Columbia in 1990. Given the importance of salaries and wages in the commissions' expenditures, it is useful to examine the impact of the conversion on this category of spending.

Commissions may have been limited in carrying out their responsibilities prior to their change in status by either or both of insufficient staff or inadequate salary levels to attract sufficiently qualified staff. Accordingly, we will consider both the employment and the salary-level components of the commissions' expenditures on salaries and wages.

### Employment

The available data on employment for the three commissions are shown in table 3.3 and chart 3.2. Both the ASC and the BCSC managed to increase their employment levels by almost 50% from the transition through 1999/2000. In the case of the ASC, staffing actually shrank during the year following the conversion and almost half of the employment growth for the period was realized in 1999/2000. It is also interesting that it took until 1998/1999 for the staffing levels to reach their previous peak level achieved in the late 1980s. The growth of BCSC's employment has been steadier than that of the ASC. Employment at the commission increased by

**Table 3.2: Long-term growth rates in commission expenditures, 1986–2000 and 1991–2000**

	OSC	ASC	BCSC
1991–2000	10.5%	11.9%	10.9%
1986–2000	15.5%	11.0%	n.a.

Source: Tables 3.1.

Table 3.3: Employment and salary levels

	ASC			BCSC			OSC		
	Total Employed	Total Salaries & Benefits (\$'000s)	Average Salaries & Benefits (\$)	Total Employed	Total Salaries & Benefits (\$'000s)	Average Salaries & Benefits (\$)	Total Employed	Total Salaries & Benefits (%'000s)	Average Salaries & Benefits (\$)
1995	73	2,994	41,041	136	7,009	51,537	n.a.*	12,315	
1996	68	2,914	42,853	145	7,770	53,586	n.a.*	11,587	
1997	77	4,247	55,156	166	8,371	50,428	n.a.*	13,546	
1998	81	5,076	62,667	172	9,512	55,302	n.a.*	n.a.**	
1999	88	6,208	70,545	175	11,209	64,051	250	18,803	75,212
2000	105	8,104	77,181	202	13,354	66,109	301	24,758	82,252

Source: Annual reports of commissions.

\* Employment numbers are not available for the OSC prior to 1999.

\*\* Salary data not available for the year of the OSC's conversion.

approximately 15% in both the first year of the conversion and 1999/2000. The OSC's 2000 *Annual Report* notes "an impressive 67%" (Ontario Securities Commission 2000: 8) increase in personnel since it began a recruitment drive subsequent to its conversion. Total staff consisted of 301 employees at the end of year 2000, 39 short of the OSC's target of 340. Raising staff to this level entailed an expansion of personnel by close to 89% since conversion.

To the extent that the motive for conversion was based on concerns about inadequate staffing, increased budgetary independence appears to have helped alleviate this problem. The BCBS and ASC have both succeeded in building up their staff by approximately 50% in the five years since conversion, while the OSC succeeded in an even larger build-up within a shorter time-frame.

#### *Scope for staff reductions?*

In considering the recent employment growth, we should take into account new regulatory initiatives undertaken by the securities commissions to reduce administration and compliance costs. One notable example is the Mutual Reliance Review System (MRRS) introduced by the Canadian Securities Administrators, which is currently in effect. Under this system, an issuer files a document with a single lead regulator for review even if filing in multiple jurisdictions. Presumably, this system should create scope for significant staff reductions by reducing duplication of efforts. However, the establishment of MRRS occurred concurrently with staff increases by the OSC, ASC and BCSC.

#### **Salary levels**

Any judgment with respect to the changing salary levels of the commission's staff is limited to some degree by available data. Two types of data will be used to give an indication of changing salary levels. The first source is the implied change in average salary levels that can be derived from comparing the data on total salaries and benefits with the data on employment levels at the commissions. The other source is the reporting of salaries payments that have been undertaken by the ASC and OSC.

#### *Average salary levels*

A measure of the average salaries and benefits paid by the commissions can be estimated by comparing their annual salary and benefits expenses of the commissions with their levels of employment. Table 3.3 and chart 3.2 show the derived values for the salaries and benefits paid by the commissions for the period from their conversion through 1999/2000.

The experience of the ASC and the BCSC with respect to average salaries and benefits differed substantially over the period following their conversion. The BCSC's salaries and benefits were \$51,500 per employee compared to the \$41,000 average for the ASC. Over the five years since conversion, the BCSC's average salaries and benefits increased by 28% over the period, or approximately a 5.1% increase per year. In contrast, the ASC's average increased by 88% over the same period, or 13.5% per year. By 1999/2000, the ASC's salaries and benefits per employee reached \$77,200, a level 16.7% higher than the BCSC's average of \$66,100.

Chart 3.2a: BCSC—indexes of employment and salaries & benefits, 1994/1995–1999/2000

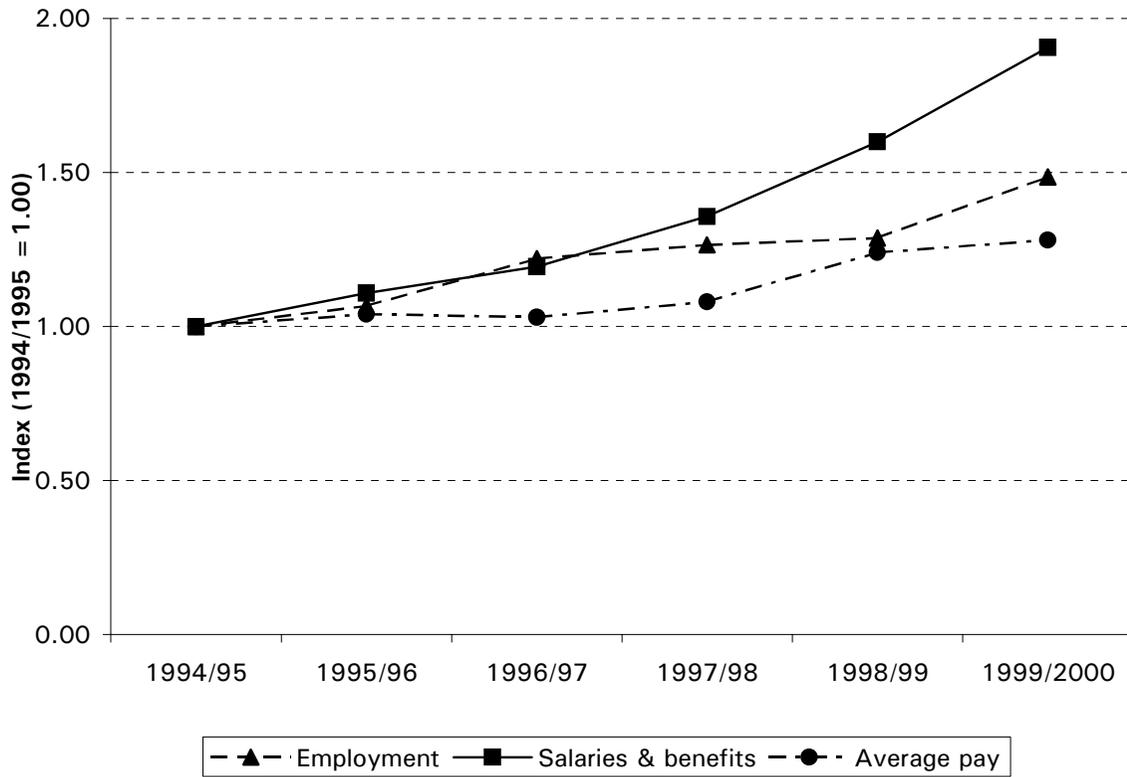
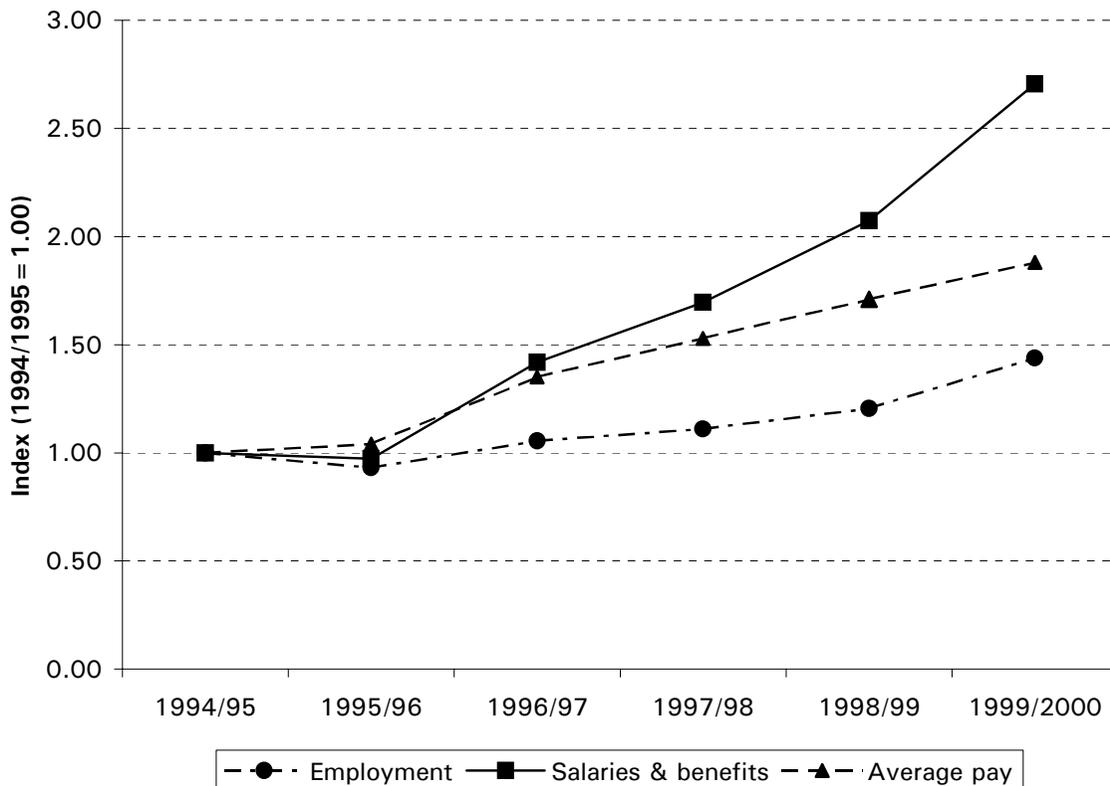


Chart 3.2b: ASC—indexes of employment and salaries & benefits, 1994/1995–1999/2000



How does this compare with the growth of salaries in the private and public sectors? Table 3.4 shows average salaries (including overtime) in 1996 and 2000 for finance and selected service industries. Average salaries grew at approximately 2.5% per year in finance and insurance. In investment intermediaries, salaries grew at 4.3% annually while salaries in accounting and law offices grew by 3.5% and 2.5%. The ASC and BCSC beat all these groups with average salary growth of 15.9% and 5.4% between 1996 and 2000. In public administration, salaries grew by 0.7% annually during this period.

*Reported salaries*

The ASC and the OSC both report selected salaries of senior management in their annual reports. Since these reports differ in their detail and coverage, we will discuss them separately.

Ontario's Salary Disclosure Act of 1996 has mandated the publication of all public sector salaries exceeding \$100,000 for the fiscal year 1996 onward. These salary data represent the salary paid as defined for the T4 slips filled out for Revenue Canada and provide useful indicators of the increases in staff salaries before and after the commission's change in status.

Chart 3.3 shows the numbers of the OSC staff receiving salaries in excess of \$100,000 over the period 1996 to 2000. In the initial year, only two OSC staff members received a salary greater than the reporting threshold of \$100,000. Even before the change of status, the number of people receiving \$100,000 grew to seven in 1997. In 1998, the year the OSC's status changed, the number of staff with reportable salaries increased to 15 and continued to grow to 34 in 1999 and 64 in 2000.

While these figures indicate a doubling of the number of staff salaries over the threshold in every year but one, they may not be a meaningful indicator of the

growth of the salary levels for senior OSC employees. Such growth in the number of staff salaries above the threshold could have been the result of quite moderate changes in salaries if a large number of staff salaries were clustered just below the threshold at the start of the period.

Chart 3.4, which shows the distribution of OSC salaries greater than \$100,000, gives a different perspective on the growth in salaries above the threshold. It indicates that, even though the number of salaries between \$100,000 and \$125,000 grew from just two in 1996 to 64 four years later, the majority of the growth in reportable salaries has taken place in ranges well above \$100,000. Salaries above \$125,000 accounted for more than half the reportable salaries in both 1999 and 2000. Thus, the growth in salaries in excess of \$100,000 represents more than just a movement of salaries above the threshold. The OSC has either substantially raised the salaries of its continuing staff or recruited new staff at higher salary levels than it has paid in the past.

**3.3 Senior management salaries**

The salaries of the commissions reflect a different set of forces than other salaries because the commissions' changed status left the determination of these salaries, in large measure, subject to their commissioners' own discretion. Thus, another perspective on the consequences of conversion can be gained from examining the trends of salaries for senior management as provided in the annual disclosures.

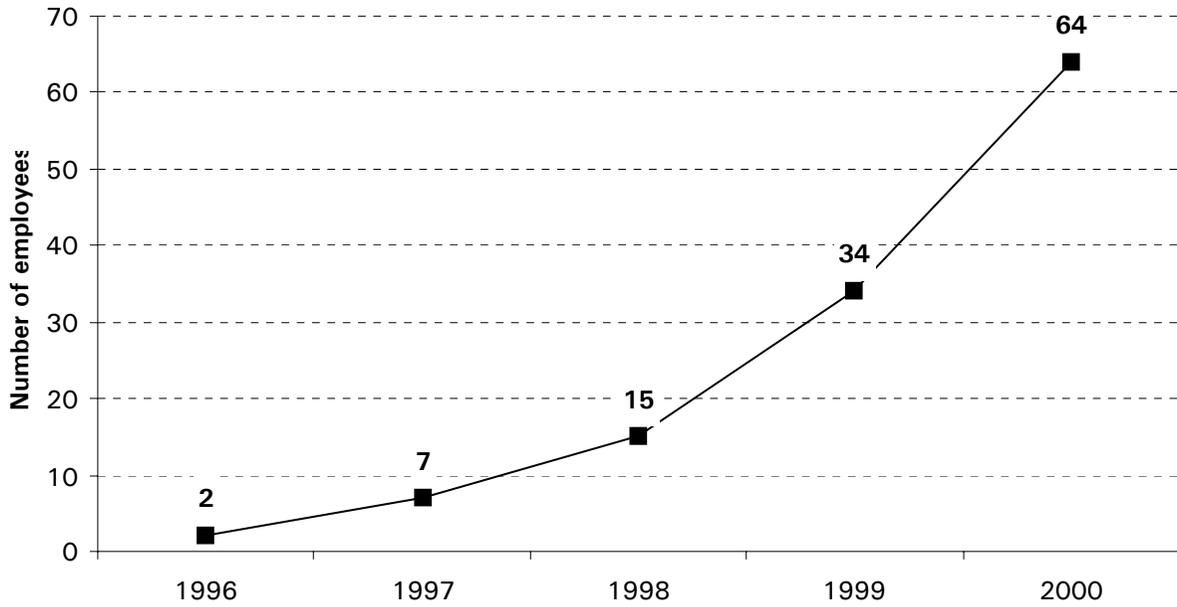
A number of factors complicate the interpretation of the salary data for senior management. First, they represent actual salary payments rather than contractual salaries. As a result, turnover in the positions can lead to

**Table 3.4: Average salaries in private and public sectors (\$)**

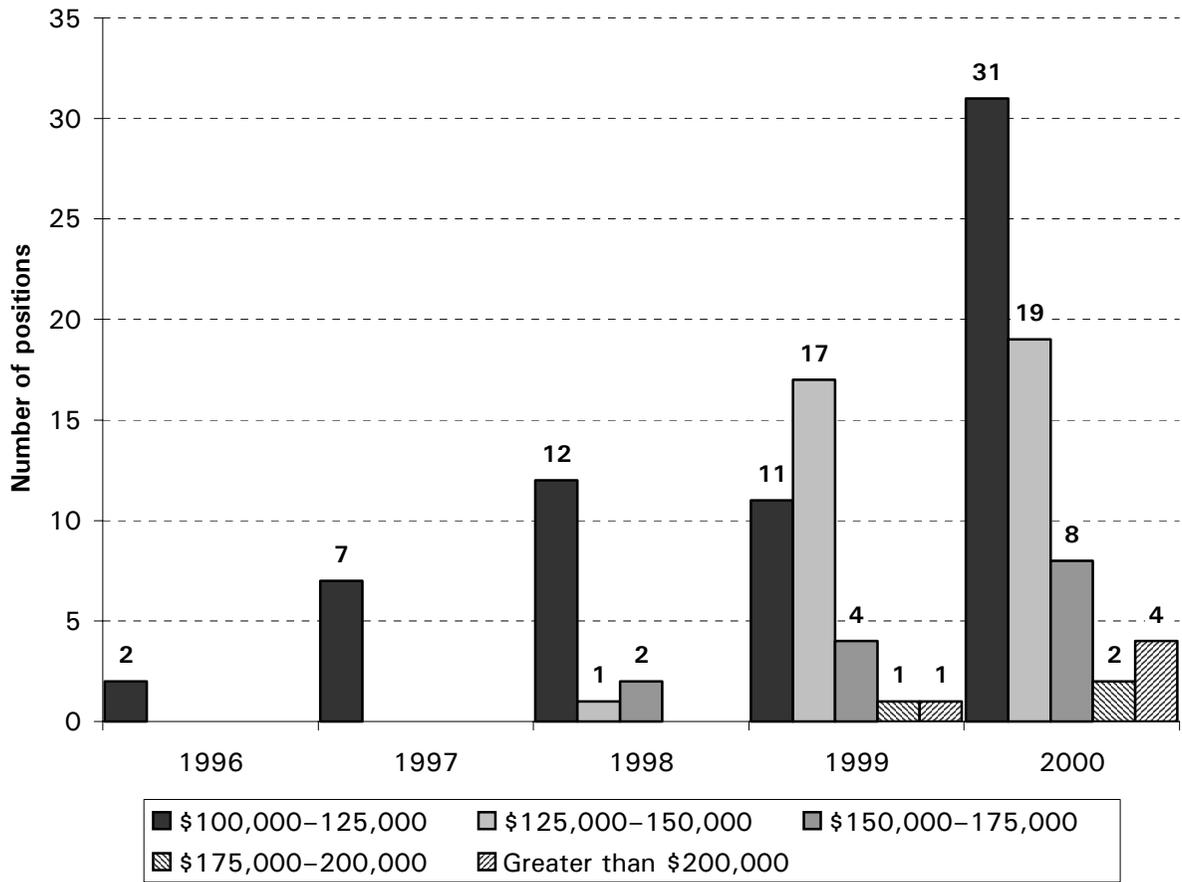
	1996	2000
<b>Finance and insurance</b>	36,639	40,431
<b>Investment intermediaries</b>	41,539	35,156
<b>Accounting and bookkeeping services</b>	31,708	36,336
<b>Offices of lawyers and notaries</b>	34,194	37,718
<b>Public administration</b>	38,483	39,528

Source: Statistics Canada, CANSIM II; available at [www.statcan.ca/english/Pgdb/Economy/finance/fin12.htm](http://www.statcan.ca/english/Pgdb/Economy/finance/fin12.htm)

**Chart 3.3: Number of OSC staff with salaries exceeding \$100,000**



**Chart 3.4: Distribution of OSC staff salaries greater than \$100,000, 1996–2000**



Source: OSC Annual Report and Ontario Public Salary Disclosure ([www.gov.on.ca/FIN/english/pssecteng.htm](http://www.gov.on.ca/FIN/english/pssecteng.htm)).

the reported salaries for some years to represent payments for less than a full year of service. Second, the published reports for some years indicate more than one person holding some positions over that year. This too will lead reported salaries to understate the actual levels. To overcome these problems, we will track senior management salaries according to the individual occupying the position in order to identify those years in which the reported payments are for less than a year of service. We will provide pro-rated estimates of annual salaries in cases where the arrival dates or departure dates are known.

### Ontario

The information in table 3.5 for the senior management salaries at the OSC shows very rapid growth since its conversion to a crown corporation. The chair's salary in 2000 was more than two and one-half times the estimated an-

nual salary for the same position in 1996. Similarly, one of the two vice-chairs in 2000 received more than three times the salary of the single vice-chair in 1996. These large salary increases also extend to the executive director's position: the 2000 salary exceeded the 1996 level by more than three times.

An alternative view of the higher management compensation can be gained by comparing the total expenditures reported by the OSC for the senior management positions of chair, vice-chair and executive director for different each years. Overall compensation for OSC's senior management positions has risen almost four times from \$405,000 to more than \$1.6 million between 1996 and 2000. While some of the difference was accounted for by the payments to an additional vice-chair, accounting for only one-vice chair still leaves the total expenditure on management salaries at \$1,367,000 in 2000, an amount well over three times the 1996 level.

Table 3.5: OSC—senior management salaries (\$), 1996–2000 (for the year unless otherwise noted)

	1996	1997	1998	1999	2000
<b>Chair</b>					
<i>Waitzer</i>	162,232 <sup>1</sup> (204,924)				
<i>Geller</i>		142,974 <sup>2</sup>			
<i>Brown</i>			316,097 <sup>3</sup> (421,000)	517,249	540,049
<b>Vice Chair</b>					
<i>Geller</i>	131,822		186,455 <sup>4</sup>	462,272	406,821
<i>Carscallen</i>		122,191 <sup>5</sup>	165,818 <sup>6</sup>		
<i>Wetson</i>				317,038 <sup>7</sup> (345,870)	367,298
<b>Executive Director</b>					
<i>Eprile</i>	103,793	118,152 <sup>8</sup>			
<i>McFarlane</i>			120,000 <sup>9</sup>	355,368	360,390

Source: OSC Annual Reports.

<sup>1</sup>Waitzer served as Chair until October 1996.

<sup>2</sup>Geller served as Vice-Chair through October 1996 and as Chair from November 1996.

<sup>3</sup>Brown became Chair in April 1998.

<sup>4</sup>Geller served as Chair until April 1998 and served as Vice-Chair thereafter.

<sup>5</sup>Carscallen became Vice-Chair in July 1996.

<sup>6</sup>Carscallen served as Vice-Chair to November 1998.

<sup>7</sup>Wetson became Vice-Chair in January 1999.

<sup>8</sup>This salary may be for less than one year.

<sup>9</sup>This salary may be for less than one year.

**Alberta**

The ASC has reported senior management salaries including the chair, the executive director and the chief financial officer on a consistent basis since 1995/1996.<sup>4</sup> These data permit the comparison of the evolution of salaries after conversion with their levels in 1995/1996, the year before the conversion. Table 3.6 and chart 3.5 shows a pattern of

growth similar to that for senior management salaries at the OSC. The chair's salary in 1999/2000 was almost 150% of its level in 1995/1996 and almost 260% of its level in 1994/1995, the year before conversion. The growth in the executive director's and chief financial officer's salaries were even greater. In 1999/2000, they were both roughly two and one-half times their levels in 1995/96.

**Table 3.6: ASC—senior management salaries (\$), 1996–2000**

Position	1994/1995	1995/1996	1996/1997	1997/1998	1998/1999	1999/2000
Chair		120,009	208,266 <sup>2</sup>	246,100	254,800	310,000 <sup>3</sup>
Executive director	75,007 <sup>1</sup>	67,530	112,956	106,667	140,000	175,000
Chief financial officer		52,280	71,881	126,417	120,000	130,000

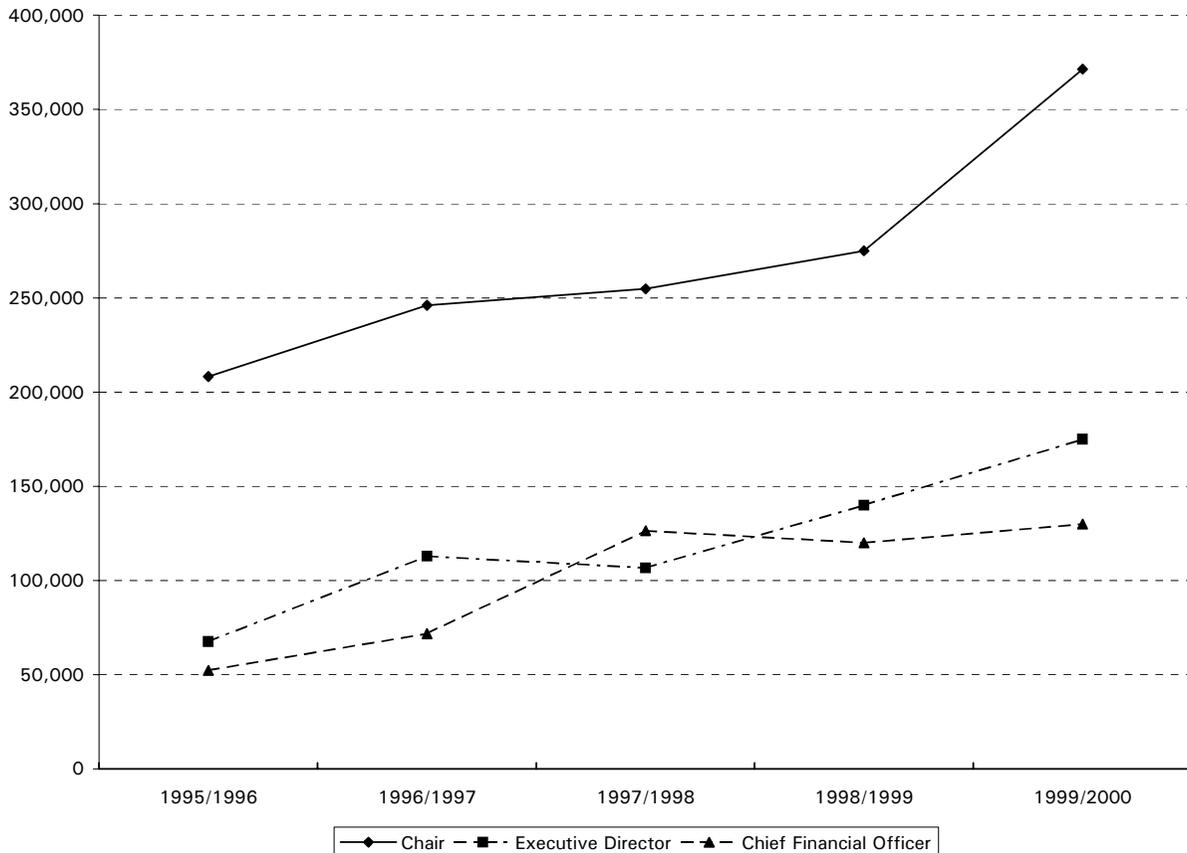
Source: ASC annual reports.

<sup>1</sup>For 1994/95, no salary was reported for the position of Executive Director; the salary reported was for the position of Chief of Securities Administration, the highest paid executive.

<sup>2</sup>Converted to annual basis from \$173,559 for ten months.

<sup>3</sup>Converted to annual basis from \$216,667 for .7 years.

**Chart 3.5: ASC—senior management salaries and benefits, 1996–2000**



### 3.4 Revenues

#### Fees

The commission’s revenues are determined by the commissions’ fee schedules for registration and reporting and the volume of these filings, which is determined by the level of securities market activities. The conversions were accompanied by differing degrees of commitment by the commissions to bring their revenues into line with their expenses through lowering their fees.

*Alberta* In 1995, the Alberta Task Force on Operational Efficiencies in the Administration of Securities Regulation in 1995 “noted that industry participants would like to see a rationalization and reduction in fees,” though cautioning that such reductions required a prior resolution of funding issues. The ASC responded by reviewing its level of fees in consultation with the industry and its own Financial Review Committee and brought an amended fee structure into place effect April 1, 1997, just two years after its conversion. This step reduced fee levels by 20% through eliminating some fees and lowering registration fees, prospectus-filing fees and the percentage distribution fee applicable to proceeds raised from securities offering in the province.

*Ontario* The OSC similarly took steps to adjust its fees structure shortly after its conversion by implementing a 10% reduction in August 1999 and a further 10% fee reduction effective June 2000. The Commission also has now put forward for comment a “concept proposal” that sets out a substantial revamping of the basis for its fees.

*British Columbia* Following the lead of the other commissions, BCSC eliminated 14 fees applicable to mutual funds and publicly traded companies on January 1, 2001.

**Table 3.7: Fees charged by the US Securities and Exchange Commission (SEC)**

	Registration	Transaction
1996	1/29 of 1%	1/300 of 1%
1997	1/33 of 1%	1/300 of 1%
2000	1/38 of 1%	1/300 of 1%
2007	1/150 of 1%	1/800 of 1%

Sources: SEC Annual Reports, SEC Fee Account Services Office

For comparison, table 3.7 shows fee reductions for the SEC in the United States, which has also experienced surplus revenues in recent years. Under the *National Markets Improvement Act (NSMIA)* registration fees charged by the SEC have fallen by close to 24% (2000) since 1996. The *NSMIA* provides for further fee reductions, which will reduce these fees by close to 81% by 2007 from their 1996 level. The other main source of revenue for the SEC, transaction fees, will be reduced by close to 63% in the same year.

#### Revenues

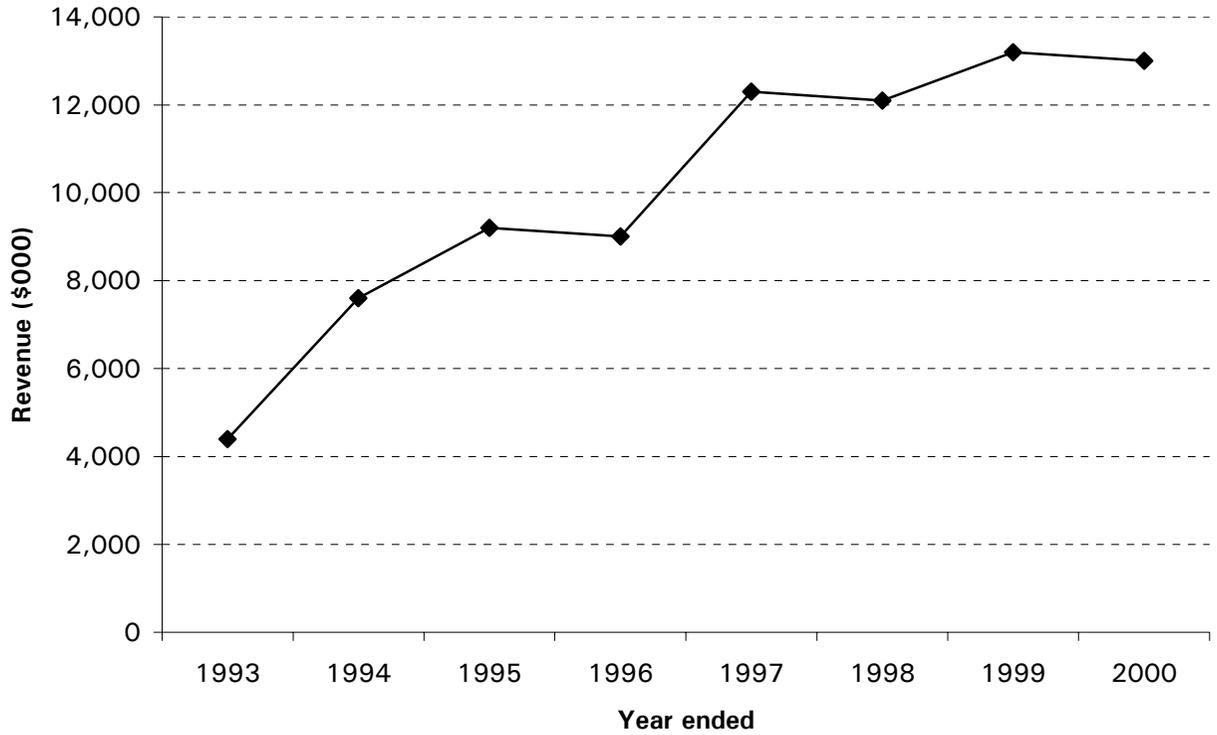
The existing arrangements prior to the conversions did not have any direct linkage between the revenues generated from the commissions’ activities and the commissions’ expenses in carrying out their responsibilities. The revenues from the commissions’ fees accrued to the benefit of the provinces’ general revenue while the commissions relied on appropriations from the provinces that were unrelated to their revenues. The commissions’ experiences with revenues have been quite different since their conversion.

*Alberta* The ASC revenues shown in chart 3.6 jumped 25% in the in the first full year following conversion, the result of activity in security markets much higher than expected and have remained steady in the years following. While the 20% fee reduction introduced by the commission in 1997 has lowered the level of revenues below what they would otherwise have been, the lack of revenue growth from 1997 onwards also reflects the lower level of activity in junior markets.

*British Columbia* In contrast to the ASC, the BCSC had failed to lower its fee schedule in the five years following its conversion. Chart 3.7 shows its revenues have grown at an average annual rate of over 11% over this period and did not show the same slowing in the late 1990s as the ASC’s revenues. Revenues grew at 14.1% and 18.7% over 1997/1998 and 1998/1999 during the years of the Asian crisis and only slowed to 6.0% in 1999/2000, reflecting the slowdown in the technology sector.

*Ontario* OSC revenues presented in Chart 3.8 have grown sharply since its change in status. Revenues in 1999/1998, the first full year after conversion, were over 32% higher than in 1996/1997, the last year prior to conversion.<sup>5</sup> These changes entirely reflect changes in market activity given the OSC’s unchanged fee levels over the

Chart 3.6: ASC revenues, 1993–2000



Note: Figure for 1996 estimated from 10-month revenues

Chart 3.7: BCSC revenues, 1994–2000

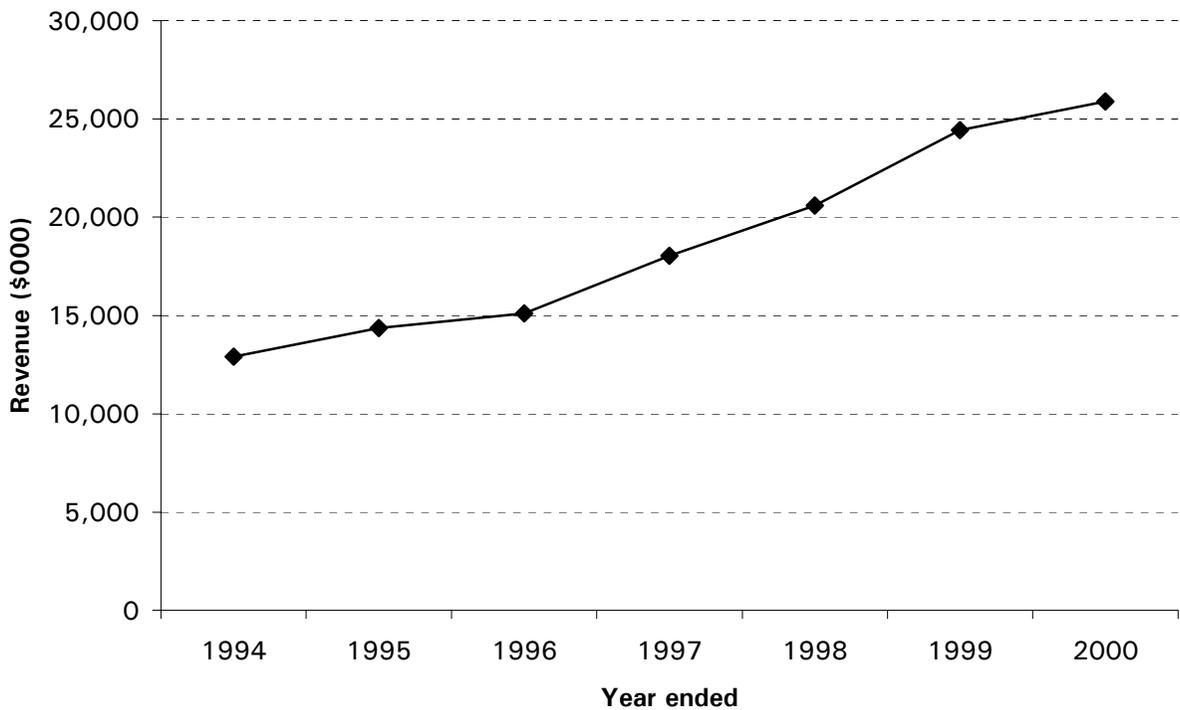
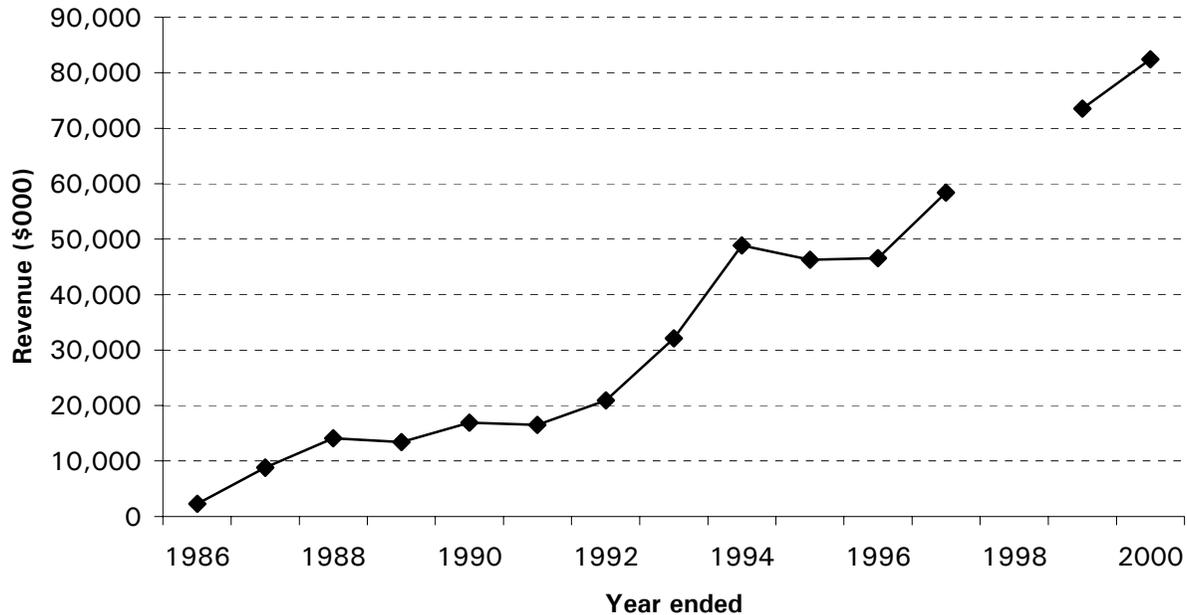


Chart 3.7: OSC revenues, 1986–2000



period. Revenue growth slowed to just 6% in 1999/2000. This slowing resulted in part from the 10% fee reduction that took effect part way through the year.

#### Revenues overall

Revenues of the commissions have grown substantially over the 1990s and have continued to grow, with the exception of the ASC, since their conversion. While the 20% fee reduction by the ASC in 1997 and the recent 10% fee reduction by the OSC have slowed revenue growth, revenue levels remain substantially higher than before conversion.

#### Surplus

One of the major changes in the conversion was the dilution of the governments' claims on the commissions. The net benefit to government from this claim consisted of the difference between the revenues and the appropriations the governments made to finance the commissions' activities. After the conversion this difference accrues to the commissions themselves as an addition to their surplus.

The effects on these surpluses of recent revenue changes together with the growth of the commissions' expenditure are shown in table 3.8. Alberta's surplus has now declined substantially from its peak of \$7 million in the year before the fee change to just \$1.8 million in 2000. In contrast, in the absence of a fee reduction, the BCSC's surplus has grown despite the increasing expenditures by the commission. Its surplus in 1999/2000 is \$7.5 million, an amount 83% higher than the largest surplus

generated prior to the conversion. The OSC's operations have continually generated surpluses many times larger than those of the other provinces. Its surpluses since its conversions are its largest to date. The \$41.1 million surplus in 1999/2000 reflected the August 1999 fee reduction and, though lower than the previous year, was 7.6% higher than the largest surplus prior to conversion.

Overall, the experience of the commissions with respect to surpluses has been varied. The surpluses of the ASC, after climbing initially, have now fallen to just one quarter of their post conversion peak. This decline in surplus resulted from both the ASC's rising expenditures and the large fee reduction it carried out soon after its conversion. Somewhat surprisingly, the BCSC and the OSC have both managed to build up their annual surpluses after their conversion in face of both rising expenditures and, in the case of the OSC, a 10% fee reduction.

### 3.5 Reserves

The terms of the conversions in all cases, with differing degree of explicitness, allowed for the commissions to build up reserves. While all the commissions have responded by steadily accumulating reserves since their conversion, the BCSC and the OSC have both established special reserves—Fee Stabilization Reserve (BCSC) and Contingency Reserve (OSC)—to protect them against revenue shortfalls.

Table 3.8: Annual surplus of securities commissions (\$millions), 1985/1986–1999/2000

	ASC	BCSC	OSC
<b>1999/2000</b>	<b>1.8</b>	<b>7.5</b>	<b>41.1</b>
<b>1998/1999</b>	<b>2.9</b>	<b>9.1</b>	<b>45.0</b>
<b>1997/1998</b>	<b>4.2</b>	<b>6.3</b>	n.a.
<b>1996/1997</b>	<b>7.0</b>	<b>5.8</b>	38.8
<b>1995/1996</b>	<b>3.2</b>	<b>3.6</b>	26.6
<b>1994/1995</b>		4.1	30.7
<b>1993/1994</b>		3.5	29.9
<b>1992/1993</b>		3.0	12.6
<b>1991/1992</b>		2.5	1.8
<b>1990/1991</b>			-0.1
<b>1989/1990</b>			3.4
<b>1988/1989</b>			2.7
<b>1987/1988</b>			-0.3
<b>1986/1987</b>			-0.2
<b>1985/1986</b>			-0.1

Bold type denotes years following conversion. The surpluses represented the net revenues to government from the commissions' operations prior to conversion.

Table 3.9 shows the level of these reserves for each commission on a year-to-year basis. The build-up started once the commission gained the status of crown corporation and, with one exception, has continued every year since. In the BCSC's case, the build-up of reserves was interrupted in 1998/1999 by the one-time transfer of \$12 million to the provincial government under the Budget Measures Implementation Act. By the end of 2000, the ASC held \$18 million, the BCSC, \$20 million and the OSC, another \$26 million of reserves for a total of over \$64 million among the three commissions.

### 3.6 Transfers to governments

The assignment of revenues to the commissions at the time of their conversion represented a major shift from the previous treatment of these revenues as part of the government's consolidated revenue fund. The operations

of the commissions had been a significant source of net revenues to the respective provincial governments from the mid-1980s onward.

The provisions in the Securities Acts governing the conversion of ASC and the BCSC did not make reference to transfers of surpluses to provincial governments despite the consequent revenue losses to governments arising from this change. Both these commissions during their early years as crown corporations had absorbed a considerable share of their revenues into increased expenditures or the build up of reserves. This situation changed markedly in 1998 for the BCSC when the provincial government enacted The *Budget Measures Implementation Act*. Section 25 of that *Act* enabled the Minister of Finance and Corporate relations to request the Commission to pay up to \$12 million to the province before March 31, 1999. On February 26 of that year, the Minister made the request and the Commission as shown in table 3.10 paid \$12 million to the Province on March 23, 1999.

Table 3.9: Reserves (\$000) held by securities commissions, 1996–2000 (as at March 31)

	1996	1997	1998	1999	2000
<b>ASC</b>	2,659	9,649	13,893	16,818	18,063
<b>BCSC*</b>					
General	3,567	9,291	15,515	1,448	6,673
Contributed			1,415	1,415	1,415
Fee Stabilization Reserve				10,000	12,000
<b>OSC</b>					
General			44	555	11,375
Contingency				7,500	15,000

Source: Annual reports of commissions.

\*The BCSC also has an educational reserve collected from administrative penalties and negotiated settlements that can be spent only for promoting knowledge of participants in securities markets.

The terms governing the OSC gave the provincial Minister of Finance the power to require the commission to transfer its reserves to the province's general revenue funds to use for its own programs. As table 3.10 shows, the OSC has made transfers to the government totalling almost \$60 million in the two years since its conversion

Table 3.10: Transfers to government relative to current expenditures (\$000)

Commission	Transfer	Revenue	Transfers/ Revenues
<b>BCSC (1999)</b>	\$12,000	\$26,101	.46
<b>OSC (1999)</b>	\$37,048	\$75,505	.49
<b>OSC (2000)</b>	\$22,750	\$82,350	.28

Source: *Annual Reports of the Commissions*

### 3.7 Conversion—overall effect

The change in status of the securities commissions can be described as a conversion from regulatory agencies within government departments to crown corporations. In large measure this description fails to capture the range of consequences that could accompany or follow from this change. As the experience of the three provinces shows, this conversion has been accompanied by differing degrees of accountability and independence for the securities commissions. The commissions in all cases appear to have gained a greater measure of financial independence. In the first instance, all of them gained the power to determine their expenditures in carrying out their duties including the salaries paid to the commissioners and their staff. Still differences exist among the provinces with respect to the degree of outside review and approval needed in these matters. There were the marked differences in the treatment of the commissions' powers with respect to any surpluses arising from an excess of revenues over expenditures. These surpluses appear to be under the control of the Minister in Ontario and equally under the control of the commissions in the others. Clearly, the consequences of the changed status will unlikely be uniform across the provinces and can only be determined by examining the effects of the changes in practice.



## 4 Underfunding—myth or reality

Few of the changes following the unbinding of securities commissions can be considered as a surprise. The expressed motive for these changes was to free the commissions from their dependence on government appropriations for financing their activities. Their new status gave the commissions control over their own revenue sources and as a result, control over the resources available to them for monitoring and supervising securities markets. But, the changes have been unsurprising for another reason. The transfer of the control to the commissions themselves left them with limited accountability with respect to their spending and their financial affairs overall. Prior to the change, any spending by the commissions had an opportunity cost for the governments and the departments within government making the appropriations. More spending for the commissions meant less spending for other government programs. After the change, greater spending by the commissions had little opportunity cost to their former overseers and, possibly, some benefit for the relevant decision makers, the commissioners themselves.

The surge of spending, the building-up of reserves and escalating salary levels of the commissions could all reflect a much needed infusion of finance into activities neglected through years under government austerity. It could also have been a spending spree lacking justification in the benefits brought to securities markets. Any definitive answer would require a cost-benefit analysis that would test the limits of the state of the art and be beyond the quality and quantity of data available for such an analysis.

Some judgment of the changes is still possible. In particular, we can ask whether securities-market participants pay fees for their required registration and reporting that are too high. Such fees could result from excessive expenditures by the commissions in fulfilling their mandate or they could result from the diversion of revenues to other uses. In this section, we try to quantify the costs to market participants of the current regime by using benchmarks from other jurisdictions and other activities in some cases and tests of reasonableness in others. But, at most it should be recognized that the approach that we undertake in this chapter produces

more of a patchwork quilt than a comprehensive judgement of the consequences of the commissions' escape from under government's wing.

The three areas that we examine are the salary costs for senior management; the surplus of commission revenues and its disposal; and Canadian expenditure and staffing levels on securities regulation as compared with other jurisdictions. The expenses of the commissions for senior management have been chosen for two reasons. First, as seen in Section 1, salaries and benefits make up around two thirds of the commissions' expenses so that high levels of expenditure here would contribute significantly to high overall costs. Second, two of the commissions have publicly reported these salaries as have bodies with staff needs comparable to those of the commission. The disposal of surpluses were chosen because it seemed likely that the funds are used in ways that are not vital to the commissions in achieving their mandate. The international comparison is included to show how Canadian securities regulators compare to their foreign counterparts in adequacy of resources.

### 4.1 Salary levels and attracting well-qualified regulators

As we have seen in Section 3, the salaries of both the ASC and OSC commissions and their staffs have grown substantially in the years following conversion. Some of this increase may be justified by the freeing of the commissions' payments for specialized professional staff such as lawyers and accountants from restrictive civil-service guidelines. Increasingly, it is becoming recognized that effective regulation of the financial sector requires regulatory authorities to pay salary levels adequate to attract high-quality staff. Yet, this recognition offers little guidance on questions such as how high a salary for securities officials is adequate and how much is excessive? While these questions should continually be asked, they are especially crucial where the regulatory authorities bear much of the responsibility for setting their own salaries.

A number of possible guidelines can be proposed for assessing the salaries paid by the commission. Salaries of the regulators' counterparts in the financial-services industry might be one possible benchmark. These would include the salaries of senior investment dealers and, since senior members of the securities commissions are often lawyers, the counsels of legal firms that provide services to the financial sector. Alternatively, salaries for positions within the same jurisdiction with similar responsibility that draw on a pool of workers with comparable background and training provide one benchmark for comparison. Similar positions in other jurisdictions provide another. We present both types of comparisons below where we compare securities officials' salaries with two reasonable peer groups—senior government officials and judges in Ontario and members and senior staff of the Securities and Exchange Commission, the major securities regulator in the United States.

#### **Executives and counsel in the financial services sector**

Increasingly, economists and others have been expressing concern with the gap of in pay between regulators and those at the highest levels in entities subject to regulation. An important dimension of this concern is the professional quality of those undertaking regulation. Will differences between the pay of the regulators and the regulated lead to a talent gap at the expense of effective regulation? This argument suggests that salaries of comparable positions within regulated industries could be a benchmark for regulators' salaries.

Have low salaries prevented securities commissions from attracting well-qualified talent or is the opportunity to serve the commission a strategic career move for those seeking advancement in law or business? Table 4.1 provides an interesting perspective on this question. It shows details about chairs of the OSC from 1978 onwards including their years of services, their ages when serving as chairman and their major accomplishments before and after their service. In general, these data suggest that the OSC has been able to attract capable people to the position of chair. Some of the chairs were seasoned professionals with substantial accomplishments prior to becoming chair. Others served relatively early in their careers and have since gone on to become prominent figures in legal firms serving the industry, major figures within the industry itself and participating in major public reviews related to the securities industry.

The data do suggest a significant rate of turn-over. Does this suggest salaries need to be higher to ensure retention? On the contrary, the turn-over appears quite normal for positions of this type. Heads of central banks and regulators have typically been appointed for fixed terms rather than on a permanent basis. Turn-over helps ensure that the Chair is someone cognizant of the important issues with a fresh outlook.

Does this evidence show that the OSC's salaries were sufficient to attract appropriately qualified professionals while it operated under government appropriations? Clearly, no conclusive answer is possible from this evidence by itself. It does show that OSC attracted capable people as shown by their subsequent careers. Possibly, with higher salaries these people would have stayed longer at the commission and been able to bring greater experience to bear on their task. On the other hand, the high quality of these people raises questions whether the commission's salaries need to be at similar levels to those paid for comparable people in the private sector.

#### **Provincial judiciary and senior officials in Ontario**

Another perspective on salaries in the security commissions can be gained from comparisons with positions of similar responsibility in the provincial government such as deputy minister and chief provincial judge. The provincial deputy minister of finance who is responsible for managing the province's finances and for developing financial policies for the government is clearly one of the most vital civil servants in the provincial government. The chief provincial judge is the head of the provincial court system and supervises provincial judges whose salaries are "generally in line with salaries of lawyers in the top quartile of their profession at a stage in their career comparable to that of a Judge at the time of appointment to the Provincial Court."<sup>6</sup> The securities commissions, as quasi-judicial bodies, share with the provincial judges the need for judicial independence, the core conditions for which include "security of tenure, including protecting Judges from being fired for making a decision the government does not like; administrative separation from other branches of government; and financial security."<sup>7</sup>

The comparisons presented here are based on comparable positions in the province of Ontario. These comparisons were possible because Ontario was the only jurisdiction that published salary data for both senior civil servants and members and employees of securities commissions.<sup>8</sup>

Table 4.1: OSC Past and Present Chairs

	Career previous to appointment	Age at appointment	Career afterserving with OSC
<b>James Baillie Q.C.</b> 1978–1980	Associate, Tory Tory Deslauriers and Binnington 1963–1977	40	Counsel, Torys (formerly Tory Tory Deslauriers and Binnington) 1980–; Chair, the Independent Electricity Market Operator (Ont); Director: Corel Corp, FPI Ltd., Sun Life Financial, Chair of federal Task Force on the Future of the Canadian Financial Services Sector 1996–1997.
<b>Henry Knowles Q.C.</b> 1980–1982	Partner, Smith Lyons 1969–1980	48	Counsel, Sheldon Huxtable 1991–; Director and Former Chair, Algonquin Mercantile Corp; Director, Samuel Manu-Tech Inc., The Gore Mutual Insurance Co., Cavell Energy Corp., Sunblush Technologies Corp., Wolfden Resources Inc; President and CEO, United Financial Management Ltd. 1987–1989.
<b>Peter Dey Q.C.</b> 1983–1985	Partner, Osler, Hoskin and Harcourt 1973–1982	42	Partner, Osler, Hoskin & Harcourt and former Chairman of Morgan Stanley Canada, Chair of TSE Corporate Governance Committee 1993–1994.
<b>Stanley Beck Q.C.</b> 1985–1989	Professor of Law, Osgoode Hall Law School 1967–1985 and Dean 1977–1985	51	President, Granville Arbitrations Ltd.; Chairman, Central Capital Corp 1989–.
<b>Robert Wright Q.C.</b> 1989–1993	Partner, Lang Michener 1964–1989	57	Deputy-Chairman (and former Chairman), Teck Corporation; Chairman, Toronto Port Authority; Director, Cominco Ltd, MDFA.
<b>Edward Waitzer Q.C.</b> 1993–1996	Partner, Stikeman Elliot 1981–1993; Vice-President, TSE 1977–1981	39	Partner, Stikeman and Elliot, 1997–; Director, BT Bank of Canada, Trimark Financial Corp.
<b>David Brown Q.C.</b> 1998–	Partner, Davies, Ward and Beck 1970–1998; Served on federal and provincial task forces	58	

Sources: *Canadian Who's Who*, 2001. *Canadian Directory of Directors*, 1999. Torys website, Stikeman and Elliot Website.

The salaries received by the OSC senior management are compared with their provincial peers in table 4.2 and chart 4.1 for the period from 1996 to 2000. This period includes two years before the conversion, the year of the conversion, and two years after the conversion. As the chart and table show, the salaries paid by the OSC were

comparable to, or even less than, the others prior to conversion. Salary patterns started to diverge during the transition year and continued to grow further apart in the two following years. By 2000, the gap between the salary of the OSC chair had grown from its initial level of 128% of the deputy minister's salary and 123% of the chief

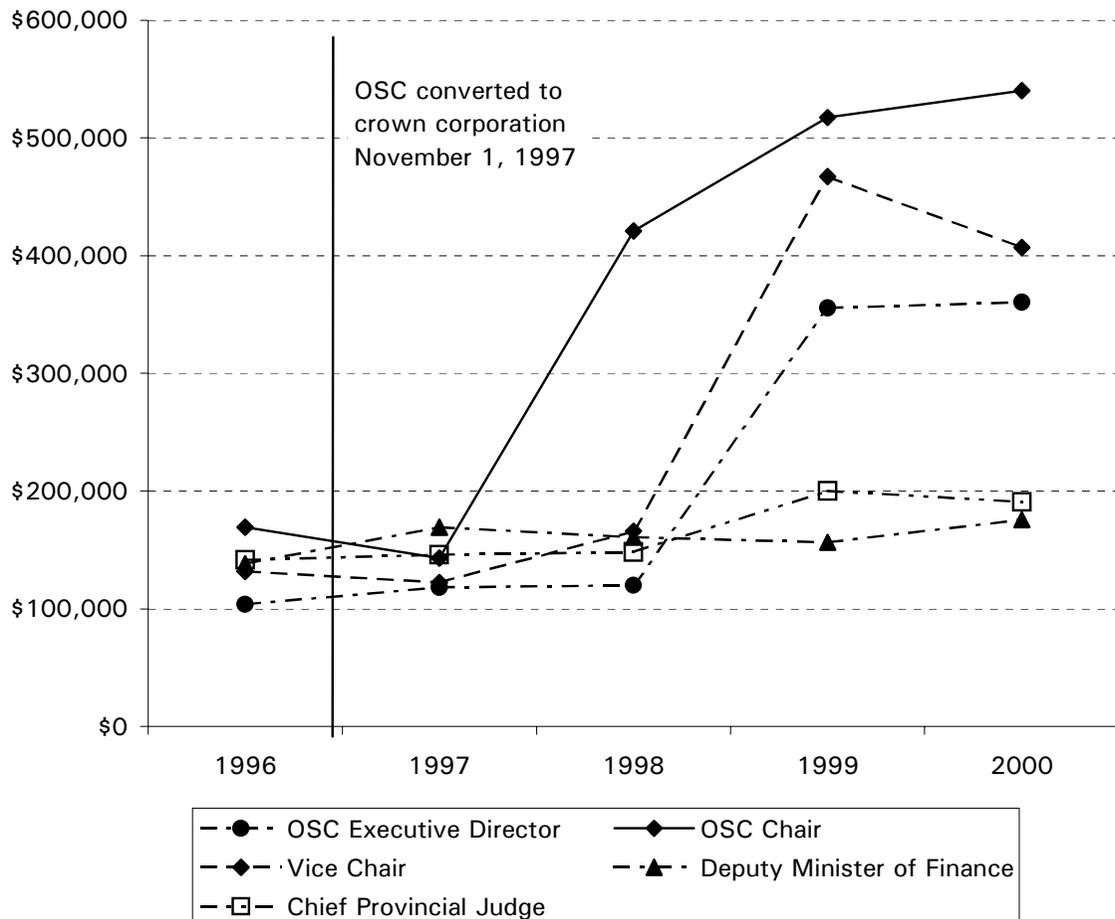
**Table 4.2: Salary comparisons (\$)—OSC and comparable positions, 1996–2000**

	1996	1997	1998	1999	2000
<b>OSC Chair</b>	169,232	142,974	421,000 <sup>1</sup>	517,249	540,049
<b>OSC Vice Chair</b>	131,822	122,191	165,818	467,222	406,821
<b>OSC Executive Director</b>	103,793	118,152	120,000	355,368	360,390
<b>Deputy Minister Finance</b>	138,172	169,296	160,752	156,503	175,660
<b>Chief Provincial Judge</b>	141,513	146,003	148,247	200,079	190,845

Source: Ontario Public Salary Disclosure ([www.gov.on.ca/FIN/english/psecteng.htm](http://www.gov.on.ca/FIN/english/psecteng.htm)).

<sup>1</sup> David Brown became Chair in April, 1998. Salary is adjusted for full year.

**Chart 4.1: Salary comparisons (\$)—OSC and comparable positions, 1996–2000**



judge's in 1996 to over 300% and 270% of these salaries. At the same time, the salary of the executive director, the senior employee of the OSC, grew from 75% to over 200% of the deputy minister's salary and from 71% to almost 190% of the chief judge's salary.

### Comparisons with the American Securities and Exchange Commission

The most germane comparisons for security commission salaries are likely the salaries paid to comparable officials in the United States, where data on salaries are available publicly for the members of the Securities and Exchange Commission (SEC), the major body responsible for securities regulation in the United States.<sup>9</sup> The salaries paid by the SEC are more than fair as benchmarks because the commission carries out its responsibilities nationally in a country with much larger security market activities than Canada. The fact that the SEC employs 3,285 staff—more than 10 times the number employed by the OSC—provides some perspective on its greater responsibilities.<sup>10</sup>

The salaries of the SEC commissioners are governed by the EX schedule established by the United States Bureau of Personnel Management. The Chair is placed at level III (\$US 133,700) and the other members at level IV (\$125,700) for 2001. These salaries corresponded to \$205,557 and \$193,266 in Canadian dollars. The salaries of the SEC's senior staff are governed by the Office of Personnel Management's ES category, which reaches a maximum of \$US125,700 at steps 5 and 6. This maximum staff salary corresponds to CDN\$193,266.

Table 4.3 and chart 4.2 compare the SEC salaries for 2001 with the salaries paid by the OSC and the ASC in 1999/2000. This comparison is based on different years and understates the difference between salaries to the extent that the OSC salaries rise from 2000 to 2001. In every case—OSC chair with SEC chair, OSC vice chair with SEC chair, and OSC executive director with the ceiling for SEC staff—the OSC salaries exceed those of the SEC and by substantial margins: the OSC chair receives 160% more than the SEC chair; the OSC vice chair 110% more than the SEC members; and the OSC executive director 90% more than the ceiling salary for SEC staff.

### Salary comparisons overall

A case could be made that the salaries paid by securities commissions prior to their conversion to crown corporations were unduly constrained by the rates payable to civil servants and that some upward adjustment would be needed to attract the calibre of staff needed for them to meet their responsibilities. It is clear also that the salaries of OSC senior management have “sky-rocketed”—there is no other suitable word—since the commission achieved budgetary independence. Are these large salary increases justified? It is difficult to find a clear benchmark for answering this question. Comparisons with comparable private-sector positions fail to take account of the future benefits from service in senior commission positions. On the other hand, it is difficult to accept that they are justified in comparison with senior provincial officials and judges and, more significantly, members and senior staff of the SEC, the major national securities regulator in the

**Table 4.3: Salary comparisons—ASC ,OSC and SEC (CDN\$)**

SEC		OSC		OSC/ SEC	ASC		ASC/ SEC
Position	Salary <sup>1</sup> (2001)	Position	Salary (2000)		Position	Salary (1999/2000)	
Chair	\$205,557	Chair	\$540,049	2.6	Chair	310,000 <sup>2</sup>	1.5
Members	\$193,266	Vice-Chair	\$406,821	2.1	Vice-Chair	163,000 <sup>3</sup>	.84
Staff (max.)	\$193,266	Exec. Director	\$360,390	1.9	Exec. Director	175,000	.91

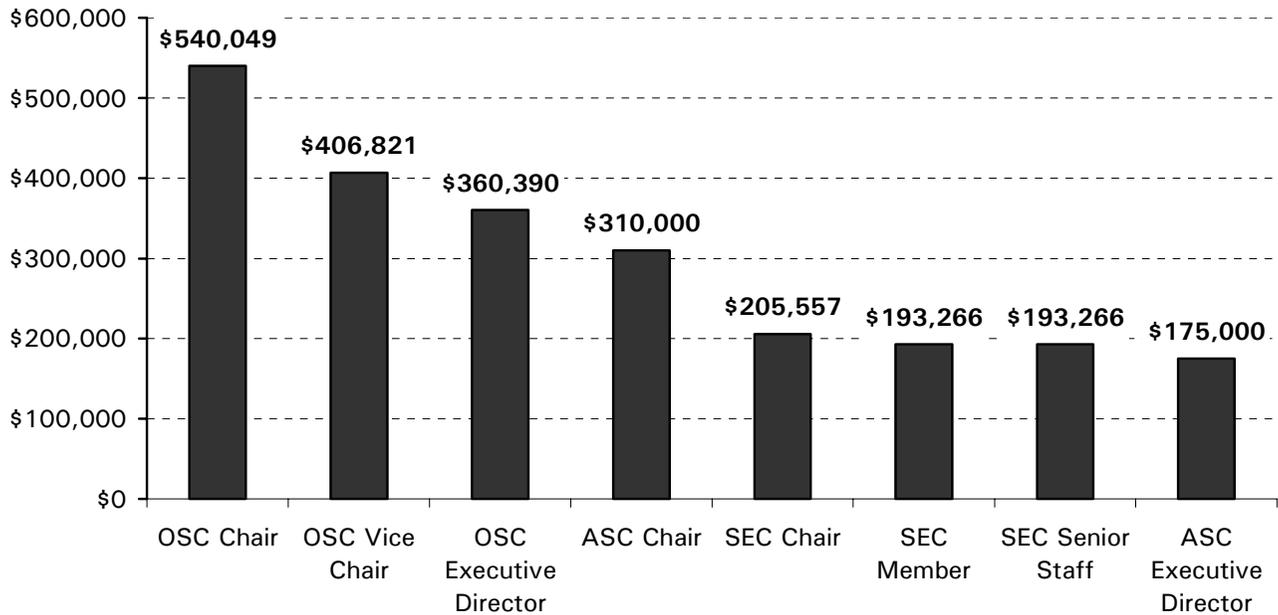
Sources: ASC salaries are reported in its *Annual Report*. OSC salaries are reported at Ontario Public Salary Disclosure ([www.gov.on.ca/FIN/english/psecteng.htm](http://www.gov.on.ca/FIN/english/psecteng.htm)). The salaries corresponding to scale categories at presented in U.S. Senate, Committee on Government Affairs, 106<sup>th</sup> Congress, 2<sup>nd</sup> Session (2000). The scale placements for SEC members and their staff are at the US Office of Personnel Management website ([www.open.gove/oca/O1table/excscs/html/O1excsc.htm](http://www.open.gove/oca/O1table/excscs/html/O1excsc.htm)).

<sup>1</sup>At C\$1 = .6504US, noon mid-market rate July 25, 2001.

<sup>2</sup>The Chair's reported salary for part of the year has been adjusted to an annual rate.

<sup>3</sup>The Vice Chair served as Acting Chair through part of the year.

Chart 4.2: Comparative salaries of Canadian and American securities commissions, 2000/2001



United States. Even though the OSC must be able to attract high-quality staff, its current salaries appear substantially above the levels needed to do this and also out of line by a substantial margin with salaries of public sector peer groups. The OSC management salary levels are surprising in that, of the three commissions, the OSC had the strongest provisions for external review and approval built into its governance framework. These safeguards in the event proved either inadequate or were not used in curbing the commission's powers to set its own salaries.

## 4.2 Reserves

The build-up of reserves by the commissions represents, in an accounting sense, an excess of the commissions' revenues over their expenses. Economically, this build-up represents revenues that the commissions did not need in order to carry out their responsibilities. In a real sense, the build-up of reserves represents an extra burden on those regulated by the commissions over the costs of providing regulatory services.

The designers of the new framework were rightly concerned with the possibility that commissions will, from time to time, experience revenue shortfalls as a result of market conditions or unexpected expenditures. It would be costly for the commissions to expand and contract their activities with respect to securities markets in

response to the ups and downs in year-to-year conditions and could impair the quality of regulation.

Two provisions were built into the commissions' powers to deal with fluctuations in expenses and revenues. In addition to building up reserves, the commissions were given authority to borrow in order to cover their costs. These two approaches differ with respect to their impact on the regulated constituency. Reserves require up-front payments from the regulated in anticipation of contingencies that may never occur. The exercise of the commissions' borrowing powers does not need to take place until the contingency actually materializes. The cost of building up reserves is offset to the extent that the reserves generate investment income whereas borrowing, when it takes place, incurs interest expense.

The choice between building up reserves against contingencies and going into debt will depend in part on expectations about fluctuations. Indeed, the appropriate strategy may involve reliance on both. Even when an emphasis is placed on debt, some minimum level of reserves may reduce the frequency with which debt is incurred.

It could be argued that, because reserves and the investment income they generate can be used to offset future regulatory costs, building up reserves does not create a significant burden for industry. However, private firms use a combination of equity, long-term and short-term borrowing to finance their operations while reserves held by the securities commissions are mostly in-

vested in the short-term government debt instruments of the province. The burden on firms is the difference between the cost of capital they face and the investment return on the reserves.

The choice emphasizing debt will be more appropriate when revenues and costs are fairly predictable and deficiencies of revenues relative to costs are unlikely. In this case, the expected costs of financing debt will be small. In addition, choosing debt avoids imposing the burden on those regulated that results from building up reserves. The difference between the two strategies becomes less significant if revenues and costs are less predictable. Both strategies impose a cost on those

regulated. In the case of reserves, it is the cost of building them up in advance. In the case of debt, it is the cost of working off the debt once it is incurred.

Table 4.4 shows the net burden of extra fees and other revenues required annually for building up of reserves. This burden can be measured by the total addition to reserves in each year less the investment earnings derived from reserves accumulated in past years. A perspective on the size of the regulatory cost burden arising from the build-up of reserves can be gained from Table 4.5, which expresses this burden as a percent of commission revenues. The patterns differ substantially from province to province:

**Table 4.4: Net additions (\$000) to reserves held by securities commissions, 1996–2000 (year ending)**

	1996	1997	1998	1999	2000	
ASC	Additions to reserves	2,660	6,990	4,244	2,925	1,245
	Less investment income	117	326	482	1,249	1,018
	Net addition to reserves	2,543	6,664	3,762	1,676	227
BCSC	Additions to reserves	3,567	5,794	6,291	9,138 (–2,862) <sup>1</sup>	7,526
	Less investment income	338	493	743	1,475	1,254
	Net additions to reserves	3,229	5,301	5,548	7,663 (–4,337) <sup>1</sup>	6,272
OSC	Additions to reserves				8,000 <sup>2</sup>	18,330 <sup>3</sup>
	Less investment income					1,910
	Net additions to reserves				8,000	16,420

<sup>1</sup>The figures in parentheses take account of \$12,000,000 transferred from reserves to the provincial government during the year.

<sup>2</sup>This figure does not include \$37,048,087 transferred to the provincial government during the year.

<sup>3</sup>This figure does not include \$22,750,492 of operating surplus transferred to the provincial government during the year.

**Table 4.5: Net additions to reserve compared to total revenue, 1996–2000**

	1996	1997	1998	1999	2000
ASC	33.4%	54.0%	31.0%	12.7%	1.7%
BCSC	20.6%	28.0%	25.7%	*	22.9%
OSC				10.6%	19.9%

Source: *Annual Reports* of the Commissions.

\* Excess of revenue over expense more than offset by \$12 million transfer to government.

*Alberta* The burden of building up reserves was substantial—in excess of 30% of revenues—during the ASC’s first three years as a crown corporation. The burden has moderated over the following two years as a result of a substantial decline in annual operating surplus.

*British Columbia* The net additions to reserves by the BCSC have exceeded 20% of its revenues in four of the five years following its conversion to a crown corporation.

*Ontario* In the two years following conversion, the OSC has built up its reserves at a slower rate than the other commissions at the same stage. In neither year did the build-up of reserves exceed 20% of income.

Given that the commissions have embarked on strategies of building up reserves, how large are the reserves relative to possible contingencies? This question can be answered in two ways. How much coverage do existing reserves provide relative to the commissions’ annual spending? How do the reserves compare with fluctuations of revenues experienced in the past? Table 4.6 shows that reserves built up by the commission exceed 60% of current expenditures in all three cases and reach levels in excess of current expenditures in British Columbia and Alberta.

The adequacy of reserves, however, cannot be judged independently from the frequency and nature of the contingencies for which they provide protection. Surprisingly, in light of the levels of reserves built up by the commissions, the revenue declines experienced by the commissions have tended to be relatively small.

The ASC’s experience has been the most extreme: it has suffered three declines of revenues in the eight years of reporting. Two of the three were under \$200,000 and less than 15% of revenues. Between 1995 and 1996, the ASC experienced a \$1.6 million drop in revenues, 20% of its current revenues.

The OSC experienced revenue declines in three of the 14 years since 1986. In two of the three cases, the drops were no more than 5% of revenues. The other drop was much more substantial: a \$2.6 million, or a 5.3%, decline from 1994 to 1995. This decline, however, resulted from an exceptional level of settlements in 1994 that inflated revenues. Revenues in 1995 were \$14 million above those in 1993, the year before the exceptional addition to revenues. In contrast to its counterparts, the BCSC did not suffer any revenue declines in the six years from 1994 to 2000.

Some perspective on the maximum revenue decreases experienced by the commissions can be gained from comparing them with the size of the reserves that the commissions have accumulated. To do this, we compare the number of years of the maximum past decline of income that could be covered by the level of reserves held in 2000. Alberta’s reserves of over \$18 million could cover a 20% decline in its revenues for over seven years. Similarly the OSC’s reserves could offset a 5% decline in revenues for over six years, and British Columbia’s reserves could cover a 10% decline in revenues over seven years. In all three cases, this coverage has been under-estimated because the commissions all currently have an excess of revenues over their expenditures.

This review suggests that the commissions together have been overly conservative in their provision of reserves in order to meet possible future revenue shortfalls. The growth of the reserves held by the commissions appears out of proportion to the contingencies that they have faced in the past. Moreover, if declines of revenue of the magnitude suggested by the reserves take place, it may be more appropriate to re-examine the levels of the commissions’ spending in these changed circumstances. As discussed above, the build-up of these reserves has imposed a burden on the regulated entities in securities markets.

**Table 4.6: Reserves relative to current expenditures for year 2000 (\$000)**

	Reserves	Annual Expenditure	Reserves/Expenditure
<b>ASC</b>	18,063	11,776	1.53
<b>BCSC</b>	20,088	19,805	1.01
<b>OSC</b>	26,375	41,300	.64

### 4.3 Comparisons with other jurisdictions

As noted in earlier chapters, the conversions were followed by significant growth in expenditure and employment numbers. Was this necessary to regulate securities markets adequately? We can explore this question by comparing cost and employment levels across various jurisdictions.

The Financial Services Authority (FSA) in the United Kingdom recently compared costs of financial regulation across different jurisdictions. Table 4.7 summarizes the data relevant to securities markets. Because of differences in countries' financial industries and regulatory structures, the data in this table are not directly comparable but it provides a general sense of where Canada stands in comparison to other countries on adequacy of resources for securities supervision.

Canadian direct costs for securities regulation (not including provincial regulators other than Alberta, British Columbia, Ontario and Quebec) exceeds those of every country surveyed<sup>11</sup> by the FSA except the United Kingdom and the United States, which both have market capitalizations at least three times that of Canada. Canadian costs and staff levels are almost six times those of France, which has a market capitalization more than double that of Canada. The United States (not including state regulators) spends close to five times that of Canada and has over three times the number of regulatory staff. However, its market capitalization is 18 times that of Canada. Costs in Canada and the United Kingdom would probably be fairly close if the Canadian figures included all the securities commissions but the United Kingdom's market capitalization is over three times that of Canada.

While we cannot make any definitive conclusions as to whether the securities commissions were significantly under-funded prior to the conversions, a comparison of regulatory costs and staff levels with other jurisdictions shows that Canadian regulatory costs and

staff levels appear currently to be relatively high, suggesting that the Canadian securities industry is more regulated than those in other countries. According to a recent news article, the OSC alone initiated 377 investigations in 2000, which is approximately 75% of the total for the SEC for the same period.<sup>12</sup> This also suggests high levels of regulation.

#### 4.4 Assessment

Overall, it is difficult to reach an overall judgement on the budgetary circumstances of securities commissions in Canada today. In some sense, this conclusion can be viewed as an implied criticism of their limited financial accountability. There is little evidence as to whether the value received of the commissions' activities are commensurate with their costs. The recent expansion of their budgets may indeed have been a catch-up from years of severely limited budgets that puts the commissions' financial resources at a level sufficient for them to meet their responsibilities effectively. On the other hand, evidence suggests clearly that management salaries have increased to levels out of line with reasonable comparison groups. It may never be possible to balance the costs and benefits of the activities of securities commissions in any conclusive way. In these circumstances, it is especially important to reduce budgetary concerns through making use of existing administrative mechanisms and putting new ones in place to support accountability.

**Table 4.7: Comparison of cost and employment levels across countries<sup>1</sup>**

	Regulatory Costs <sup>2</sup> UK£ millions	Number of Staff <sup>2</sup>	Market Cap UK£ billions
Canada <sup>3</sup>	117.0	1,673	526.4
Australia	87.2	1,774	205.1
France	20.4	287	1,456.4
Hong Kong	48.8	510	425.2
Singapore	8.4	n.a.	102.8
Sweden	3.9	n.a.	207.6
United Kingdom	144.0	n.a.	1,644.3
United States <sup>4</sup>	577.1	5,697	9,508.8

Source: U.K. Financial Services Authority Annual Report 2000/01.

<sup>1</sup>The FSA used the best available figures. All the figures are recent, but do not relate to the same accounting period. The figures include both government regulators and SROs (including the staff of exchanges). The FSA table also covered Germany and the Irish Republic, but the costs attributable to securities regulation by these integrated regulators were not broken out.

<sup>2</sup>Includes:

- prudential supervision of securities and fund management firms
- supervision and standards for exchanges, clearing and settlement systems and market service providers
- supervision and standards for market conduct in capital markets
- standards and approval of listing of securities
- regulation of collective investment schemes and fund management
- regulation of financial advisors and intermediaries

<sup>3</sup>Does not include provincial regulators other than Alberta, B.C., Ontario and Quebec.

<sup>4</sup>Includes the SEC, Commodity Futures Trading Commission and SROs (including the National Association of Securities Dealers).



## 5 Looking to the future

The conversion of the securities commissions of Alberta, British Columbia and Ontario into autonomous self-financing agencies clearly had unintended effects. In two areas where we have marshalled evidence—management salaries and the build up of reserves—the reduced financial accountability that was part and parcel of the commissions’ changed status appears to have worked to the detriment of low cost, efficient regulation of the securities industry.

This section undertakes two tasks flowing from our findings. The first is to consider two possible critiques of our own critique of the commissions’ conversion. The first of these could claim that we have taken insufficient account of the commissions’ quasi-judicial status: the public may have to accept inefficiencies flowing from budgetary independence to preserve the quasi-judicial independence needed for the commissions’ credibility. The other is quite different: it suggests that we have failed to recognize that the commissions’ revenues are either a tax on the securities industry or, alternatively, a user charge for services the commissions render.

The second task is to consider questions arising from our findings about the organization and accountability of the securities commissions and for other regulatory agencies in general. Must the realization of self-financing status necessarily come at the sacrifice of financial accountability? In what ways can budgetary accountability be assured without jeopardizing the judicial independence of independent regulatory agencies?

### 5.1 Critiquing our critique

#### **Judicial and budgetary independence**

Final judgment of the budgetary accountability of securities commissions may depend on understanding of the particular status and role of the commissions. The commissions hold a quasi-judicial status in the administration of securities laws. Because of this quasi-judicial status, the commissions share with other parts of our judicial system the need for judicial independence that is “widely

acknowledged as the foundation of our judicial system.” Further, as Chief Justice Larmer has declared, an essential of part of judicial independence is “the imperative of protecting the courts from political interference through economic manipulation.”<sup>13</sup> The sum of these views leaves the impression that budgetary independence is a clear prerequisite for the judicial independence of quasi-judicial bodies like securities commissions.

The case for independence of the judiciary is part—possibly the most critical part—of a broader argument for independence of all elements of our legal system. Justice Ted Hughes’ report on the APEC demonstrations of 1997 reemphasized the need for the insulation of the policing authority from political interference. Similarly, there exists a tradition that provides independence for politically sensitive prosecutions through appointment of a special prosecutor removed from the normal governmental hierarchy.

As we discussed in Section 1, the commissions carry out, in some measure, all the tasks of investigation, prosecution and judgment with respect to securities law. Thus, the arguments for the independence of each of the elements of our legal system appear to strengthen the case for the independence of the commissions from political interference and hence their need for budgetary independence.

This argument fails to take account of the actual organization of our legal system: we manage to preserve judicial independence despite the absence of absolute financial independence. The financing of all of the policing, prosecutorial and judicial elements is dependent on allocations from government in the same way as the commissions prior to their conversion. In the case of the judiciary in British Columbia, the scale for their remuneration is partly removed from dependence on appropriations by a periodic review from an independent committee.

Judicial independence appears compatible with arrangements where government determines the level of activity but not its direction. Similarly, government also determines the level of support for policing and prosecutions but is removed from determining what is investigated

and who is charged. Any argument for the budgetary independence of securities commissions must show why the need there is greater than elsewhere in our legal system.

### **Tax, user fee or neither?**

The revenues of the commissions come, as we have seen, mainly from a variety of fees levied on the filings of the prospectuses of enterprises seeking additional funding, the annual reporting of corporations and the registrations of securities firms and their agents. From this perspective, the large surpluses accruing to the commissions indicate a level of fees far in excess of the level needed to oversee these filings. In addition, these fees are more than sufficient to cover the commission's various activities related to the enforcement of securities law.

Some may criticize our judgment that the fees are excessive by claiming that they are a tax on security market activities or, alternatively, that they are a broad service fee not just for filing and registration but for the overall services of the commissions in assuring effective markets. Either of these arguments, if accepted, reduce the force of our criticism of the changed status of securities commissions and its consequences.

### *Fees as a tax*

In Section 4, we criticized the commissions' excess revenues as creating an undue regulatory cost on participation in securities activities. Our critique could be questioned on the grounds that these excess revenues should really be viewed as a specific tax on securities market participants. On this basis, criticizing the securities commissions for running surpluses and transferring them to governments is similar to criticizing Canada Customs and Revenue agency for doing the same. This critique of our judgment of the current levels of commission revenues is subject to at least two shortcomings.

First, this argument has been outdated by the conversion of the commissions into financially independent agencies. Before this change, the provincial governments all claimed the surpluses from the commissions, some immediately and others after some delay. The conversion of the commissions in the cases of the ASC and BCSC explicitly eliminated any claims of government to the revenues, although in the case of British Columbia this was overridden legislatively later on a one-time basis. In the OSC's case, the government's claim was substantially attenuated by the agency's new status.

The second shortcoming arises from the foundation of this argument on the Willie Sutton philosophy of

taxation. When asked why he robbed banks, Willie allegedly replied "that's where the money is."<sup>14</sup> Apparently on the same grounds, governments cannot resist the temptation to tax the financial sector. Kevin Dancey, in a study for the Task Force on the Future of the Canadian Financial Services Sector, found for the financial sector as a whole that "[t]he tax system applying to [it] does not meet the basic design principles of any business tax: equity, efficiency and simplicity" and "[t]he tax burden on the financial sector is higher than on other sectors and has increased relative to the burden on other sectors" (Dancey 1998: 8). The strongest defence for viewing these high fees as taxes appears to be their convenience as a source of revenue.

### *Fees as user charges*

A slightly different argument for the excess fees could suggest that filing fees are not a tax but a user charge paid by members of the securities industry to finance the commissions' activities in maintaining public confidence in securities markets. While it may be conceded under this view that the filing activities of the commissions cost only a fraction of the fees charged for them, these filings serve to meter the benefits accruing to participants in securities markets from the commissions' activities.

There is a real life parallel to this argument in the arrangements financing the activities of the federal government's Office of the Superintendent of Financial Institutions (OSFI), the primary regulator of banks and federally incorporated insurance companies. OSFI finances its supervisory activities though levies on participants in the industries it regulates.<sup>15</sup> This same argument appears to be at the center of the OSC's recent proposal to base its fees on the benefits received from participation in the securities market by different parties (OSC 2001: 1971–95).

This user charge accepted at its face value can only be a limited defence for the excess revenues levels of the commissions. Moreover, it sets a clear standard for the level of fees. In meeting this standard, OSFI sets its assessment rates so that the revenue it collects from industry offsets its expenditures exactly so that it does not run deficits or surpluses, nor does not transfer excess funds to the government.

As we have seen, for the securities commissions, a significant share of the revenues has supported the building up of reserves and the maintenance of generous salaries. The argument, in effect, could only justify fee revenues for the commissions much lower than their current levels.<sup>16</sup>

Even the broader argument justifying fees for the confidence-supporting activities of the commissions is questionable. This function of the securities commissions is not unique in a modern economy. A cursory review of newspapers over a recent period calls attention to boards and agencies such as the Canadian Food Inspection Agency and the Transportation Safety Board, all of which serve to protect the public interest in their respective industries in the same way as securities commissions do. These bodies do not appear to levy fees to their industries but gain their resources from government appropriations. Interestingly, the exceptions to this mode of financing—the commissions and OSFI—are both in the financial sector.

### *13 securities regulators*

It is common practice for Canadian securities firms to operate across provincial jurisdictions. So, in considering the burden associated with the escalation in expenditure by the securities commissions after conversion, it is helpful to note how this escalation interacts with the structure of securities regulation in Canada, which is conducted at the provincial level.

For example, a firm with its headquarters in Ontario might also be registered in Alberta and, therefore, subject to the fees of the securities commissions in both provinces. Thus, the Ontario firm is contributing towards financing not only the cost of the OSC's Chair but also that of the ASC as well. Earlier, we compared the salaries of these chairs with that of the SEC's Chair in the United States and found that both the OSC and ASC Chairs earned substantially more. For the firm operating in both Ontario and Alberta, it must help finance a combined \$850,049 in salary costs for commission chairs, compared to the \$205,557 faced by an American securities firm that operates across the United States for the SEC Chair's salary. For firms that operate in more provinces, the costs are even higher. Because of the provincial regulatory structure, the need for appropriate discipline on costs becomes even more important.

## **5.2 Lessons for accountability**

Reduced financial accountability became an unintended side-effect of the conversion of securities commissions into independent agencies, creating an unnecessarily high burden on those regulated. What lessons does this

experience provide for the governance of bodies such as the commissions that require policy independence to perform their jobs? Can financial accountability be achieved without intruding on judicial independence?

### **Lesson 1 The crown corporation experiment was not a success and probably unnecessary**

Overall, the conversion of the commissions into crown corporations was not a success. Little was achieved in that the commissions had adequate policy independence before the conversion and most other judicial authorities manage to maintain their independence under the same arrangement as the commissions before the change. The change came clearly at the cost of financial accountability.

The experience with respect to the securities commissions offers a clear lesson. Care must be taken in the design of budgetary mechanisms for agencies, tribunals and other bodies that require policy independence. The approaches taken for securities commissions in these three provinces were not up to the task. This lesson is especially timely in light of Ontario's announcement in 2000 that it intends to roll the securities commission together with the agency regulating provincial financial institutions into a single financial-sector authority. Our results suggest that such a move would be unwise if the institutional arrangements for the OSC remain in place. If this goes ahead, the current lack of financial accountability characterizing the OSC will be further compounded with an expansion of its domain.

### **Lesson 2 The budget of the securities commissions should be subject to arm's length review and approval**

The creation of budgetary independence has been one effect of the conversion of securities commissions into crown corporations. While better budgetary provision for the commissions' activities was clearly part of the intent behind these moves, it is difficult to imagine that this intention extended to reducing the commissions budgetary accountability so drastically.

With the exception of the Financial Review Committee of the ASC, the commissions lack the types of mechanisms generally used to assure sound governance. While all the commissions have both full-time and part-time directors, the part-time directors are involved in policy activities of the commissions in the same way as full-time directors and remunerated for their services. Thus, the commissions have neither the presence of truly

outside directors on their governing boards nor arms-length mechanisms for determining outside compensation that are commonly found in the private sector. The absence of any such governance mechanisms is especially surprising in light of the commissions' often expressed concerns for the effectiveness of the governance of those whom they regulate.

Our discussion below suggests alternative governance models for the commissions. Whatever structure is chosen, re-establishing financial accountability for the securities commissions should be a priority. Still some care must be taken with the arrangements to ensure a competence to judge the activities of the commission and at the same time avoid conflicts of interest.

**Lesson 3 The salaries and benefits of the commission's senior management should be based upon clearly stated benchmarks of positions of similar responsibility and authority**

While the salaries of the commission's senior management should be one of the key responsibilities of the supervisory committees, governments should establish a framework for these decisions. Several groups are obvious comparisons for securities commissioners and were used in this study. The salaries of the senior judiciary in the respective provinces provide one obvious benchmark. These judges oversee the administration of justice over criminal and civil matters in the same jurisdictions as the securities commissions. In addition, their salaries reflect the priorities attached to the enforcement of laws in that province. The salary of the federal superintendent of financial institutions provides another reasonable benchmark. The superintendent, like securities commissioners, is also responsible for protecting the integrity of financial markets, in this case primarily banks and insurance companies.

We believe that, of the benchmarks used in the study, the comparisons with the SEC will be the most germane for gauging salaries in the future. Not only is the SEC participating in the same activities as the Canadian commissions, it also shares the same competition as the commissions with the private sector for talented staff.

The members of the Securities and Exchange Commission in the United States are a very appropriate peer group in that they are the nearest counterpart in the United States to the provincial commissioners. This counterpart may be particularly generous in that the SEC commissioners have oversight for a national securities market that is the most extensive in the world.

**Lesson 4 The fee levels of the securities commissions should be set to cover commissions' legitimate expenses over a medium-term horizon**

The revenues of the commissions beyond the amount necessary to provide for the appropriate degree of supervision and enforcement can be considered as an unwarranted tax on securities market activity. Some recognition has been given to this problem by the recent initiatives taken by commissions to reduce their fees. Even with these reductions, the revenues of the BCSC and OSC commissions still continue to exceed their level of costs by a substantial margin. The conservatism of commissions in reducing their fees may reflect different concerns with respect to both the short-run and long-run stability of the commissions' revenues.

In the short-run, the commissions may be concerned about the year-to-year fluctuations in their revenues in response to the fluctuations in security market activities. One of the first steps taken by the securities commissions upon gaining the status of crown corporation was the building up of reserves that protected them against fluctuations in their revenues. As discussed earlier, these reserves appear to be more than sufficient to meet the short-run

Concern about a decline in revenues over the longer run may be based on the view that recent levels of activities in financial markets are a break from sustainable levels. A decline in revenues over the longer run raises much different issues from a short-run decline as it could eventually deplete the commissions' reserves. Nevertheless, this possibility cannot justify the build-up of even larger reserves. A long-run decline in revenues should signal a reassessment of a commission's level of activity. Fewer registrations, mergers and takeovers and other forms of reporting, whether from lower levels of securities market activities or from a shift in activity away from a jurisdiction may indicate that the oversight of securities markets needs fewer resources.

The other reason for a margin of revenues above costs is to provide transfers from securities commissions to general government revenues. As discussed earlier, such transfers are an unlegislated tax directed toward one area of economic activity. Such transfer of profits to governments as owner may be justified and even necessary when crown corporations are carrying on commercial activities. This would be the case for crown corporations supplying privately consumed services such as electric power, transportation or postal services. Securities com-

missions, on the other hand, are monopoly suppliers of regulatory services, a form of public good. The revenues from securities commissions come in large measure from fees charged to parties meeting mandatory registration requirements.

Setting commission's fees at levels that cover the expenditures over the medium term deals with both the short-run and the long-run concerns. The reserve that the commissions have built up through their early years as crown corporations can insulate the commissions' activities and programs from short-run fluctuations of revenues. On the other hand, the absence of any cushion between revenues and costs in the medium term together with limits to the build-up of reserves means that long-run trends in revenues will precipitate reviews of the activities of securities market regulators to determine the levels warranted under the changed conditions.

#### **Lesson 5 Provincial auditors should periodically conduct performance (value-for-money) audits on securities commissions**

Performance audits examine whether organizations are achieving what needs to be done economically and efficiently. The provincial auditors for Ontario, Alberta and British Columbia all do performance audits on ministries, agencies and crown corporations. Each provincial auditor's office has its own selection criteria for determining which government entities are audited on performance. Although eligible, none of the three provincial securities commissions described in this study has undergone one of these audits since conversion to crown corporations.

### **5.3 Judicial independence with fiscal accountability**

There is a strong case for the policy independence of securities commissions because of their responsibility for enforcement of securities law through their combined judicial, prosecutorial and investigative roles. In this respect, there roles are similar to those of the courts and the police with respect to criminal law. The governments' motives for changing the status of the commissions was not clear. The commissions already appear to have been assured the same policy independence as the judiciary while operating within the structure of government departments.

The conversion of the commissions to crown corporations did reaffirm and strengthen that independence

but at a clear cost. Budgetary independence, however, conflicts with another tenet of democratic government: the public accountability for those responsible for handling public funds. The evidence suggests that the conversion experiment, as it was conceived, has not been a success: the limited mechanisms do not give adequate oversight and control over commission spending. Still our conclusions may be no more than a mirage unless there are ways to assure the financial accountability of securities commissions while preserving their independence.

How can accountability be increased without sacrificing policy independence? In answering this question, it is useful to consider the arrangements used for other public bodies where independence is vital. Possible approaches include the *appropriations model*, formerly used for the commissions and now used for the judiciary, crown prosecutors and law enforcement agencies, and the *outside board* or *oversight model* used for the Bank of Canada and a variety of other crown corporations.

#### **Oversight model**

The oversight model provides another alternative that may be particularly suitable for agencies with their own source of revenues such as the commissions. Policy independence and financial accountability both can be fostered through the presence of two distinct governance mechanisms: the policy council and an outside board of directors. The policy council in the case of securities commissions would be composed of the chair and the other directors and would be responsible for the commissions' regulatory responsibilities. The policy council would have the same responsibility to the minister with respect to policy as the commissions' directors have today. The administrative boards, in contrast, would be composed of outside directors and would be ultimately responsible for financial and personnel administration matters including the appointment and the remuneration of senior management. This separation of responsibilities between the two bodies provides a means for protecting both policy independence and financial accountability.

#### **Appropriations model**

While the three governments discarded the appropriations model for their securities commissions, they continue to use appropriations for the finance of the courts, the independence of which is a recognized cornerstone of democracy. The use of appropriations for support of the judiciary does not guarantee that the needed level of

funding as perceived by jurists will be forthcoming through appropriations. However vital the judiciary may be, it is recognized that it—or any other function of government—cannot preempt other uses, such as health-care or education, for scarce tax revenues. It seems difficult to argue that the task of securities commissions is so vital that it has a claim for security of funding any greater than other functions of government. Despite being discarded in the conversion experiment, the basic appropriations model still seems suitable as a mechanism for commission funding.

Under an appropriations process, governments set up budgets to determine spending levels. Departments and agencies must develop proposals of what they believe they need to spend in order to manage their responsibilities. Typically these proposals are reviewed by a central agency that takes into consideration competing interests for funding and makes choices based on needs and priorities. Once the comprehensive budget has been assembled, it must be submitted to the legislature for spending authority.

Hence, under the appropriations model, a securities commission has the opportunity to make its case for funding and budget makers will respond, taking into consideration the interests of taxpayers and the need to spend money in other areas such as health-care, education or enforcing environmental regulation.

Is this process ideal? As in any process where subjective judgments must be used and trade-offs made, inevitably the appropriations process is not perfect in its allocation of resources. However, we continue to use it in making choices for spending in areas such as health-care and public safety. But for securities regulation, does it lead to persistent severe under-funding?

Many securities regulators continue to operate under the appropriations model, including those in Australia and the United States. Is the SEC, which regulates the largest securities exchanges in the world, unable to supervise market activity effectively because it is subject to budget appropriations? It does not seem to think so. The American government recently released an assessment of how its financial regulation and supervision compares to international best practices. As part of this exercise, the SEC compared its practices against the International Organization of Securities Commissions' (IOSCO) principles for securities regulation. The third of these principles states that "The regulator should have adequate powers, proper resources and the capacity to perform its func-

tions and exercise its powers."<sup>17</sup> The SEC concluded that, while it is required to submit an annual budget like any other federal agency (first to the Office of Management and Budget and then to Congress), this principle had been implemented.

Even though the appropriations model may provide a discipline against the payment of excessive salaries, there is no assurance that it will lead to a suitable level. One problem with the appropriations model is that the staff salary levels may be unduly constrained by government salary scales that fail to take account of the agencies' needs for specialized staff. This issue is especially important for the commissions in that they must compete for legal talent with the private sector. As we have suggested earlier, the competition need not mean a dollar-for-dollar matching as there are benefits beyond salary from experience with the commissions.

If this model is adopted, it may be useful to add to it the same type of independent mechanism as used for determining judiciary salaries in British Columbia.<sup>18</sup> In this case, the government every three years appoints a compensation committee to make recommendations with respect to the salaries for provincial judges for the period up to the next review. The membership of the committee is determined by the *Provincial Court Act* and, for the 2001 review, consisted of two members appointed by the Chief Judge (a labour lawyer and a former deputy minister) and two members appointed by the Attorney General (a mediator/arbitrator and a management consultant). These four jointly appointed the chair (a distinguished management consultant who had already chaired the committee on two previous occasions). In arriving at its conclusions, the committee was required to consider:

- the current financial position of the Government,
- the need to provide reasonable compensation to judges,
- the need to build a strong court by attracting qualified applicants,
- the laws of British Columbia, and
- any other matter the Committee considered relevant.<sup>19</sup>

The 2001 Report of the Committee was made public after its presentation to the Attorney General.

The committee was established to deal with the same type of issues raised by compensation for the commissions. The committee process "is designed to maintain an appropriate separation of the political branches of government and the judiciary and thereby help ensure judicial

independence is maintained in the compensation for Provincial Court Judges.” We believe that such a body would be an important supplement to the appropriations model in determining commission salaries. The use of such a body could provide the flexibility needed to pay salaries outside

of the government’s normal scale at the same time as placing salary decisions at arm’s length from commissions and their management. It is important that the report become a public document to provide for the accountability of the committee in making its recommendations



## Notes

- 1 The OSC experienced three declines in prospectus fees and one decline in registration fees in the late 1980s and early 1990s.
- 2 The OSC was converted to a crown corporation on November 1, 1997. Its by-laws took effect January 18, 1998.
- 3 The respective years were 1994 for Alberta and British Columbia and 1997 for Ontario.
- 4 The title of the latter position changed from Director of Finance to Chief Financial Officer between 1995/1996 and 1996/1997. The other titles remained unchanged throughout.
- 5 The OSC did not report revenues for 1997/1998, the year in which the conversion took place.
- 6 British Columbia 2001: 22. Judges' salaries in Ontario appear to be considerably above those in British Columbia. Provincial Judges there received salaries 8% higher in 2000 than the level recommended for British Columbia for 2001.
- 7 Chief Justice Larmer as cited in British Columbia 2001: 6.
- 8 The ASC, to its credit, has published salaries at least since the time of its conversion. Comparable data could not be found for the Alberta civil service. The BCSC does not publish its salaries even though the British Columbia government publishes salaries of senior civil servants.
- 9 State securities commissions have much more limited powers than the provincial commissions in Canada.
- 10 See United Kingdom, *Financial Services Authority Annual Report 2000, Appendix 5* ([www.fsa.gov.uk/pubs/annual/ar00-01/appendices.html](http://www.fsa.gov.uk/pubs/annual/ar00-01/appendices.html)).
- 11 Excluding countries for which securities-specific costs were not broken out.
- 12 OSC appears more vigilant than American counterparts, *National Post* (October 11, 2001).
- 13 British Columbia 2001: 6, 14.
- 14 When asked why he robbed banks, Willie Sutton allegedly replied, "because that's where the money is." See Steve Cochran, "The bank robber, THE QUOTE, and the final irony" ([www.banking.com/aba/profile\\_0397.htm](http://www.banking.com/aba/profile_0397.htm)) which suggests an enterprising reporter was responsible for this much cited quotation.
- 15 For details, see Office of the Superintendent of Financial Institutions, *Assessment of Financial Institution Regulations 2001*.
- 16 The fraction, as we have discussed earlier, differs from province to province.
- 17 IOSCO's *Objectives and Principles of Securities Regulation* (September 1998): 3.
- 18 For more on the procedures, see British Columbia 2001.
- 19 See British Columbia 2001: 8.



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