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February 22, 2013

Dear Sirs and Mesdames:

RE: Canadian Securities Administrators Consultation Paper 33-403: The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients (the Consultation Paper)

The Investment Industry Association of Canada (IIAC or the Association) appreciates the opportunity to comment on behalf of our members in response to the request for comment issued on October 25, 2012 by the Canadian Securities Administrators (CSA) on the Consultation Paper related to exploring the desirability and feasibility of introducing a statutory best interest standard in Canada.

In response to the request for comment, the IIAC formed a Working Group of members to review the Consultation Paper and assist in formulating a response. The Working Group was comprised of compliance, legal and business professionals and totalled 29 members from various small and large firms across Canada. The Working Group's views were consistent in both the concerns expressed and its approach to the questions posed in the Consultation Paper.

The Association wishes to point out that as there was some overlap in many of the questions set out in the Consultation Paper, we have not necessarily responded to each one individually but have either grouped questions together or made high level comments in one section but responded in more depth elsewhere in our response letter.

Furthermore, as the Consultation Paper did not specify the parameters of the proposed statutory best interest duty, we have found it difficult to provide comments on the perceived benefits of the standard. Specifically, it is difficult to assess investor protection concerns based upon an unqualified best interest standard when the Consultation Paper notes, albeit briefly, that qualifications would be required. These definitive qualifiers would significantly impact the perceived advantages for investors and the operation of investment dealers' businesses. As a result, without a clearly articulated proposed framework, we found it challenging to prepare detailed responses to some of the questions posed.

Overview

The IIAC and its member firms believe in providing advice that is best for their clients and we are consistently working towards raising the quality and increasing the integrity of investment advice. The securities industry in Canada has been proactively advancing a regulatory regime to provide clients with significant investor protections. Without the opportunity to fully implement the recent changes to the securities regulatory regime and evaluate their impact, the CSA should not introduce a statutory best interests standard (or fiduciary duty), as there are potential negative consequences for both investors and the industry, including: reduced choice among business models, reduced access to financial products, decreased affordability of financial advice, uncertainty regarding the obligations within the client-advisor relationship, onerous compliance requirements, and increased exposure to risk and liability for advisors.

Securities regulators have a variety of policy tools that they are able to use to address investor concerns. The policies under the Client Relationship Model (CRM), including enhanced suitability assessment requirements, increased conflict of interest management and disclosure rules, proposed new requirements related to transparency of cost disclosure, performance reporting and client statements, along with financial literacy initiative programs and an increased focused on enforcement and arbitration measures, reflect an understanding of the client - advisor relationship and provide a comprehensive investor protection regime. The CSA, the Investment Industry Regulatory Organization of Canada (IIROC) and industry participants have spent over ten years developing this regime and it is still in the process of being implemented. The current and proposed regulatory framework embodies most of, if not all, the essential investor protection elements raised by the CSA's discussion of a proposed best interest standard. The existing duties and obligations require advisors to determine suitability and deal fairly, honestly and in good faith with clients, and to effectively disclose and manage conflicts of interest. As such, we believe that the current regulatory and legal regimes fulfill their purpose of protecting investor interests.

Further, there are several legal remedies available to investors and additional legal safeguards for vulnerable investors. A common law fiduciary standard will apply when a client is vulnerable, places reliance and trust on the advisor, and their advisor has discretion over the client's account. A statutory best interest would apply uniformly regardless of the actual relationship between the client and advisor. The courts have stated that it is not appropriate to apply a fiduciary standard when the client is sophisticated, not vulnerable, the advisor does not have discretion over the account, the client does not rely on the advisor and participates actively in the investment decision-making process. We question why the CSA would propose to overrule the common law to extend a fiduciary duty to sophisticated, non-vulnerable investors.

The proposal for a statutory best interest duty has been put forward without identifying either a regulatory failure or a failure by the courts in their application of fiduciary duty at common law. What is the regulatory gap that needs to be addressed through overriding the common law and introducing a statutory fiduciary duty? It is unclear what we are trying to change by modifying the duty of care. Is there any empirical evidence that suitability standards or legal remedies under a breach of duty of care are lacking?

Overall, the CSA has not demonstrated that a clear benefit will be achieved through the implementation of a statutory best interest standard. We are unaware of any cogent position having been articulated as to why the regulators feel such a response is necessary in light of the extensive CRM regime currently being implemented. The Consultation Paper has failed to adequately capture and define the perceived short-comings in the existing regulatory regime which warrants further intervention. This analysis needs to be conducted and articulated in advance of rule formulations; otherwise, the regulatory proposal cannot be measured against the objective which it is intended to address.

Response to CSA Questions

Question 1: Agree or disagree with the investor protection concerns discussed

The IIAC agrees that there may be some investor protection issues that warrant further examination, including certain concerns identified by the CSA. However, the IIAC disagrees with characterizations that suggest that the current regulatory regime cannot adequately respond to those concerns and disagrees with an assertion that a statutory best interest standard is the most effective method to advance investor protection in Canada.

Concern 1: Principled foundation

The IIAC disagrees with the view that the financial advisory industry is based on a "buyer beware" principle. The Canadian securities regulatory regime, through the CSA, IIROC, and the legal system ensures that laws and regulations are in place that prevent a "buyer beware" environment. In fact, the current regime and expected standard of conduct for advisors and dealers are both premised on the principle of investor protection. There are many examples of this, including a clear acknowledgement of this principle in the IIROC Notice 09-0120: *Request for comments on Client Relationship Model*, which in part stated, "[a]mendments to the account suitability requirements have been introduced to **enhance** the **level of investor protection** for retail clients by ensuring that the suitability of investments in each client's account is assessed in certain circumstances".

The Canadian financial industry is not a "buyer beware" environment and there are numerous principled foundations underlying the current regime that protect investors, including:

(1) *The disclosure regime*. Securities law and IIROC's rules require disclosure to investors of meaningful information about products and investment risks. Prospectus disclosure requirements, trade confirmations and account statements, the Fund Facts Document, CRM requirements for disclosure of charges and other similar requirements demonstrate that the securities regime is not premised on a buyer beware principle;

(2) *Regulations such as the CRM enhanced suitability assessment requirements*. IIROC has issued guidance on regulatory expectations for meeting its suitability requirements. Dealers and advisors are reminded that compliance with suitability requirements is fundamental to compliance with general business conduct standards and is essential to good business practice. In addition, know-your-client obligations include taking reasonable steps to ensure the purchase or sale of a security is suitable for the client. The Consultation Paper itself acknowledges that advisors cannot "satisfy the suitability obligation by simply disclosing the risk involved with a transaction";

(3) *An advisor's statutory duty of care owed to the client*. The suitability requirement is complementary to this fundamental obligation under securities legislation for all dealers and their representatives to deal fairly, honestly and in good faith with clients. This fundamental obligation includes a duty to disclose known or discoverable risks to the investor before the investor enters into any transaction. Further, the IIROC Conduct and Practices Handbook (CPH) imposes a duty of care, trustworthiness, honesty, fairness and professionalism requirements on registered dealers. Additionally, IIROC Rule 29.1 requires that investment professionals observe high standards of ethics and conduct in the transaction of their business; not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and be of such character and business repute as is consistent with the standards of the rule;

(4) *IIROC registration and proficiency requirements*. IIROC requires advisors to adhere to professional standards of conduct, comply with ongoing proficiency requirements and comply with the CPH. IIROC Rule 2900 sets out proficiency requirements for various registrants, including advisors, and requires completion of the Canadian Securities Course and the CPH. It also mandates a 90-day training programme and completion of the Wealth Management Essentials course within 30 months of approval as an advisor. Furthermore, there are additional proficiency requirements if the advisor is trading in futures and options. Lastly, the ongoing Continuing Education Program sets out a program that advisors must complete in three-year cycles. Each cycle requires a 12 hours of Compliance courses and 30 hours of Professional Development courses;

(5) *A robust complaint handling system as well as an ombudservice to provide compensation or redress for investors where warrante*d. IIROC has a comprehensive complaint handling rules to address issues that may arise between clients and the firm. In the event that the client is not satisfied with the outcome of the process with the firm, they may take advantage of the free dispute resolution service provided by the Ombudsman for Banking Services and Investments (OBSI), which investigates and makes compensation recommendations for complaints up to $350,000. Clients may also take advantage of IIROC's

arbitration process, which is a lower cost alternative to civil litigation, and is available for complaints up to $500,000; and

(6) *The CSA's mandat*e. A fundamental responsibility of securities regulators is to "provide protection to investors from unfair, improper or fraudulent practices."

In addition, requirements surrounding know-your-product further support the principle that investor protection is paramount under securities regulation. The suitability assessment obligations include a requirement to know and understand the characteristics and risks associated with any investment product approved or recommended to clients. Clients are not simply provided with an offering document for their review. Dealers have the responsibility to assess the risks associated with the products that firms approve for sale. Advisors are expected to understand, and be able to clearly explain to the client, the reasons that a specific security is appropriate and suitable for the client.

Concern 2: Information and financial literacy asymmetry

The IIAC agrees that the lack of financial literacy among Canadians is a concern and recognizes that there is often a financial literacy asymmetry between the client and the advisor. However, the IIAC believes that a statutory fiduciary duty would not increase financial literacy.

As we discuss later in this submission, the fiduciary standard will increase the cost of advice (due to increased legal, supervisory and compliance costs) which will result in more clients being unable to receive personalized investment advice. These clients may have to switch to non-advice firms and lose the access to professional advice.

It is important to recognize that a financial literacy imbalance between the client and advisor may be large in some cases but minimal or non-existent in other cases. Consequently, it is unclear why a sweeping best interest standard would be necessary to address an imbalance that is not present in many client-advisor relationships.

The IIAC also questions the concern expressed in the Consultation Paper about the fact that advisors and dealers usually "have more knowledge and information about the financial products they recommend to their clients." This is usually why investors enter into relationships with advisors, as the advisor is not only expected to have more knowledge of the financial industry but is responsible for knowing the client and knowing their risk tolerance, investment objectives and current investment portfolio composition and to advise clients accordingly. The fact that advisors and dealers have more expertise in the financial products they recommend than many clients is precisely why these clients seek out investment advice.

Concern 3: Standard of conduct expectation gap

If an expectation gap exists in connection with the advisor's legal duty, it may be the result of clients not sufficiently understanding the current duty of care owed by their advisor - their duty to act fairly, honestly and in good faith under securities legislation. CRM should alleviate this issue as it will result in clear disclosure of the details of the account relationship and the services to be provided, which will better inform clients of the nature of their account relationships. As such, it will address any perception gaps and better engage clients in their relationships with their advisors.

Furthermore, a statutory "best interest" duty is a legal duty which, depending on how it may ultimately be qualified, is unlikely to be consistent with the average investor's understanding of what it means for an advisor to act in their "best interest" in any event. In our view, the imposition of a "best interest" standard is not the appropriate avenue to address any expectation gap. This gap would be better addressed by CRM and investor education initiatives.

Concern 4: Recommendations of suitable investments versus investments in the client's best interests

The IIAC believes it is misleading to compare a best interest standard to the suitability standard in isolation from the related duty of care and duty to act fairly, honestly and in good faith.

In particular, the IIAC takes issue with the comment in the Consultation Paper that in the "face of so many 'suitable' options, the advisor or dealer may be tempted to select a 'suitable' product that is not necessarily the best one for the client." The Consultation Paper goes on to suggest that this may result in investors acquiring a "suitable" investment but at an inflated price. In our view, if an advisor were to suggest a product that resulted in higher fees to the client and impacted the value of the client's portfolio in the long term, this could be contrary to the advisor's duty to act fairly, honestly and in good faith. It could also breach IIROC Rule 29.1 which requires that investment professionals observe high standards of ethics and conduct in the transaction of their business; not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and be of such character and business repute as is consistent with the standards of the rule.

In addition, as pointed out in IIROC Notice 12-053: *Request for comments on draft guidance regarding compensation structures for retail investment accounts*, IIROC states that it:

> recognizes that the account offering the lowest cost will not necessarily be the only suitable account type for a given client. For example, a client may prefer to incur a

slightly higher charge in a fee-based account (as compared to the charges she would incur in a commission-based account) for other reasons, including enhanced services, a superior quality of advice or greater certainty and consistency of cost.

Thus cost alone is not the only factor that the advisor and client consider when selecting a suitable product. It would be a disservice to investors were the CSA to require that cost be the only or the primary consideration when assessing the suitability of a recommendation.

Lastly, the IIAC disagrees with the general statement in the Consultation Paper that "a suitability standard could have the effect of the client acquiring an investment that may be suitable but in circumstances in which another investment at the same price may be a better investment for the investor." It appears the Consultation Paper is taking a very strict and overly literal approach to the meaning of "suitable" rather than considering what are, in fact, an advisor's actual suitability obligations. Moreover, as the CSA has acknowledged, there is no single "best" product or recommendation for a client. To suggest that there may be a "better" product available – and that this is always the product that should be recommended – implies that investment advisors must not only have an encyclopaedic knowledge of the entire universe of potential investments in order to meet a "best interest" standard, and that all such investments must be available to the client through their advisor and dealer but that there is, in fact, an objective "best" product. This is not just an unrealistic expectation that would fundamentally change the nature of many business models currently approved by the CSA and supported by IIROC, it is also a test upon which reasonable people may never agree.

The advisor must examine a client's personal circumstances including his or her financial situation, investment knowledge, investment objectives, time horizon, risk tolerance, current investment portfolio composition and the risk level of the other investments within the client's account(s) to determine the appropriateness of a particular investment. If an advisor is comparing two investments but one, in the opinion of the advisor, is a "better" investment for the client, the advisor is already obliged under the regulatory requirements described above to select this better investment.

Concern 5: The application in practice of the current conflicts of interest rules might be less effective than intended

Despite the comment in the Consultation Paper that current conflicts of interest rules might be less effective than intended, the Association is of the view that the National Instrument 31-103 (NI 31-103) regime does effectively manage conflicts. The management and disclosure of conflicts has been further improved and enhanced with requirements under IIROC's CRM Rule 42. This Rule's accompanying guidance requires and clarifies that all material conflict situations between the advisor and the client or the member firm and the client be addressed by either: avoiding the conflict, disclosing the conflict or otherwise controlling the conflict of interest situation. The requirements and expectations surrounding conflicts of interest in the Rule and the extensive guidance require members to develop and maintain policies and procedures to identify, disclose and address all real and potential conflicts. The requirements state that an *IIROC member firm* must address the existing or potential material conflict of interest in a fair, equitable and transparent manner, and considering the best interests of the client or clients. In addition, existing or potential material conflicts of interest between an *advisor and a client* must be addressed by the advisor "in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients". All of these obligations are consistent with and informed by the advisor's duty to act honestly, fairly and in good faith with respect to clients.

The enhanced conflict of interest provisions under CRM are still in the midst of implementation, with the conflict disclosure requirements in the relationship disclosure information for new clients effective in March 2013 and for existing clients in March 2014. It is unclear as to why the CSA has reached the conclusion that the CRM conflicts of interest rules are not effective, given that the CRM is not yet in force. Therefore, we would ask the CSA to provide clarification regarding concerns associated with how conflicts rules are being interpreted in practice. Further, we question if these concerns have arisen with IIROC-regulated dealers or in relation to non-IIROC registrants.

If there are specific concerns relating to compliance with conflicts of interest requirements, these should be addressed by augmenting and enhancing the current requirements and ensuring appropriate adherence rather than by imposing a fiduciary duty.

Question 2: Other key investor protection concerns that have not been identified

The IIAC believes that there are other significant investor protection concerns that the CSA did not address in the Consultation Paper, such as fraud prevention. According to a study conducted by the CSA, the 2009 Investor Index, approximately 38% of Canadians have been offered a fraudulent investment. Instances of fraud such as Ponzi schemes can have devastating effects on investors and fraudsters will not be dissuaded from committing fraudulent activities due to the existence of a fiduciary standard. In most instances the perpetrators of fraud actively avoid any regulatory oversight and, accordingly, do not seek registration. Increased enforcement against unregistered individuals performing registrable activities and further investor education aimed at the importance of using a registered IIROC dealer may be more appropriate and effective mechanisms to protect investors from fraud than a fiduciary standard.

Question 3: Effectiveness of a statutory best interest to address concerns

The IIAC reiterates that the imposition of a fiduciary standard is not the best policy tool to address the investor protection concerns identified in the Consultation Paper. In the IIAC's response to Question 1, we have identified alternative policy measures that address each of the identified concerns in a more targeted and effective manner. A fiduciary standard is an overly broad approach that does not clearly respond to the investor concerns identified by the CSA and will have negative consequences for investors, including a reduction of access to advice and choice in both advisors and available investments.

Further, the timing of the potential introduction of such a standard is inappropriate as the CSA and IIROC are currently implementing other significant policy regimes to address the same investor protection concerns. For instance, under CRM, it is expected that clients will better understand their relationship with their advisors, which will resolve the expectation gap regarding an advisor's obligations to his or her clients. In turn, CRM will lead to greater advisor understanding of the client's needs. For example, the CRM suitability assessment criteria encompass portfolio composition and investment time horizon and the new triggers will result in more regular portfolio reviews. As part of the CRM relationship, clients will become more engaged in the investment process, which may reduce client literacy issues

Once CRM and its corresponding policies have been fully implemented, it would then be appropriate to determine if there are any remaining investor protection concerns and if enhancements to CRM are necessary or if new policies are required.

Question 5: Should a best interest standard be imposed by securities regulators

At this time, the CSA should allow CRM, which is a comprehensive regulatory regime, to be fully implemented. Securities regulators were instrumental in developing this regime which has required the financial industry to make substantial changes to benefit investors. Investors will only fully begin benefiting from these changes in March 2013 and going forward, thus it is premature to disregard the potentially significant improvements that may result once the regulations come into effect.

As stated above, it has not been demonstrated that a fiduciary standard is necessary to address the investor protection concerns outlined in the Consultation Paper. Furthermore, in our responses below, we will outline the potential negative consequences associated with the imposition of a fiduciary standard for investors and the financial services industry. The most sensible approach for the CSA to take related to any existing investor concerns is to specifically target the causes of these concerns, rather than to impose a broad, vague and sweeping duty, the consequences of which will be greater uncertainty, reduced access to advice, reduced choice in products and services and greater costs to the investor.

Question 8: Potential benefits and competing considerations in imposing a statutory best interest standard

The IIAC disagrees with the view that the imposition of a fiduciary standard will result in the perceived benefits asserted in the Consultation Paper. In particular, certain of the noted potential benefits are dependent on the scope and qualifications of the final standard. Moreover, the IIAC believes that the gravity of the potential competing concerns identified by the CSA are compelling and should at a minimum require a cost-benefit analysis to be conducted to ensure that any statutory standard does not result in net negative consequences to investors and the financial industry.

Does not provide a more principled foundation for client relationship

As stated in our response to Question 1, there are currently several fundamental regulatory requirements underlying the client relationship that provide investor protection.

Would not alleviate need for detailed prescriptive rules

The IIAC disagrees that a fiduciary standard would alleviate the need for detailed prescriptive rules. A fiduciary standard is complex and subjective, and will require extensive guidance, supplementary rules, and case law to properly define its parameters. We understand that the CSA is considering a qualified standard and to the extent that this statutory duty deviates from the traditional elements of fiduciary duty, clear and definitive guidelines will be required. In addition, it is not clear how a principle-based fiduciary standard would affect the current CRM model and other prescriptive CSA and IIROC rules, leading to additional uncertainly for firms and investors.

Product suitability

As stated in our response to Question 1, it is misleading to discuss suitability obligations in isolation from the other rules and requirements that inform them. In particular, suitability obligations should be considered in conjunction with the requirement for the advisor to act fairly, honestly and in good faith and in the context of the required conflict of interest disclosures.

Would not mitigate the information and financial literacy asymmetry

As stated in our response to Question 1, the IIAC believes that the imposition of a fiduciary standard would not mitigate financial literacy asymmetry. Additionally, the IIAC believes the implementation of CRM Performance Disclosure rules will promote financial literacy. CRM encourages clients to become more engaged in their investment relationship and requires firms to provide more extensive information to clients in a meaningful way to increase their understanding of their investment portfolio.

Legal rights

While the Consultation Paper argues that there is legal uncertainty as to when a fiduciary standard currently exists, in fact there are well-established criteria – developed through over seventy years of case law – that judge's use when considering if the client-advisor relationship at issue warrants the imposition of a fiduciary standard. The courts have repeatedly declined to impose a uniform fiduciary standard on all advisors because they have recognized that many advisor-client relationships do not embody the criteria to elevate the relationship to that of a fiduciary.

Where a fiduciary duty is applied at common law, it is appropriately applied by an objective trier of fact and the Consultation Paper has not demonstrated that this approach has not been effective.

Legal remedies for retail clients

Clients currently have well established legal remedies available to them to seek compensation based on either a breach of the duty of care that is owed by the advisor to the client, or a breach of contract. Given that a client could also need to engage the normal judicial process to seek a remedy based on a breach of fiduciary duty, we do not understand how the duty would simplify the litigation process or reduce the cost of litigation for retail clients.

As the current costs for litigating cases is high, the financial services industry also provides investors with other avenues through which their concerns and complaints can be addressed. Firms have robust internal complaint departments that can resolve and compensate the client, many firms participate in mediation, as well as an ombudservice which can provide compensation or redress for investors where warranted. IIROC's arbitration process also provides an alternative to litigation. These alternatives may be better options for retail clients than pursuing litigation.

Limited application of a statutory duty

The Consultation Paper does not state how the CSA intends to limit the applicability of a statutory best interest standard. Consequently, it is very difficult to provide detailed feedback regarding any possible benefits for investors and/or the financial industry. In addition, as previously mentioned, qualifications to the best interest standard may correspondingly limit its potential benefits.

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Competing Considerations

Current regimes may be functionally equivalent to a fiduciary duty

As we have previously outlined, the Association is of the view that regulatory requirements related to know-your-client, suitability, know-your-product, CRM including the relationship disclosure information, enhanced suitability assessment and trigger events, management of conflicts of interest, cost disclosure and performance reporting will all provide clients with significant investor protections without the additional increased costs, potential harm and unintended consequences of the imposition of a fiduciary duty.

Greater costs for advice

As we will discuss in further detail in our response to Question 17, a best interest standard may increase client costs.

Negative impact on investor access to, and choice and affordability of, advisory services

The IIAC believes that the imposition of a fiduciary standard will negatively impact retail clients with regards to choice, product access and affordability of advisory services.

Reduced choice

The unqualified fiduciary standard, as currently articulated in the Consultation Paper, would reduce client choice among products and services. Clients have different needs and should not be put into a one-size-fits all model.

Commission-based accounts

A fiduciary standard that is interpreted as prohibiting or limiting the use of commissions could result in reduced access to brokerage accounts. Currently, the commission-based brokerage model is the most popular model among retail clients, particularly clients with smaller net assets. In the United States, approximately 95% of retail clients prefer commission-based brokerage accounts.[1] Similarly in Canada, commission-based accounts continue to represent a greater portion of full-service brokerage client assets. In Canada, in the second quarter of 2012, $109 billion of assets were held in fee-based brokerage accounts as compared to $386 billion of assets in commission-based accounts.[2] Fee-based accounts accounted for only 11% of assets held in full service (which includes managed, wrap accounts, stand-alone mutual funds, etc.) and discount brokerage accounts combined.

[1] Oliver Wyman, Standard of Care Harmonization - Impact Assessment for SEC (October 2010), online: http://www.sifma.org/issues/item.aspx?id=21999.
[2] *Investor Economics.*

For smaller investors, or those with more limited trading activity, a commission-based account is likely to be the more economical choice, particularly given that fee-based accounts often require minimum assets (i.e. $250,000 in investable assets) or a minimum fee. As a result, commission-based accounts are the most popular model among smaller asset investors and those who trade infrequently. Therefore, these smaller investors – the precise group of market participants the CSA seeks to protect with a statutory best interest standard – would be disproportionally negatively affected with the removal of a commission-based compensation model.

A study conducted in the United States by Oliver Wyman[3] for the Securities Industry and Financial Markets Association (SIFMA) found that fee-based models were 23 to 27 basis points more expensive than commission-based brokerage accounts. Investors with $200,000 or less in assets would see their expected returns to be reduced by $20,000 over 20 years as a result of the higher cost of investing.

In Australia, the Commonwealth Bank of Australia estimated that it would cost $3,570 to produce a one-time full service financial plan for a client.[4] The 2010 study by the Life Insurance and Market Research Association (LIMRA) found that if an advisor charged a $2,500 up-front fee for providing a financial plan, that 71% of clients would either try to find advice elsewhere or forgo personalized investment advice.[5]

As of January 1, 2013, the U.K. requires independent advisors to take upfront fees from clients; commission are prohibited. Research conducted by Allianz Global Investor found that only 7% of "affluent" advisors were willing to pay the projected upfront costs that advisors will charge.[6] Some U.K. financial institutions are setting fees as a percentage of assets and requiring minimum asset amounts to obtain advice. For example, HSBC will now require £50,000 minimum of assets. Many clients will not be able to satisfy the minimum assets and the percentage cost for clients with lower assets is not financially feasible. A possible indication that clients are being diverted to the non-advice channel is that execution-only companies, such as Hargreaves Lansdown plc reported a 42% increase in net flows of money in 2012 as clients prepared for the compensation changes.

[3] Oliver Wyman, *Standard of Care Harmonization - Impact Assessment for SEC* (October 2010), online: http://www.sifma.org/issues/item.aspx?id=21999.
[4] LIMRA International on behalf of NAIFA, Survey of NAIFA Members (December 2010), online: http://www.naifa.org/advocacy/documents/DOLCommentsonFiduciary.pdf
[5] LIMRA International on behalf of NAIFA, Survey of NAIFA Members (December 2010), online: http://www.naifa.org/advocacy/documents/DOLCommentsonFiduciary.pdf
[6] Financial Times, *Fewer to take advice under RDR,* Steve Johnson (February 10, 2013)

Many smaller investors and infrequent traders may not be able to reasonably justify the increased costs associated with a fee-based account. The alternative business model for many individuals would be to forego personalized advice and use direct-investing programs.

A decreased choice among business models that reduces access to affordable investment advice is not in the best interests of retail clients. Advisors provide significant value to their clients and the CSA should ensure that the policies it proposes does not decrease the accessibility of advice.

Other reduced choice implications

A fiduciary standard would reduce client choice among products and services that may be needed to fulfil their specific needs and objectives. The industry has developed a variety of different business models to provide services to different types of clients, with different needs, some of which would be inconsistent with a fiduciary standard. For example, certain dealers and advisors offer proprietary products, or a limited shelf of products. These services may be more appropriate for smaller or less affluent retail investors who do not have the experience or the need to invest in a broad range of products. If the CSA's proposed best interest standard is interpreted as requiring dealers and advisors to offer a broader range of products to clients, this will significantly impact those dealers whose business model is based upon a limited product shelf. Mutual fund dealers in particular would be negatively impacted by such an interpretation. Reducing investors' choice in the type and cost of services they would like to be provided, and with whom they would prefer to deal, is not in investors' best interest.

Furthermore, given the legal implications and inherent risk associated with a fiduciary standard, it is likely that many firms would consider simply offering managed accounts to their clients, thereby pushing smaller and middle-class investors out of the advice market. Additionally, those that chose to stay with the advisor relationship and move to a managed account would see reduced choice in products available as most firms limit the shelf of products available in managed accounts.

Decreased affordability of investment advice

A fiduciary standard will result in increased legal, compliance and supervisory requirements, which will likely result in an increased cost of financial advice for clients. We provide a more detailed discussion of costs in our response to Question 17.

The U.S. Oliver Wyman study found that operating margins within the financial industry have been continually decreasing and that many firms will not be able to absorb any further increase in operating costs. Canadian firms have experienced a similar trend; profit margins for the industry as a whole decreased approximately 14% over the past five years. Factors such as increased compliance costs and challenging markets left retail firms, on average, with only a 2% profit margin in the third quarter of 2012. In the current economic environment, firms cannot absorb unlimited increases in operating costs without eventual cost increases for their clients. In addition, the U.S. Oliver Wyman study demonstrated that an estimated twelve to seventeen million small investors could lose access to current levels of advisory services if even two hours per year of additional services per client are required in order to satisfy the compliance, disclosure and surveillance costs associated with the heightened standard of a fiduciary duty.

Additionally, the increased legal and compliance costs may result in advisors leaving the industry or becoming more selective in the clients they advise in order to reduce risk. Advisors may refuse to accept new or less wealthy clients based on concerns about costs and increased personal liability. A study conducted in 2010 by the U.S. National Association of Insurance and Financial Advisors found that if compliance costs increased by 15%, then 31% of their members would only offer services to affluent clients, and that 20% of the members would no longer offer securities directly to their clients.[7]

A 2012 study, The Economics of Loyalty, conducted by Advisor Impact found that 78% of Canadians believe that their primary advisor adds value above and beyond market performance.[8] It is very important that advice does not become unaffordable for Canadians as advisors provide significant and measurable value to their clients. There is a risk of displacement of the middle-class, who needs access to affordable financial advice. A best interest standard cannot be so onerous that a critical segment of the investing population is shut-out.

Reduced access to financial products

Currently, advisors are able offer clients a range of financial products and services. However, the imposition of a fiduciary standard on the financial services industry could restrict or prohibit certain products and activities. For example, depending on the scope of the standard advisors may not be able to act as principal (e.g. providing liquidity through market making and principal trading) or sell proprietary products (e.g. underwritten offerings, proprietary products and affiliated issuer products).

If any of these products and services were to be prohibited, clients could be severely disadvantaged in their returns and portfolio performance.

[7] LIMRA International on behalf of NAIFA, Survey of NAIFA Members (December 2010), online: http://www.naifa.org/advocacy/documents/DOLCommentsonFiduciary.pdf

[8] Advisor Impact on behalf of the Investment Industry Association of Canada (January 2013), online: http://www.iiac.ca/resources/5693/advisor%20impact%20survey%20report%20-%20economics%20of%20loyalty%202012_canada.pdf

If products are suitable for the client's needs and the advisor has provided meaningful disclosure of the potential risks and benefits, then clients should have the ability to trade in that product. For example, many clients want access to new issues underwritten by an affiliate (other division/related entity, etc.) of their firm. Clients should not be required to open accounts with other dealers so that they could participate in these offerings.

Principal transactions involve trading bonds from inventory. While a firm may make a profit from the spread between the bond price and the current market trading price, there is no corresponding disadvantage to the client as the firm must ensure best execution. Principal trading also has the benefit of increasing liquidity, which is beneficial to all investors.

There may also be a reduction in non-proprietary products available to clients as firms choose to use their discretion to limit product choice due to increased due to associated liability and risks under the standard. Products such as small or mid cap initial public offerings or new issues, the securities of junior resource companies and other venture issuers, structured products and options are all potentially risky investments. High-risk investments are, however, suitable and appropriate for certain retail clients. These products may provide opportunities for higher returns and form an important part of a balanced portfolio. Because a fiduciary standard increases an advisor's potential liability for each recommendation made to a client, firms and/or advisors may choose to no longer offer clients the opportunity to purchase these types of securities. If, an advisor, in order to reduce liability exposure, moves to lower risk investments, overall returns will be impacted.

Possible negative impact on certain business models

A best interest standard would negatively impact certain business models and segments of firms that primarily engage in transactional advisory services, new issuances, junior resource or other venture exchange sales, and option sales. It is not clear how an advisor that predominately provides recommendations (often limited in scope) related to transactions, and whose function more closely resembles an order-taker for the client executing trades, could transition to the relationship and compliance requirements that would be necessitated by a best interest standard. Even if qualifications permitting certain practices are introduced into the fiduciary standard, firms or segments of firms that sell "riskier" products such as resource company equities, options, and new issuances may not be financially viable due to the increased liability associated with the standard. Clients, if financially able to afford to do so, will have to pay higher transaction fees or if unable to afford the costs - move to the non-advice channel.

Similarly, other firms or segments of firms may be negatively impacted if the best interest standard results in prohibitions of the sale of proprietary products. For firms whose business model is predicated on the sale of proprietary products, if the sale of proprietary products

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were limited or prohibited, this business model would effectively be eliminated and these firms would have to entirely overhaul their processes, or cease to exist. This may disproportionately impact smaller or less sophisticated investors that want investments from an institution with which they already have a relationship.

Negative impact on capital raising

The Canadian capital markets are an integral part of Canada's economy. The imposition of a fiduciary standard may significantly negatively impact both debt and equity capital raisings in Canada. Certain business practices or business models may be prohibited if the statutory duty prohibited advisor compensation through embedded fees. Currently, these fees can be disclosed to the client and managed to ensure the client is not disadvantaged. The market in Canada is concentrated, with many cases where the firm underwriting the IPO is the same firm or related to a firm that is selling the IPO to clients. The advisor selling to clients must disclose the conflict and ensure that the product is suitable. However, under a fiduciary standard, in order for clients to have access to these IPOs, the statutory duty would require that they have different advisors at different firms in order to access an advisor that would not be in conflict selling the securities to a client.

Other countries such as Australia have had to specifically work with their brokerage industry to try and create carve outs from the fiduciary standard to minimize its impact on the IPO market. Irrespective of permissive qualifications to a fiduciary standard related to new issuances, a fiduciary standard will create a risk averse environment that will impact small and mid-size firms' ability to raise capital. Similarly, if principal trading is prohibited, the cost of debt raisings will increase if firms are not providing the corporate bond markets with liquidity or maintaining those securities in their inventories.

Additionally, the viability of certain firms would be impacted if there are restrictions in the sale of proprietary products under a fiduciary standard as their incentive to develop these products is significantly reduced.

Question 9: Criteria used to identify an investment is in a client's best interest

The IIAC is concerned that determining the criteria for what is in the "best interests" of a client will be highly subjective and it will be very difficult for advisors and firms to understand how to comply. As noted, new enhanced suitability assessment criteria are in the process of being introduced. During the enhanced suitability assessment rule formation process, much consideration was given towards preparing a comprehensive set of factors an advisor should consider when ensuring investments are suitable for a client. It would be a disservice to investors if cost became the primary consideration for determining what is in the "best interest" of the client. Cost is merely one aspect that the advisor must consider.

Presumably, a fiduciary standard will require advisors to examine additional criteria and as such, a new element of uncertainty will be introduced.

Question 12: Standard of conduct is functionally equivalent to a fiduciary duty

The current regulatory framework (together with CRM) embodies most of the essential investor protection elements of a fiduciary duty. However, as outlined in our response, there are a number of legal implications and practical implications of a fiduciary standard that differ from the current regulatory regime that may result in unintended negative consequences for investors and the financial services industry.

Question 13: Clear that investors can enforce duty as a private matter of law

As previously stated, clients are currently able to enforce a breach of duty of care or contract as a private law matter. If there is a lack of awareness among investors regarding their legal rights related to alleged breaches of their advisor's duty of care or contractual duties, then education or awareness programs are preferable approaches to resolving that concern rather than implementing an entirely new regulatory regime with a fiduciary standard.

Question 15: Can investor protection concerns be addressed by issuing guidance about current business conduct requirements

We are unclear as to whether this question related to guidance is directed at advisors or clients. If there are concerns related to firms, perhaps guidance for non-IIROC member firms would be helpful as the Association believes IIROC-registered firms are aware of their obligations both under securities legislation and the additional requirements imposed via IIROC rules. If the guidance is directed at investors, with the implementation of CRM, it should not be necessary as the client will be engaged and made aware of their relationship.

Question 16: Concerns addressed by increased enforcement of business conduct rules

With respect to IIROC registered dealers, we believe that IIROC is already rigorously enforcing its business conduct rules. Member dealers have regular examinations and there is a comprehensive complaint process to address any other rule related issues. The IIAC questions whether if enforcement issues exist, they are related to non-IIROC registrants.

Question 17: Potential increased costs

Securities regulators in other jurisdictions that have examined the feasibility of a fiduciary standard have conducted cost-benefit analyses. The IIAC believes that it is necessary for the CSA to conduct a similar cost-benefit analysis in Canada. The parameters of a fiduciary standard were not defined in the Consultation Paper, consequently firms do not know what

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business models and practices may become prohibited and what may be permissible pursuant to a qualification and it is therefore not possible to quantify the impact that a fiduciary standard will have at this time. While exact potential increased cost amounts for imposing a fiduciary standard are uncertain, our members have indicated that costs would increase without question.

For comparative purposes, one firm indicated that the cost involved for CRM upgrades was approximately $2 million. However, this amount and the proportionate impact of the costs would vary between smaller firms and larger or bank-owned firms and whether they used their own systems or relied on a third-party service provider, which usually results in even higher costs. Members have indicated that while costly and time consuming, the requirements to satisfy CRM requirements (such as suitability tests for trigger events) are not as onerous as the upgrades that may be required under a fiduciary standard.

For example, one firm indicated that to shift advisors to something akin to portfolio managers, as may be needed to satisfy a fiduciary standard, compliance, system and operational costs would increase *five-fold*, when one includes the in-house programs necessary and the extensive supervision systems used in the portfolio management realm today. From a staffing perspective, this firm indicated it would need to increase its full time compliance staff by 25%. These increases would be the result of requiring more information for every client to determine what is in their best interest. Further, it would be expected that advisors would need to increase their proficiency and training. Additionally, due diligence procedures regarding review of various services and products would also be heightened. (It is also expected that a detailed review of complex products would also be necessary at the outset, as it is likely that these products would no longer be offered by firms either due to specific prohibitions or at the discretion of firms in order to reduce their risk.) It is anticipated that these changes would additionally cost approximately $2 million for the firm.

The upgrades of client forms and information systems to capture all this new data would result in system changes costing a further $2 million for the firm.

The IIAC has attempted to identify below the general areas of cost increase that would likely result from the introduction of a statutory best interest duty.

1. Regulatory assessment

   - Firms will have to reassess all of the products on their shelves based on the new standard and may choose to no longer offer products that are potentially “riskier”. These undertakings will be time consuming and expensive. In addition, it may result in fewer products available for clients.

- With respect to client assessment, the Consultation Paper suggests that the enhanced suitability assessment may not be sufficient. Consequently, advisors will be required to perform additional assessments on clients, increasing costs. It is also not certain at this time what would be required, increasing uncertainty for firms as to what are their obligations.

2. Compliance/IT

- As we will discuss in Question 19, service providers believe that current computer programs would not be sufficient and that significant modifications or new systems would be required to ensure compliance with a fiduciary standard.
- Computer systems cannot be developed until the exact parameters of the rules are finalized. This process can take several years and is very expensive. The financial industry is currently spending millions of dollars to create entirely new systems for CRM. It is not clear if the necessary modifications for a best interest standard would be compatible with the new systems.
- Depending upon the firm's size, it may either develop its own internal systems or pay for a third party system.
- Electronic trading surveillance by third party vendors can cost some firms in the range from $100,000 to $400,000 for implementation plus an additional $100,000 to $200,000 per year.

3. Supervision

- Firms would have increased supervision requirements. A firm's liability would also increase further necessitating expansive supervision of all advisors.
- As stated above, one firm estimated that it would require an additional 25% increase of full-time staff in their compliance department.

4. Ensuring representative proficiency

- If advisors' duties become more akin to portfolio managers, firms may require advisors to satisfy the higher education and training requirements.
- Portfolio managers have more stringent requirements including a CFA Charter, a Canadian Investment Management designation and 12 months experience in investment management.
- This would impact a significant number of advisors that would not currently be able to satisfy those requirements. It would also greatly impact firms training and recruitment processes.

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5. Client documentation/disclosure

- As a result of the increased liability under a fiduciary standard, advisors and firms will need to ensure that there is extensive documentation of all recommendations and advice provided to clients.
- While the CSA suggests that an advisor can allow a client to make a trade where the advisor believes that trade is not in the client's best interest, given the associated liability if an advisor does allow this trade, he or she may require an affidavit or similar legal document. This would increase transaction costs.
- With respect to disclosure, CRM encourages client engagement and encourages the clients to read and understand the disclosure provided to them. It is not clear what type of additional disclosure would be required. A fiduciary standard requires the avoidance of all actual and perceived conflicts of interest. If the CSA creates exceptions to allow for certain types of conflict of interest, the type and amount of disclosure may be increased.

6. Insurance

- The increased litigation costs and exposure that advisors and firms have will increase the cost of insurance.
- Those costs may dramatically increase depending on the products a firm offers (i.e. riskier products).
- Currently a small to mid-sized firm with about 100,000 accounts would pay $2,000 per advisor per year for errors and omissions insurance. Firms have indicated that they expect premiums to increase several fold.
- Other firms are concerned that many errors and omissions insurers will stop offering insurance.
- The ability to obtain insurance, at a reasonable price is very important to the viability of many firms; especially if there is significant increased liability associated with each client.
- In Australia, there is compulsory professional indemnity insurance. In 2009, with the discussions of proposed reforms (a best interest standard) and increased risk, many insurers left the business and others companies began scaling back coverage and reviewing product lists and discussed having coverage and premiums based on the perceived liability associated with certain products.

7. Litigation/compliant handling

- The litigation costs for both clients and firms will not decrease with the introduction of a fiduciary standard. While a statutory duty may remove the common law requirement to prove its existence, it is not clear what a "best interest" standard means. The body of common law jurisprudence to may be overridden. There will be years of litigation to determine exactly what a "best interest" standard.
- There is increased potential liability for advisors and firms because the awards for damages could be higher. Consequently, the litigation costs may increase significantly. These costs will need to be priced into the cost of advice for clients.
- In addition, in order to mitigate litigation risks, firms will likely become more risk averse. We have outlined some of the possible changes that firms will undertake in our response including: reducing the selection of products available (i.e. not offering "riskier" products), becoming more selective in the clients served, increasing compliance and supervision.

Question 18: As duty already owed in certain circumstances why does clarifying when duty owed affect ongoing costs

There are fundamental differences between the types of accounts under which the common law may impose a fiduciary duty and the types of accounts to which a statutorily imposed fiduciary duty would apply.

In general under the common law, an advisor will be found to owe a fiduciary duty to their client in a managed account. In these circumstances the client places complete reliance on the advisor, meaning the client is not involved in the day-to-day managing of the account, including determining what investments are in the account at a given time. The advisor has complete discretion over the account, subject to the client's risk tolerance and objectives.

Managed accounts are a small portion of a firm's total accounts and in order to mitigate the risks associated with managed accounts, they are generally limited to certain types of clients (often knowledgeable and sophisticated), and restrictions are placed on the types of products that may be purchased within such accounts. Most often, managed accounts have a much more limited shelf of permissible products, including prohibiting the purchase of options or the use of margin. New issuances and structured products are also relatively rare. In addition, many firms will require a minimum amount of investable assets in the account to offset costs. The processes and procedures applicable to managed accounts cannot merely be replicated and expanded to non-discretionary accounts because of the inherent differences between these types of accounts.

The most important difference between a managed and non-managed account is the lack of full discretion the advisor has over the products selected. In non-managed accounts, the advisor makes recommendations but the client retains discretion as to whether or not to purchase/sell an investment. Client participation and sophistication may vary dramatically with respect to non-managed accounts. In some of these accounts, the advisor may only minimally be providing recommendations and the client may direct what is purchased or sold. Often, the clients in non-managed accounts have numerous accounts at different firms, as such clients are frequently more transactional based. These clients are looking for access to capital markets rather than seeking advice and therefore interested in making their own decisions.

As a result of the variation with respect to non-discretionary accounts, if a fiduciary duty were imposed on such accounts, firms and advisors will have to manage a greater number of risks for a larger number of accounts. This will inevitably result in increased costs. The supervision and compliance documentation of an account where the client does not provide input into the investment decisions, and accounts where the client does have input but the advisor or firm has full liability for the client's input will be much greater. Advisors will have to receive extensive training to manage a client's demands to purchase/sell certain products against requirements related to acting in the best interest of the client.

Question 19: Are computer systems used today able to support a statutory best interest standard

As the Consultation Paper does not articulate the parameters of a fiduciary standard, service providers were not able to provide detailed responses regarding the scope of work, cost and timelines required to develop computer systems. However, Canadian service providers believe that significant modifications or new systems would be needed to capture new fields of information and for firms to maintain records for compliance purposes. The service providers believe that potential upgrades or the development of new systems could be as costly and time consuming as the current system builds firms are undertaking to comply with CRM enhanced suitability assessment criteria.

Question 20: Cost-benefit analysis conducted in other countries

It is beneficial to examine the proposed and actual reforms in the U.K., E.U., Australia, and the U.S. as compared to Canada in order to understand why Canada's current policy direction, CRM, is the preferable approach to achieve investor protection.

The U.K. and E.U.'s best interest standard may not be functionally equivalent to the best interest standard proposed in the Consultation Paper sample statutory language. The European standard requires advisors to "act honestly, fairly and professionally in accordance with the best interests of its clients"; however, the Financial Services Authority has interpreted the standard to be a qualified standard and not an "absolute requirement".

Prior to the enactment of the best interest standard, advisors in the U.K. did not have a similarly comprehensive set of investor protection principles similar to those imposed on Canadian advisors under the CSA and IIROC as detailed throughout our response. While the U.K. and E.U. under the Markets in Financial Instrument Directive (MiFID) enacted their best interest standard in 2007, it is difficult to determine its effect in isolation due to other separate significant policy reforms that impacted business models, such as reforms to compensation structures, qualifications and categorization of advisors.

In Australia, in response to negative high-profile events related to their own regulatory regime, legislation was approved introducing a number of changes to the financial services industry, including a qualified best interest standard for advisors. The previous standard of advice was "appropriateness" for a client. The appropriateness threshold was arguably a lower threshold than that required of Canadian advisors under the existing suitability regime and there was no corresponding duty of care and duty to act fairly, honestly and in good faith.

The new Australian standard will not be in force until July 2013, and it is difficult to determine, at this point, whether it will achieve its intended objectives. The Australian standard is challenging to interpret and it is already unclear when an advisor will be able to rely on the safe harbour exception. While perfect advice is not expected, the threshold of what is acceptable in Australia is ambiguous and this places an immense amount of responsibility and liability on the firm and advisor. Australia has introduced extensive guidance to address the concerns but thus far many market participants comment that the draft guidance has not been able to clarify these issues to manageable levels. The Financial Services Council of Australia (FSC) was opposed to many of the reforms in the Future of Financial Advice legislation and specifically criticized the "unprecedented uncertainty" it will create for clients and advisors. The FSC, using modelling based on industry data, estimated that the full implementation costs of the reforms will be $700 million and the annual cost to the industry for compliance will be $375 million.

If the Australian model was to be introduced in Canada, there are numerous prohibitions on practices that would require Canadian firms to fundamentally alter their business models. Australian firms will be restricted in their compensation structures as "conflicted remuneration" is prohibited. In addition, it is not clear if principal trading would be permissible.

In terms of comparisons with the U.S. regime, Canada currently has developed a more comprehensive set of rules governing the suitability and conflict disclosure process than what is currently imposed on "brokers" in the United States. Canadian investors already have the essential protections under the Canadian regulatory system (with CRM, conflict of interest disclosure rules, point of sale rules, etc.) that the supporters of a uniform fiduciary standard in the United States are seeking to gain.

While four individual U.S. states have imposed a non-statutory fiduciary standard on brokers, it is a common law (judge based) fiduciary standard. Therefore, it is not uniformly applied and but reflects the actual relationship the client and advisor have - "the duty depends on the facts and circumstances of a given case".[9] This cannot readily be compared to a statutorily imposed unqualified fiduciary standard. Furthermore, in these states, brokers are still able to use a commission-based model, sell clients proprietary products and conduct principal trades.

A commonality among the discussion of the other jurisdictions experiences is that each country had unique regulatory regimes in place at the time that reforms related to a best interest standard or fiduciary duty for advisors was or is being considered. Canada is in its own unique position as well. The CSA, in conjunction with various stakeholders (including investor protection groups), has spent the past ten years working to address similar investor protection issues and, in that regard, Canada has been proactive in its regulatory development. Canada should allow these important policy initiatives to be implemented, and then evaluate if there are short-comings that need to be addressed. Canada should not detour from its policy direction on the basis of unproven policy initiatives in other jurisdictions.

Question 21: Impact on choice, product access and affordability of advisory services

A fiduciary standard will negatively impact retail clients with respect to choice, product access and affordability of advice. Please refer to our response to Question 8, for a detailed discussion of this issue.

Question 23: Business models unable to continue under a best interest standard

It is not appropriate to impose a fiduciary standard on client-advisor relationships that do not embody the essential elements of a fiduciary relationship. Therefore, clients may no longer have access to those business models if a fiduciary standard is introduced. For example, if commission-based accounts are not permitted, clients who seek those services will be required to move to non-advice channels. Transactional-based practices may also no longer be financially viable to clients resulting in clients being forced to non-advice channel and lose the value and benefits associated with advice. The nature of the relationship

[9] Duffy v. Cavalier, 215 Cal. App. 3d 1517 n.10 CCt. App. 1989.

between transactional advisors and clients differs significantly from the relationship that portfolio managers may have with their clients.

Furthermore, as a result of the potentially increased liability associated with “riskier” products, business models or segments of firms that primarily focus on selling options, commodities, and small/mid cap equities to retail clients may no longer be sustainable. While these products may be “riskier”, they have a corresponding potential for higher returns and are appropriate for certain retail investors. The sale of resource-based equities is very important to Canada’s financial well-being and this type of business could be too expensive (due to potential liability) for advisors or firms to continue. Clients may also be denied access to proprietary products of affiliates, or products underwritten by an affiliate (division/related entity, etc.) of the firm as a result of issues around potential conflicts of interest. These limitations on product choice are not in the client’s best interests.

Question 24: Australian and U.K. reforms of restricted and scaled advice

An unqualified fiduciary standard could require firms to offer an unlimited amount of products to clients in order to determine the “best” product. This is not feasible from a practical perspective as firms must conduct effective product due diligence investigations before they allow a new product onto their platforms and advisors are required to have extensive knowledge of each product offered. Australia and the U.K. have introduced restricted and scaled advice categories to allow firms to offer selected products and provide advice on specific aspects of financial planning or investing. As a result, there are different standards and rules for advisors depending upon the advisor’s categorization. Rather than drafting a standard with numerous carve outs, adding complexity to the standard, and diluting its perceived benefits to investors, the CSA’s investor protection goals can be more easily achieved through targeted policy initiatives.

Question 25: Specific qualifications required

No jurisdiction has implemented or proposed to implement an unqualified fiduciary standard on advisors. A fiduciary standard, as legally and traditionally understood, is not directly compatible to most advisor-client relationships or business models. As discussed throughout our submission, a best interest standard, however qualified, could result in substantial changes to the Canadian financial advisory industry, including a prohibition on commission-based accounts, principal trading, sale of securities by underwriting firms to their clients, and proprietary products. In order to avoid results that could negatively impact investors and the financial industry, the industry needs further clarity on any qualifications to the standard. However, as stated above, qualifications may dilute the perceived benefits of a best interest standard. The IIAC maintains that targeted policy changes to the current policy regime, if necessary after the implementation of CRM, will be a more effective tool to further investor protection.

Question 27: Effect of a statutory best interest standard on capital raising

As we outlined in our response to Question 8, a fiduciary standard could have harmful effects on the ability of companies to raise capital in Canada. An unqualified best interest standard could prohibit firms that underwrite IPOs or new issues from selling those securities to their clients. This would create a disincentive for firms to underwrite IPOs or new issues, and because the Canadian market is highly integrated, companies would have increased costs and difficulties raising capital. Even with a specific provision allowing for firms to sell these securities to clients, many firms may chose not to, due to increased liability associated with "riskier" products under a fiduciary standard.

Question 28: Effect of a statutory best interest standard on compensation practices

A fiduciary standard's impact on compensation practices will be dependent upon how the CSA frames the standard. An unqualified fiduciary standard could prohibit compensation practices with an actual or perceived conflict. The most significant impact would be on the use of commission accounts. Australia has banned volume-based payments and embedded commissions. We have discussed the potential negative impact a prohibition on commission accounts would have for average retail clients in our response to Question 8.

Question 36: Relationships between firm/advisor and client where a fiduciary duty is inappropriate

At common law, an investment advisor will only be deemed to be in a fiduciary relationship with a client under certain specific circumstances. Under the common law, the court will not impose fiduciary duties upon an advisor where the client has discretion in the relationship, is not vulnerable or otherwise placing complete reliance on the advisor. However, a uniform statutory fiduciary duty would extend to sophisticated, non-vulnerable retail clients who want to exert their own discretion when making investment decisions. Many retail clients want to be active participants in their investment decisions and do not want their advisor preventing them from engaging or abstaining from advising in respect of a particular strategy based on the protective requirements of a fiduciary duty. These clients receive benefits from their advisor and it is not in these clients' best interests to divert them to the non-advice channel in order to achieve that autonomy.

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Question 37: Introduction of a best interest duty require new rules

The Consultation Paper does not provide clear guidance as to the scope and applicability of a proposed best interest standard. Consequently, it is difficult to comment specifically on potential new rules that would likely have to be introduced in conjunction with the duty.

Question 38: Introduction of a best interest duty requires revision of/or repeal of existing rules

The response to this question is dependent upon the scope of the best interest standard and what current activities would be permissible or prohibited.

Question 39: Existing rules inconsistent with statutory best interest standard

Again, the response to this question is dependent upon the scope of the best interest standard and what current activities would be permissible or prohibited.

Question 40: Implications for conflicts of interest rules

As currently proposed in the Consultation Paper, the conflicts of interest standard would have to be amended. NI 31-103 allows firms to address conflicts through avoidance, disclosure or otherwise controlling the conflict of interest situation. The CSA's formulation of a traditional fiduciary standard would require that actual or perceived conflicts be avoided. NI 31-103 would need to be revised to reflect the new restrictions. The revised rules would need to identify any exceptions, and there would need to be clear guidance to assist advisors in complying with their obligations.

Question 42: Impose a best interest standard for only specific requirements

This question is not clear. Even if it was the CSA's goal to introduce a fiduciary standard that is "limited or targeted" to conflicts of interest or suitability requirements, it would still broadly impact the client-advisor relationship. The IIAC is not aware of any jurisdiction that has implemented or recommended a targeted fiduciary standard in this manner. We believe that the concerns discussed throughout our response would be applicable to a targeted best interest standard.

Question 49: Implications of a best interest standard on current duty of care

Currently, advisors are subject to the duty to deal with their clients fairly, honestly and in good faith at all times. If a best interest standard actually means something other than an obligation to act fairly, honestly and in good faith and if advisors had different standards of advice that would be applicable to their clients in various circumstances – for example, if the statutory best interest duty only applies in certain cases rather than on an on-going basis –

the expectation gap regarding advisors' obligations would not be alleviated and instead there would be increased confusion regarding the nature of their relationship.

Question 51: Best interest duty only apply to personalized investment advice

The IIAC believes this question highlights the difficulty in determining the scope of a best interest standard and the potential for confusion regarding the advisors obligations to the client in various circumstances.

Conclusion:

Canada has been a policy leader in terms of developing CRM to address investor protection issues. CRM represents a significant undertaking by the CSA, IIROC and the financial industry to provide increased investor protections. In addition to CRM there are numerous other CSA, IIROC and legal protections for investors. These policies should be allowed to be fully implemented in order to determine if there are any regulatory gaps thereafter.

The CSA has not provided evidence of investor harm under the current regulatory and legal regime, and it cannot yet measure the impact CRM will have on investor protection concerns. In addition, it is not clear that the perceived benefits identified by the CSA would be addressed under a fiduciary standard. We hope that the CSA considers the concerns that we have raised in our response to the questions posed, including: the potential reduced choice among business models, reduced access to financial products, decreased affordability of financial advice, uncertainty regarding the obligations within the client-advisor relationship, onerous compliance requirements, and increased exposure to risk and liability for advisors. As part of the CSA's analysis on the desirability and feasibility of a best interest standard in Canada, it is necessary to execute a cost-benefit study to determine if any rulemaking in this area is in fact warranted.

The IIAC would greatly appreciate the opportunity to discuss these issues with you further, or provide additional input as required.

Sincerely,

M. Alexander

Michelle Alexander

Adrian Walrath

Adrian Walrath