Kenmar Associates
The Voice of the retail investor

COMMENT LETTER /SUBMISSION Statutory Best Interest Duty

CANADIAN SECURITIES ADMINISTRATORS

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

http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20121025_33-403_fiduciary-duty.htm

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EXECUTIVE SUMMARY

Research clearly demonstrates that a Best interests advisory regime is required when investment advice is provided. Eliminating financial incentives will improve the client-advisor relationship. Regulators have a range of options in establishing a uniform 'standard of care' for dealers and investment advisers in Canada

– Selected changes to current business model/changes to enforcement tactics
– A 'standard of care' with strong fee disclosure / consent to conflicts that preserves commission-based sales practices
– Wholesale adoption of a Best interests regime for all dealers and dealer representatives

Our recommendation is to adopt a Best interests regime because any other course of action could lead to major socio-economic issues and even political instability. Adoption of such a regime means that the suitability approach must be discarded, proficiency standards set, and the KYC system dramatically improved. Financial industry Regulators need to work to eliminate regulatory arbitrage.

We provide rationale to support the argument that if a wholesale adoption is chosen, small investors would have access to a reasonable level of investment advice.

Kenmar Associates is pleased to comment on this Consultation paper. We have studied the role of financial incentives and their adverse impact on retail investors for nearly 20 years. The parallel CSA Fund Fee Consultation cites research showing "mutual fund investors tend not to review disclosure documents for cost information and instead primarily rely on advisors to tell them about costs," and add "further research indicates that many advisors do not tell their clients about costs.". This highly correlates with our own work with complainants especially switch fees and early redemption penalties. There is abundant independent research (See APPENDIX I) to demonstrate that commissions constitute a conflict-of-interest issue whether or not costs are disclosed. The CSA Fund Fee Consultation also notes there's "no evidence to substantiate" that investors can expect an increase in services and advice if their fund's trailer commissions rise. In fact, we witness ,with few exceptions, very little in personalized advice beyond "Buy-and-Hold:, "Invest in your RRSP" , " Borrow to Invest", "Active management is superior to indexing" , " Dollar cost averaging is the Best way to reduce risk" and the like. Selling is priority #1, advice is secondary, likely incidental and often used to further the sales process.

We quote from the Consultation Paper- FIVE Concerns:

1) There may be an *inadequate principled foundation* for the standard of conduct owed to clients.
2) The current standard of conduct may *not fully account for the information and financial literacy asymmetry* between advisers and dealers and their retail clients.
3) There is an expectation gap because *investors incorrectly assume that their adviser/dealer must always give advice that is in their best interests*.
4) Advisers/dealers must recommend *suitable investments but not necessarily investments that are in the client's best interests*.
5) The application in practice of the *current conflicts- of- interest rules might be less effective than intended.*

Any one of these concerns should raise RED flags for regulators. Taken together, they practically write the solution. The current client – adviser (dealer) relationship works against the retail investor in a material way. If the status quo prevails, critical socio-economic issues are virtually certain. This Consultation will prove to be a litmus test of regulator resolve to protect retail investors**.**

What is "advice?"

A financial planner focuses on client needs first before recommending a course of action. Most planners have been trained to take a broad look at a financial situation, while accountants, investment advisers, stockbrokers or insurance agents may focus on a particular area of a person's financial life. In our experience, there are several levels of advice needed by retail investors

At the highest level, there is a financial plan that integrates budgeting, savings, insurance and tax, retirement and estate planning. This level of advice is the most expensive and is generally tailored for HNW clients. There is continuous monitoring of the portfolio to ensure any changes in assumptions are effected.

An intermediate level of advice would deal with savings rate, RRSP /RESP's, key tax considerations, portfolio design and security selection and location. Investor behavior management is an important element as well. This level of advice would typically including rebalancing.

The basic level involves security recommendations, asset mix and some very basic tax advice. At its essence, a transactional relationship. [Per the OSC, for investment funds as a whole (includes mutual funds, pooled funds, LSIFs, ETFs, hedge funds and segregated funds) at December 2012, there was $262 billion invested in fund wraps (fund-of-funds and wrap programs) representing 28% of total investment fund assets. In these cases, even the elemental advice to be provided is handled by the fund manager freeing the "advisor" from having to provide even these basic services.]

At the extreme low end is discount brokers whose assistance is limited to a variety of online tools, calculators and educational materials. This is commonly referred to as order execution only ("general advice") with no personalized advice provided.

There are many graduations but the major point is that there are levels - securities regulators should focus on *investment* advice and the levels (if more than one) that will be regulated.

The most common core investor questions requiring advice appear to be:

How do I pay off my student loans and save for a house?"

Should I contribute to my RRSP, my TFSA, my children's RESP or pay down my mortgage?

Should I contribute to an RRSP and how much?

What should I invest my money in?

If I keep doing what I am doing now, what income will I have in retirement?

Financial advisors should be helping their clients with these tough decisions. It's possible that the best financial advisors already do help in this way, but in our experience, the industry as a whole, does not. It's still centered on the rather facile service of securities selection/balancing portfolios, probably because that's a lot easier to do than to help someone understand what's worthwhile and how to use their money to maximize their current and long-term happiness. Professionalism in the advice business is more an illusion than a reality.

Of course advice will be required at such key life events such as an inheritance, divorce and death. At these points, true professionals such as accountants and lawyers are usually the advice providers.

If unbiased, competent advice could be provided to these core questions, Canadians and Canada would be immensely better off. In some circumstances they might even be able to deduct advice fees and thus save on income taxes, an option they do not have with embedded commissions.

One big problem involves Canada's licensing system for representatives. Can an "adviser" who is only licensed to sell mutual funds ever act as a fiduciary? The advisor knows, or ought to know, the fee/tax advantages of low cost ,passively-managed index based broadly diversified funds or ETFs over much more expensive actively- managed mutual funds; which as statistics reveal under perform the indexes .While a small percentage of the funds will outperform the indexes the vast majority will not. Here's the result for actively-managed Canadian Equity fund returns as at December 31, 2012 per http://www.theglobeandmail.com/globe-investor/funds-and-etfs/funds/summary/?id=17581

	Group Avg	Index*
1 year	7.02%	7.19%
2 year avg	-2.17%	-1.08%
3 year avg	3.08%	4.79%
4 year avg	9.58%	11.65%
5 year avg	-1.15%	0.81%
10 year avg	6.90%	9.22%
15 year avg	4.88%	6.51%
20 year avg	7.01%	9.15%

* S&P/TSX Total Return Index

Note that for all time periods the Globe's peer Group underperforms the passive index and by a wide margin. The effect of this after 30 or 40 years of investing is dramatic. Mutual funds are the most commonly held investment product, with 62% of Canadians with savings or investments set aside holding this product in their investment portfolios. In addition, mutual funds make up the largest share of investable assets for the typical Canadian household. At June 2011, the average Canadian household held 36.1% of its investable assets in mutual funds. Given the observed underperformance due primarily to fees, it can be expected that portfolios will lose a huge share of market returns over a 30-40 year investment life cycle. With approximately 12 million Canadians invested in mutual funds and about $840 billion in assets [22.5 % in mutual fund-of-funds] the scope of the conflict-of-interest problem becomes clear.

We do not see how a MFDA licensed advisor or a mutual fund transaction/trailer based compensation model could transition smoothly into a statutory requirement for Best interests level of care. Fee-for-service/fee-only compensation and advice/product which is demonstrably in the client's Best interest are the foundation for fiduciary level of care. We could accept that mutual funds for a small investor making small monthly contributions might be an appropriate choice as long as the cost of advice is an isolable cost and fees, risks and performance are disclosed <u>before</u> purchase.

The basic principles of advice giving is that it should be based on an understanding of the investor's personal situation, goals/needs , risk tolerance , time horizon and loss capacity. A key deliverable of investment advice is performance measurement. If account rate of return results are not measured and disclosed to clients, we are in the realm of sales not advice. Accordingly, any dealer or advisor who is unwilling or unable to provide personalized return information should not be permitted to use any title that suggests investment advice is being provided.

The advice environment
Of course, a Best interests standard assumes that advisers have the necessary proficiency to provide the necessary advice. This should not be assumed as generally speaking Canadian regulators have neglected this element and need to address it.

Unlike the United States which at least has one category of advisers called Registered Investment Advisers (RIA's) who must provide advice with a fiduciary level of care (http://en.wikipedia.org/wiki/Investment_Advisers_Act_of_1940), Canada has no such statutory requirements except under very narrow context. According to the Consultation paper currently only four provinces (AB, MA, NL and NB) have a "statutory requirement that when advisers/brokers/dealers have *discretionary* authority over their clients' investments, the adviser or dealers must act in the clients' best interests". In Quebec "according to both the general Civil law and the *Securities Act* (Québec), registered dealers and advisers are currently subject to a duty of loyalty and a duty of care and must act in the client's best interest" which according to some experts quoted in the Consultation paper "is comparable to that of the common law fiduciary standard". Therefore, except for possibly Quebec, there is a problem. We recommend the CSA closely examine the Quebec model for possible applicability in other provinces.

We add parenthetically that we have been told that at some firms, supervisors are permitted to act as salespersons and that Branch managers are compensated in part based on the profits of the Branch. We're not sure that is all that comforting.

Retail Investors are vulnerable. Most retail investors need some level of financial advice. And as we know, most Canadians lack financial literacy and numeracy is weak. Canada has many rules and regulations regarding investor protection but investors remain vulnerable. There are several well researched academic papers published on the topic (see Appendix I) to demonstrate vulnerability but here's a sampling of specific reasons retail investors are vulnerable:

- a low suitability standard for advisers permits a wide array of abuses
- clients are overconfident in their investment knowledge
- relatively weak regulatory enforcement
- A broken NAAF/KYC tick -off- the- blocks system; unless system integrity is improved, adding a Best interests regime is like building a home on a foundation of Jello.
- information, knowledge and experience asymmetry put clients at a disadvantage
- misleading sales and marketing materials/ "free lunch "seminars
- misleading titles used by "advisers" that imply competencies that don't actually exist
- increasingly complex products not understood by clients (and sometimes advisers too)
- low proficiency standards for "advisers" especially in mutual funds
- "advisers" compensated by transactional commissions (conflict-of-interest)
- legalese, jargon filled prospectuses and a misleading Fund Facts (for mutual funds)
- the Ombudsman (OBSI) is under existentialist threat by industry participants
- a growing (in absolute numbers and as percentage of population) population of seniors with a long list of known vulnerabilities

"Advisors" are the key influence on investors' decision-making, according to a study the ***Investor Behaviour and Beliefs: Advisor Relationships and Investor Decision-Making*** released by the Investor Education Fund, an Ontario Securities Commission (OSC) funded education entity. The study found that Canadian investors most commonly look to their Reps for advice on asset mix and specific types of investments to buy. The study found that investors' trust in their Reps' opinions dominates all other factors in the decision to buy investments. In addition, the study revealed that investor knowledge of mutual fund fees and what affects them is weak, and investors are unaware of potential conflicts-of- interest. Most retail investors incorrectly believe their Representative has a legal duty to put their interest ahead of his or her own. Apparently the words fairly, honestly and in good faith don't include the prices of products when making recommendations. Further, according to the study, most retail investors are not aware of what products their advisors are licensed or registered to sell. Such blind trust can be hazardous to the financial health of investors. A summary is available online at
http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/Investor-behaviour-andbeliefs.aspx

Most Canadian investors have no idea what their portfolio returns are or the fees they are paying for advice. As Company Defined Benefit pensions disappear, many boomers must rely on their RRSPs to generate retirement income but they're uncertain how long their nest eggs will last. Bad or flawed advice could put these folks in a serious financial predicament.

This was identified way back in 2004. The OSC's Fair Dealing Model recognized the bias introduced by commissions. **"In each specific case, there is reason to believe advisor compensation - rather than the best interests of investors - is driving asset-allocation choices to a significant extent, even though all the relevant information is publicly disclosed in some form,"** the FDM concept paper noted. It also found that the effort investors would have to expend to collect all the relevant information is too much to expect.

It's all very well to shift the regulatory focus from trades to advice and to beef up disclosure, but until the compensation system is product-neutral, clients can never be certain that advisors are truly focused on their best interests. Former OSC Commissioner Glorianne Stromberg's classic mutual fund industry reports, in 1995 and 1998, pointed to the compensation system as one of the major reasons for some of retail investors' most common complaints against the industry: portfolio churning and suitability issues. In her 1998 report, she noted: **"The reward system is a systemic problem that needs to be addressed by the industry. If it is not addressed, a major credibility gap between the industry and its clients is likely to occur. This credibility gap is likely to increase as clients become increasingly knowledgeable and aware."** This awareness is starting to happen assisted by the growing success of ETF's, growing competition, consumer activism and media attention.

Current disclosure of fees is ineffective; indeed, disclosure as a foundation of regulation is a weak investor protection according to recent academic studies. The 2012 OSC Investor Education Fund study (pg 28) found that 51% of investors had no view as to whether there was a conflict- of-interest or not. Among this group, the majority (29% not aware, 22% aware) indicated that they were not aware of all these sales commissions prior to the survey. Others said they were aware, but hadn't formed an opinion. Among the half of investors with an opinion on conflict -of-interest, an astonishing 73 % [36/49] believed that their advisor would look out for their best interest regardless of how the advisor was paid. Given the nature of compensation structure, available academic research and the sheer number of complaints, Settlement Agreements and civil actions these statistics are a bright, flashing Red flag for regulators.

There is no question about it- Canadian retail investors, especially mutual fund investors, are highly vulnerable to abuse. [For mutual funds, at June 2012, assets held in registered plans totaled $430.1 billion or 54% of total mutual fund assets. Registered plans include, individual and group RRSPs, RRIFs, DC plans, DPSPs, RESPs, TFSAs, and RDSPs.]

Mis-selling a result of a lack of a Best Interests obligation

Saving for retirement or saving for a child's education is not the same as taking up a unnecessary and costly extended warranty on a large screen TV. Mis-selling in the financial services industry can be a life-altering event for Main Street.

The mis-selling due to financial incentives paid to "advisors" is an enormous issue with attendant adverse consequences on retail investors. These incentives have for instance led to Canadians having to pay among the highest mutual fund fees in the world. In our view, financial advice givers should not be incentivized by sales volume– instead they should perform as true professionals like doctors, lawyers and engineers. It will take a major cultural shift to bring the financial services into a fiduciary relationship. Canadian regulators are partially addressing this issue by introducing better disclosure of fees/ conflict-of-interest and by requiring dealers to present personalized rate of return information on client account statements. It's a start -necessary but inadequate. Industry lobbying delaying tactics has been allowed to go on for far too long. There are too few players in Canada and the monopolistic structure of the financial system prevents competition from driving down costs and leading to efficiencies and best practices.

Clients Vulnerable, impact is significant

The observed abuse incidence rate is high, the downside potential demonstrably evident and the likely effects truly serious. Seniors remain the most vulnerable and are being targeted- a modern democratic country has a moral obligation to protect its vulnerable citizens. Even if the abuse incidence rate was low, contemporary regulation must have a preventative element. We don't wait for a heart attack to have an annual medical checkup or cancer screen. Canada has a long-range radar system to protect against an enemy attack. When clear and present vulnerabilities exist, rational people take action and that is exactly what regulators need to do without undue delay.

While the impact of deficient investor protection is financially enormous, the collateral damage is often more devastating. A 2007 CSA study found that victims of investment fraud experience negative effects on their physical and mental health. Fraud victims in the study reported higher stress levels, increased feelings or displays of anger, depression, and feelings of extreme loss or isolation, as well as physical effects such as panic or anxiety attacks. Financial loss for a senior is a life altering event from which it is difficult or impossible to recover, either financially or emotionally. Losses under the prevailing low suitability standard are not outright fraud, but the devastating effects are the same. Conversely, if advisers worked under a Best Interests / fiduciary standard like professional engineers, doctors, accountants, then they would be trustworthy neutral allies for seniors protecting against all manner of exploitation including family, friends and caregivers and wealth creators.

The financial services industry has chosen to bend the playing field in favour of distributors and “advisers” to the detriment of retail clients. It's time that regulators level the playing field and put “service” back into the industry.

“adviser” compensation models

Financial incentives are based on a simple principle : ***What gets rewarded , gets done*** That's why it's imperative that incentives such as sales commissions and trailers be examined sooner rather than later . Sales Commissions represent a problem that has been long recognized, but never dealt with - people don't understand that they are paying a continuing commission and that it can lead to financial assault .Paying that trailing commission substantially cuts down on the investor's reasonably expected return so it has made mutual funds and other products in Canada a very expensive way of investing. These embedded commissions really put the adviser in conflict with his or her client.

> *“It will not be possible to do away with commissions in Canada unless you can break the very strong link between product distribution and the investor, and “advisors” have fiduciary type responsibilities towards their clients. You pay for a service, and you pay for advice, and until you are actually paying for accountable and regulated advice and not the transaction, moving to a fee only industry cannot happen effectively.”* - Industry observer Andrew Teasdale [CFA]

In Canada, there are five basic forms of “advisor “compensation, with many hybrid combinations and variants.

- First, the adviser can be paid on commissions generated when you make transactions. One example is the stockbroker, who earns a commission every time a stock or a bond is bought or sold through the broker. In this case the cost s transparent but the client will still be exposed to unsuitable recommendations.

- Second, in a "fee-only" arrangement, the advisor is paid strictly by the hour or task. Here, the customer is buying only the advisor’s experience and expertise – and of course his or her time. This type of advice is a rarity in Canada.

- Third, the money manager may be paid according to the amount of account assets under management. For example, some advisors’ fees are a percentage of the portfolio, say one-quarter of 1 percent every calendar quarter.

- Fourth (a variation on the third), the advisor could be on an incentive program. Incentive programs are legal only for accredited investors. One common arrangement is for a money manager to get a straight percentage of any profits on investments, say 10 to 20 percent. A variation is a higher-than-normal advisory fee that only gets in years when the client makes at least some agreed-upon return. Depending on how these are set, the retail investor may come out on the losing end.

- Fifth, commissions embedded in financial products like mutual funds .These are independent of any incentives offered by dealers.

Of course , firms also use ***disincentives*** to focus advisors attention to sales. This could include demanding sales quotas that if not met would result in termination. A delay in a salary increase could be effective in getting an advisor to play ball. Even a bad performance review can steer an otherwise ethical advisor off course. No doubt ,the CSA is aware of the vast arsenal of disincentive techniques used to bring "non-producers" in line with the firm's short term sales and profit targets.

A broker whose compensation depends on transactions has a financial incentive to generate transactions. A broker or a commission-based financial planner might determine that the most appropriate investment for a client is Treasury bills or even to pay down credit card debt. But he or she cannot afford to reveal that, because there's no commission involved. A mutual fund salesperson whose compensation includes commissions has more incentive to persuade clients to invest in a mutual fund with a 1.00 % trailer than an ETF with no trailer.

As part of its education initiative, it might be a good idea for the CSA to prepare a plain language booklet ***"Streetproofing for Retail Clients"*** so that retail investors come to appreciate the role of incentives in advice giving and other Bay Street shenanigans.

Disclosure is necessary but inadequate

As research demonstrates, incentives create a conflict -of-interest between a customer and his/her "adviser". Regulators are planning to implement mandatory disclosure via the Client Relationship Model. We regard disclosure of conflicts-of-interests as a weak and ineffective way to address the core issue. Researcher George Loewenstein from Carnegie Mellon University studied the effects of conflict -of interests disclosure from advisers, on the decision making of their clients. The study "The Dirt On Coming Clean – Perverse Effects of Disclosing Conflicts of Interest " Not surprisingly, he found that compensating the advisers for encouraging a desired outcome influenced their behaviour. What was surprising is that disclosing the conflict-of- interest actually increased the bias even more.Lowenstein says that "moral licensing" is one of the reasons this happens. Basically this theory says that an adviser with an undisclosed conflict- of- interest will feel guilty enough about it that they will try to "do the right thing" to some degree. By disclosing the conflict-of-interest, it allows the adviser to do whatever they want since they have admitted the conflict and therefore don't have to feel guilty about it any more. "*Anything goes, as long as you disclose"* doesn't work for Main Street.

Some important potential conflict examples

A broker who is paid on commissions can make money only if a client buys or sells products on which the broker gets a commission. A broker might conclude that the best bet is to make no transactions in the stock portfolio. But the broker can make money only if a client trades, so there's an incentive for him or her to recommend a transaction, even if that transaction might not be what's best for customers. Suitable, but clearly not in the client's best interests. Another tactic is to encourage leveraging- the "advisor "can make money by being rewarded for instigating a loan AND by receiving trailer commissions on a larger asset base. Again, such actions may not be in the client's Best interests but they serve salespersons very well.

An adviser whose pay is based on the size of account assets has an incentive to see those assets grow – and of course to persuade customers to place a higher percentage of assets under his or her management. This can and has led to excessive/unnecessary leveraging of accounts. Instead of paying off 18% +credit card debt, a conflicted adviser might suggest taking out an investment loan. Conversely, a fee-only advisor has a financial incentive to take as much time as necessary to do the work you need – but no incentive to steer a consumer to any particular product or a risky leveraging strategy.

Some advisors may want clients to buy load mutual funds, and they offer to subtract the load from their fee. That makes it seem that the customer is getting a fair deal. But there's a reason that planners prefer load funds. They may collect poorly disclosed and understood "trailing" commissions each year that a client continues to own the fund, and they may collect commissions on subsequent investments. Larger commissions can be earned using lucrative commission grids that escalate incentive rates as sales increase above pre-determined levels. Load funds generally have higher expenses than no-load funds so retirement savings take a serious hit due to mis-selling.

There's a conflict if, for example, an elderly client needs low-risk Bond funds that are safe but aren't likely to make the account grow in size very fast. The manager's interest might be best served by putting a client's money into expensive, risky Equity funds instead.

As previously noted, the lack of fiduciary duty and skewed incentives cause significant harm to retail investors. In particular, they're faced with financial advisors who have the ability to withhold recommendations to benefit themselves and also churn their portfolio. This can occur where brokerages and mutual funds structure the sales commission to the financial advisor based on the amount the client invests. An example scenario would be where the sales commission an investor would pay is 6% on an amount invested less than $30,000 but it drops to 5% once they invest $30,000 or higher. In this case, $30,000 is considered the breakpoint. Advisors may withhold recommending an investment in a particular product so that the customer is unable to take advantage of the lower sales charge. Instead, they can recommend splitting capital between similar products. This would still meet the "suitability standard" and would help maximize the amount of money they stand to make. Such an abusive maneuver is hard to detect by supervision or Management information (MI) systems.

Fee-based accounts are no panacea. The fee- based account is really a volume transaction discount, strategically priced at a level that ensures both advisor and firm earn a good return from their clients who decide to proceed with this option. Such a recurring revenue model is perfect for the dealers.

While one of its advantages is that it removes the temptation to churn an account, there is plenty of room to take advantage of the investor: clients who transact little and therefore have a minimal commission trail can be plunked into a fee- based account and thereby increase advisor and firm revenue. We too often see IPO's purchased for retail accounts where embedded commissions are not only attractive to dealers but actually, in the case of closed-end funds, harmful to investors. When a client holds both a commission and a fee-based account, the firm should ensure that trades are directed to the appropriate account. We have seen advisors charge a client a commission on the purchase of a security and subsequently earn an additional fee by transferring that security into a fee-based account!

An advisor who sells no products and is paid only by the hour may have the least potential conflict with a financial consumer. This advisor's incentive is to generate billable hours. But a client can keep this under control by making it clear what work is authorized and what's not.

Policies and procedures should be designed to enable the firm to detect improper activity occurring in any account including unsuitable transactions, trading in restricted securities, conflicts- of -interest, unauthorized trading and manipulative trading, among others. We do not believe that this can be effectively accomplished without the necessary management information infrastructure. Perhaps the CSA (or SRO's) in its industry sweeps can confirm that systems, as opposed to policies and procedures, actually exist to operationalize existing policies, rules and regulations at the working level. Such management information systems are commercially available to check for unsuitable investments, the single largest cause of client complaints.

We believe planned CSA/SRO rule changes are important. Nevertheless, there will be cases where only sound management control mechanisms can mitigate the skewed recommendation issue if commissions are not going to be banned outright. These include but are not limited to:

1. Incentive Schemes that have been formally vetted by Compliance and others for mis-selling risk. The policy should also deal with *off-book* sales and *referral agreements* by advisors.

2. Disciplined new product pre-release reviews that formally identify characteristics that might lead to mis-selling (and inadequate disclosure). An example would be leveraged and inverse ETF's .There is a risk this might reduce product innovation or market size– we say "So what"? Most of the recent "innovations" have not been investor-friendly.

3. Professionally qualified advisors fully trained on the product(s) they sell. Marketing materials should be approved by Compliance to ensure that the target client market is identified ["Who is this suitable for?"], that there are no false or exaggerated claims made about the product and that all key facts are presented including risks.

4. A robust policy and procedure on KYC- suitability, tailored to the firms products and services, that is documented and hard-wired into employee training and communication programs and documentation/forms and compensation packages. A number of progressive dealers are requiring annual signed statements of compliance with the firm's Code of Business Conduct.

4. Adequate supervision of transactions by a responsible supervisor (incentivized only by annual or long-term results); this would likely need some software system infrastructure to support the manager [exception reporting in near real time].

5. Prompt attention by supervision to consumer enquiries and complaints; this would include a mechanism to detect and report advisor-specific trends and systemic issues promptly to operating and senior management. In this regard, the CSA may want to partner with the OBSI who we expect would be an excellent early warning indicator of an industry-wide mis-selling problem.

6. An accessible root cause complaint handling system based on ISO 10002 *Quality Management - Customer satisfaction - Guidelines for complaints handling in organizations* as the foundation standard for internal complaint handling. This internationally recognized standard provides sound guidance on the process of complaints handling related to products/services within an organization, including planning, design, operation, maintenance and responsive feedback for continuous improvement. According to OBSI statistics, about 35 % of complaints originally rejected by dealers are overturned. This suggests that either suitability standards have too much "flex" and/or dealers are not treating complainants fairly. Based on our experience a large number of complaints are rejected without just cause and an even greater number remain unreported altogether.

We have noticed that the firms with the least complaints have publicly disclosed Ethics policies, employ Engagement letters and utilize Investment Policy Statements (IPS) http://im.morningstar.com/im/InvestPolicyWS.pdf . Our view is that an IPS is a core document for any person holding themselves out as an investment adviser. This should be mandated by regulation.

We have observed a disproportionate number of complaints coming from seniors and recent immigrants- a vulnerable client segment. Canadian demographics are such that this problem will only get worse with time. For seniors, the threat is particularly ominous as their age limits their ability to recover from financial loss or obtain compensating employment income. For example, we have observed "Free lunch" seminars funded by firms or mutual funds are used to lure retirees and pensioners into expensive, risky products they don't need. We recommend that the CSA adopt a Seniors initiative to address this growing issue of targeted mis-selling of the elderly.

Cost-Benefit analysis not required

One tactic used by industry lobbyists is to push regulators into having to cost-justify even the most obvious and basic reforms. We have a definite view on Cost-Benefit analyses. Our experience is that they are very difficult to do for regulatory matters and are often a numbers game. The costs are always inflated by industry and generally understated by regulators. Benefits can be elusive unless one accepts that not duping customers is inherently the right thing to do. One could try to estimate all the wrongdoing that could be prevented by the regulation and present it in dollar terms. In many cases the benefit may accrue to the State by avoiding an increase in social benefits to victims of mis-selling. In any event, so many assumptions need to be made that industry can always shoot holes in any analysis. It is our view that the effort to protect financial consumers and markets from mis-selling due to incentives is so fundamental to modern society that no C-B analysis other than common sense, fairness and decency should be applied.

Some interim action recommendations

We conclude by providing a list of actions that regulators can take now to curb much of the financial assault. Best interests/Fiduciary duty is nice but that will take a considerable time to introduce. Here's what could be done in the interim:

>> Provide BOLD plain language conflicts-of-interest warnings on NAAF documents, in FF and wherever such warnings will be effective to alerting the retail investor of the true nature of the advisory relationship. Viz
"Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. Please ask us questions to make sure you understand your rights and our obligations to you, including the extent of our obligations to disclose conflicts of interest and to act in your best interest. We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits and our salespersons' compensation may vary by product and over time." -- A **cigarette industry like disclosure that might catch retail investor attention**

>> Require dealers to provide personalized rates of return for each client account along with appropriate benchmark on client statements. This will open people's eyes to the abuses. We rank this in priority even above dollars and cents fee disclosure.

>> Require dealers to prepare an IPS for all accounts greater than, say $150,000

>> Improve the NAAF document, standardize it across the industry and clarify relationship disclosure and importance of form on KYC (and liability) AND ensure KYC is signed off by client upon origination and when updated or revised.

>> Require dealers to document and disclose how they determine client risk tolerance and match to "adviser" recommendations and client risk capacity

>> Hold dealers accountable for all regulatory fines imposed on employees and agents ie make dealers responsible for payment if registrant doesn't pay. It's well known that regulators collect only a tiny fraction of the fines imposed on Reps. whom they hold responsible for investor abuse. We therefore argue that the deterrence value is NIL. We argue that the advisory contract is with the dealer NOT the individual Rep. Imagine if aircraft manufacturer Boeing practiced this way. An aircraft maintenance technician would be held responsible by the FAA- Boeing would be off the hook even if the plane went down. Our view is that the dealer recruits "advisers", trains them, incents them to meet sales quotas, provides the systems, policies and practices under which they operate and supervises them plus assigns a compliance officer to quality control the whole process. The dealer gains from the active selling but when the person at the bottom of the food chain gets caught, the firm walks away. This is an attack on natural justice that ends up leaving trusting clients on their own. The latest MacQuarie-OBSI fiasco is a perfect example of this malpractice. Dealers like it this way because they are immunized from wrongdoing and Reps like it because they know IIROC/MFDA can't collect the fines. The only loser is

Main Street. Note that OBSI rightly always holds the dealer responsible for wrongdoing by "advisers" .The dealers" Trust us "marketing materials hold out the promise of integrity and fairness. It is the dealer who makes declarative statements and ads re trustworthiness and it is therefore the dealer that should be held accountable for fines.

>> Sanction and fine dealers for utilizing misleading sales and marketing materials or providing deficient disclosures. According to **2012 OSC Annual Summary Report for Dealers, Advisers and Investment Fund Managers**
OSC Staff Notice 33-738 http://www.osc.gov.on.ca/en/SecuritiesLaw_sn_20121122_33-738_annual-rpt-dealers.htm we are told ". Many Investment Fund Managers (IFM) are preparing marketing materials for investors with information about their investment funds that is outdated, misleading, or contain unsubstantiated claims. For example, some IFMs use terms such as "best", "exceptional" or "leading" to describe their services or the performance of their investment funds without also including disclosure containing evidence to support using these claims. Some IFMs are also comparing an investment fund's performance against the returns of benchmarks that are not comparable to the fund's investment strategy, without any explanation on why the comparison is relevant.". This material is then adroitly used by "advisers" to promote unsuitable sales.

>> Sanction and fine dealers for deficient complaint handling processes. This process is rarely enforced despite overwhelming evidence that unsuspecting retail clients are getting hosed and hoodwinked by unfair dispute resolution practices. Best interests should apply to dispute resolution.

>>Require dealers to implement enhanced control and compliance policies and procedures for dealing with the elderly, new immigrants and the infirm. Retirees are a particular challenge as they begin de-accumulating assets and enter the distribution phase. Regulators should initiate research on the potential effects of sales incentives on Baby Boomers accounts like RRIF's. There is significant potential for serious harm.

>> Prohibit any registrant from using any title that implies an advisory role unless the person meets minimum professional qualifications and the dealer provides personalized rates of return, discloses dollars and cents fees and transparently states the limitations and nature of product recommendations. There are too many financial advisors who really aren't financial advisors at all – they're product salespeople who are limited by the licenses they hold and can only provide certain solutions to consumers. If titles are standardized, consumers might actual know who they are talking to. We think the public needs to understand who they're talking to so that they're not mislead. If one is unable to call a spade a spade, an advisor an advisor, and a salesperson a salesperson, then there is no improvement and consumers will continue to be misled and overcharged.

>> Support OBSI. Name & Shame does not appear to be working. The great risk for any 'Name & Shame' regime is that the naming becomes too commonplace for the 'shame' to have any serious, lasting impact on dealer reputations. If dealers begin refusing OBSI's recommendations routinely, OBSI's already impaired credibility and ability to operate effectively will be further damaged... The harm will be felt not just by clients whose compensation recommendations are refused. ; victims will inevitably start accepting low-ball settlement offers rather than run the risk of a refusal and continued

delay/frustration. Even more dealers will play hardball with OBSI, using time proven delaying tactics, resisting information requests, making no or *10- cent -on- the- dollar* compensation offers. We therefore recommend that regulators follow up on every case where the dealer has not accepted OBSI's recommendations and compel compensation as appropriate.

It should be understood that the majority of financial assault occurs within the suitability regime endorsed by regulators. Another significant amount of assault occurs when "advisers" cross over the foggy suitability line. These assaults include , but are not limited to, breach of confidentiality, theft, fraud, misappropriation or misuse of funds or securities, forgery, unregistered investments, misrepresentation, unauthorized trading relating to the client's account(s), other inappropriate financial dealings with clients such as borrowing and engaging in securities related activities outside of the dealer ("off book" transactions) . The most publicized type of assault comes from outright frauds such as unregulated boiler room operators and Ponzi schemes like the Earl Jones (an unlicensed "adviser") case in Quebec but these are a minority. A Best interest standard would prevent a lot of abuse but clearly not all. CAVEAT EMPTOR rules at this time.

Summary and conclusion

It is an empty argument to posit that current regulations provide sufficient investor protection when "suitability" is considered crucial but is so poorly defined and interpreted. The industry claim that investors are protected by law when fiduciary duty can be proven in court is a hollow one. To argue that victims, especially seniors, have the right to take legal action is meaningless when statute of limitation periods have been slashed from 6 years to 2 years (Ontario) and the victim is trying to cope with the consequences of the life-altering event of losing their nest eggs and dreams. When investors entrust their nest eggs to a dealer or adviser they should be able to know that there is a legislated Best interests accountability. Civil actions are costly, stressful and time consuming and must be dealt with when the victim is still trying to recover from account losses and emotional distress.

Over the last 10 years, retail investors have been subjected to a large number of defective products coupled with nasty sales practices. Examples include the insane tech boom, the Great mutual fund market timing scandal, busted Income trusts that were sold via misleading claims, risky Labour Sponsored Investment funds, broken Target Date funds, mis-sold leveraged/inverse ETF's, the $32 billion non-bank ABCP fiasco, mis-sold ROC funds and complex structured products using derivatives and swaps .We could add mis-sold Closed-end fund IPO's, excessive leveraging and outright misappropriation of assets. Financial incentives to advice givers are the key driving force behind egregious behaviour. The adverse impact of this on the financial health of Canadians has been enormous. It needs to end.

Bad advice can turn a person's life into a nightmare. For seniors especially, conflicted financial advice can be life-altering. Increased anxiety/insomnia. Having to take a low paying job at age 75. Forced out of a comfortable retirement home. No money for gifts for grandchildren. Increased medical expenses due to stress. Divorce. No more RESP contributions for grandchildren. Some elderly couples worry the burden may eventually fall on their children as their carefully laid-out retirement plans vanish. Retirees who are living longer also are wondering if they will outlive their money.

If not dealt with, these abuses will cause a drain on Canada's social benefits system and on society itself. The regulation of advice is a major socio-economic issue that requires prompt regulatory and political attention and action.

We believe it is a no-brainer to get on with regulating advice - the Best interests standard is an idea whose time has come.

APPENDIX I hereto provides backup for the comments and observations we have made. The evidence is overwhelming; the current incentive system and suitability standard is causing Canadians significant harm. The current commission structure is wholly misaligned with the goal of providing services tailored to an investor’s personal circumstances, expectations and preferences.

As an aside, we include as APPENDIX II, some viable alternatives for small retail investors should the CSA follow the investor protection reforms of such progressive regulators as the UK and Australia.

We hope this Comment letter proves useful to the CSA in its deliberations .Reforms are needed now if a demographic fiasco is to be avoided. Do not hesitate to contact us if there are any questions regarding our submission.

Permission is granted for public posting.

Sincerely,

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APPENDIX I: Selected References

1. Mutual Fund Fees: The High Cost Of Canadian Funds http://www.boomerandecho.com/mutual-fund-fees-the-high-cost-of-canadian-funds/

2. How Mutual Fund Sales Are Compensated In Canada http://wheredoesallmymoneygo.com/how-mutual-fund-sales-are-compensated-in-canada/

3. **Morningstar Research report Global Fund Investor Experience 2011**
http://corporate.morningstar.com/us/documents/researchpapers/globalfundinvestorexperience2011.pdf
“Canada is the only country in the survey with TERs in the highest grouping for each of the three broad categories.”

4. **CSA93/01 Mutual Fund Sales Incentives [CSA Notice - Rescinded]**
http://www.bcsc.bc.ca/histpolicy.aspx?id=4148&cat= (January 20, 1993)

5. **"Out of Sight, Out of Mind: The Effects of Expenses on Mutual Fund Flows**", Barber, Brad, Terrance Odean, and Lu Zheng, 2005, Journal *of Business* 782095−2120.http://papers.ssrn.com/sol3/papers.cfm?abstract_id=496315 ABSTRACT: We argue that the purchase decisions of mutual fund investors are influenced by salient, attention-grabbing information. Investors are more sensitive to salient in-your-face fees, like front-end loads and commissions, than operating expenses; they are likely to buy funds that attract their attention through exceptional performance, marketing, or advertising. Our empirical analysis of mutual fund flows over the last 30 years yields strong support for our contention. We find consistently negative relations between fund flows and front-end load fees. We also document a negative relation between fund flows and commissions charged by brokerage firms. In contrast, we find no relation (or a perverse positive relation) between operating expenses and fund flows. Additional analyses indicate that mutual fund marketing and advertising, the costs of which are often embedded in a fund's operating expenses, account for this surprising result.

6 **Bridging the Trust Divide: The Financial Advisor-Client Relationship** http://knowledge.wharton.upenn.edu/papers/download/ssga_advisor_trust_Report.pdf'

7. Bridging the Advice Gap :Delivering Financial products in a post RDR world [UK] http://knowledge.wharton.upenn.edu/papers/download/ssga_advisor_trust_Report.pdf' Full report at http://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Industries/Financial%20Services/uk-fs-bridging-the-advice-gap.pdf

8. **The arguments against Cost-Benefit Analysis**
http://www.brighthubpm.com/project-planning/58627-arguments-against-the-cost-benefit-analysis/

9. **Implications of the Commission Grid for Investors**
http://blog.getsmarteraboutmoney.ca/preet-banerjee-commission-grid-for-investors#.UE3rddZlSco
"These complex grid structures are designed to influence behaviours of investment advisers. For example, we can see that an investment adviser whose production is less than $100,000 per year is heavily penalized no matter what size the individual transactions are. (Rookie advisers are not subject to the full grid during their first few years.) As another example, an adviser who has a book of client assets totaling $10 million and charges them an average of 1% in commissions per year will generate $100,000 in commissions overall, but keeps as little as $10,000 while the firm takes $90,000. This adviser will either be forced to quit due to lack of income or he/she will have to change the way they do business in order to hit higher production levels.""The grid is the enemy of savings-it creates an incredible amount of pressure to generate volume."

10. **"Free lunch" seminars: Avoiding the Heartburn of a hard sell**
http://www.finra.org/Investors/ProtectYourself/InvestorAlerts/FraudsAndScams/P036745

11. Assessing the costs and benefits of brokers in the mutual fund industry http://www.cfr-cologne.de/download/researchseminar/WS0607/CostsAndBenefitsOfBrokers.pdf

"Many investors purchase mutual funds through intermediated channels, engaging and paying brokers or financial advisors for fund selection and advice. This paper attempts to quantify the benefits that investors enjoy in exchange for the higher costs they pay in order to purchase funds through the broker channel. We focus on five measurable potential benefits to consumers of brokered fund distribution: (a) Assistance selecting funds that are harder to find or harder to evaluate; (b) Access to funds with lower costs *excluding* distribution costs; (c) Access to funds with better performance; (d) Superior asset allocation, and (e) Attenuation of behavioral investor biases. Exploring these dimensions, we do not find that brokers deliver substantial tangible benefits. In short, while brokerage customers are directed toward funds that are harder to find and evaluate, brokerage customers pay substantially higher fees and buy funds that have lower risk-adjusted returns than directly-placed funds. Further, brokered funds exhibit no better skill at aggregate-level asset allocation than funds sold through the direct channel. This analysis implies that any benefits that exist must be found along less tangible dimensions. "

12. **Why-A-Fiduciary-Standard**
http://faircanada.ca/wp-content/uploads/2012/06/Why-A-Fiduciary-Standard_-Kivenko.pdf

13. **Intermediary Commissions and Kickbacks**
http://www.cepr.org/meets/wkcn/5/5567/papers/OttavianiFinal.pdf

14 . Understanding the Incentives of Commissions Motivated Agents: Theory and Evidence from Indian Life Insurance http://www.centre-for-microfinance.org/wp-content/uploads/attachments/csy/1918/Life%20Insurance%20Agents.pdf

15. **Financial Advisors Encourage Bad Behavior**
http://www.forbes.com/sites/rickferri/2012/03/30/financial-advisors-encourage-bad-behavior/
The Market for Financial Advice: An Audit Study This working paper by Sendhil Mullainathan (Harvard), Markus Noeth (University of Hamburg), and Antoinette Schoar (MIT), was recently published by the National Bureau of Economic Research (NBER), a private, non-profit, non-partisan research organization. Most individual investors consult a financial advisor before purchasing investments. Given the central role of advisors in the investment process, Mullainathan, Noeth and Schoar tested whether financial advice serves to de-bias individual investors and thus correct mistakes they might make without these inputs, or whether advisors encourage the same bad behavior. The study defines 'good advice' as recommendations that move investors toward a low-cost, diversified index fund approach, which textbook analyses on mutual fund investing suggests. Overall, their findings suggest that the market for financial advice does not alter individual investor biases, and if anything may exaggerate existing biases. They also found that advisor self-interest plays an important role in generating recommendations that are not in the best interest of the clients. They are unwilling to lean against these biases even when they know they exist because not doing so helps them further their own economic interest.

16. **The Role of Ombudsmen in Canada and the USA** http://www.tarion.com/New-Home-Buyers/Ombudsperson/Documents/The%20Role%20of%20Ombudsmen%20in%20Canada%20and%20the%20United%20States%20-%20Bello%20Horizonte%20speech.pdf

17. **What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?** http://www.smeal.psu.edu/csfm/PERS3_201110.pdf "Although we cannot conclude that those investing through a broker would have been better off investing on their own, our findings suggest that brokers are a costly and imperfect substitute for financial literacy..."

18. **Risks to Customers from Financial Incentives** http://www.fsa.gov.uk/static/pubs/guidance/gc12-11.pdf [UK FSA] This is an excellent document demonstrating how incentives distort advice. The FSA found that:
• Most firms did not properly identify how their incentive schemes might encourage staff to mis-sell. This suggests they had not sufficiently thought about the risks to their customers or had turned a blind eye to them.
• Many firms did not understand their own incentive schemes because they were so complex, making it harder to control them.
• Firms did not have enough information about their incentive schemes to understand and manage the risks.
• Most firms relied too much on routine monitoring, rather than risk-based monitoring, such as performing more checks on staff with high sales volumes.
• Some firms had sales managers with a clear conflict of interest that was not properly managed.
• Many firms had links to sales quality1 built into their incentive schemes that were ineffective.
• Some firms had not done enough to control the risk of potential mis-selling in face-to-face situations.
Such results have caused the FSA to essentially ban commissions.

19. **Financial Advisor or financial salesperson?** http://retirehappyblog.ca/financial-advisor-or-salesperson/ "One of the big challenges of the financial industry is that most compensation and profits are driven by the sale of financial products like mutual funds and RRSPs. Unfortunately for Canadians, most financial advisors do not get paid to do financial or retirement plans. In fact most financial advisors are not paid for advice. All of their plans and advice are "FREE"." Article lists some of the scare tactics used to get clients to invest more.

20. **Conflicts of interest in the financial industry** http://balancejunkie.com/conflicts-of-interest-financial-industry/ The author provides some examples of questionable advice coming from the financial industry because of conflicts of interest. Example: "Pay off debt or invest?: "Why won't my advisor sell Exchange Traded Funds? Jon and Irene have some friends that have decided to move out of their mutual funds and into Exchange Traded Funds (ETFs). ETFs are appealing because they are low cost investment products. Their friends showed them some compelling research showing how higher fees puts investors at a disadvantage. Why didn't their advisor suggest ETFs? Most ETFs are lower cost because they either have lower compensation or in most cases, NO compensation built in for the advisor. As a result advisors must either charge a transaction fee to get compensated or they have to charge a discretionary fee directly to the client. What's best for Jon and Irene really depends on the value provided by the advisor."

21. **90% SALES 10% ADVICE :A SNAPSHOT OF THE FINANCIAL PLANNING INDUSTRY** http://www.industrysupernetwork.com/wp-content/uploads/2011/10/A-snapshot-of-the-financial-planning-industry-110930-1010version.pdf **"**The facts set forth in the report support the position long held by ISN that ongoing commissions and asset-based fees for advice enable planners and dealer groups to earn 'passive' income at the expense of consumers and should be banned, along with all other forms of conflicted remuneration. If ongoing asset-based fees are permitted to continue, credible reform requires that these fees be subject to a regular 'opt-in' mechanism. The ASIC [Australian

Securities Commission] report has pulled back the curtain to reveal the extent to which the structure of the financial planning industry impedes planners from being able to act in the best interests of their client. The *Future of Financial Advice* reforms are essential to restructure this industry to serve the interests of clients, who are relying on advisers to help them save for retirement, build wealth, and otherwise manage their financial lives. However, the financial planning industry has stridently opposed the key aspects of reform legislation that would clean up their industry. The ASIC report makes this opposition easy to understand: this is an industry built around conflicted remuneration and passive income charged to millions of unwary clients (often from their compulsory super) who receive no ongoing services. "

22. **What renders financial advisors less treacherous? – On commissions and reciprocity** https://papers.econ.mpg.de/esi/discussionpapers/2010-036.pdf "An advisor is supposed to recommend a financial product in the best interest of her client. However, the best product for the client may not always be the product yielding the highest commission (paid by product providers) to the advisor. Do advisors nevertheless provide truthful advice? If not, will a voluntary or obligatory payment by a client induce more truthful advice? According to the results, only the voluntary payment reduces the conflict of interest faced by advisors.

23. **What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives** by SUSAN E. K. CHRISTOFFERSEN, RICHARD EVANS, and DAVID K. MUSTO. **ABSTRACT** We ask whether mutual funds' flows reflect the incentives of the brokers intermediating them. The incentives we address are those revealed in statutory filings: the brokers' shares of sales loads and other revenue, and their affiliation with the fund family. We find significant effects of these payments to brokers on funds' inflows, particularly when the brokers are not affiliated. http://onlinelibrary.wiley.com/store/10.1111/j.1540-6261.2012.01798.x/asset/j.1540-6261.2012.01798.x.pdf?v=1&t=hckxeghx&s=3bcea6c51c751e62a4f9b8a974adf03762dd1e61 February 2013.

24. **The Pension Fund Advantage: Are Canadians Overpaying Their Mutual Funds?** By Rob Bauer Maastricht University and Luc Kicken ,October 1, 2008
Rotman International Journal of Pension Management, Vol. 1, No. 1, Fall 2008
Abstract: The institutional structure through which individuals accumulate retirement savings is an important issue. Ideally, it is expert and low-cost. This article compares the cost-effectiveness of the pension fund structure with the mutual fund structure. The authors hypothesize that the pension fund structure provides investment management services at lower cost because most mutual funds are conflicted between providing good financial results for their clients and good financial results for their shareholders. Specifically, they compare the investment performance of a sample of domestic fixed income portfolios of Canadian pension funds with those of a sample of Canadian fixed income mutual funds. They find an average performance differential of 1.8 percent per annum in favor of pension funds. This performance gap is approximately equal to the average cost differential between the two approaches. They conclude that high mutual fund fees significantly reduce the net returns of mutual fund investors. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1290645

25 Blog **Financial Planning and Understanding Money** A thought provoking blogger from Australia lays out some key issues regarding financial advice.http://www.michaelsmusings.com.au/financial-planning/fees-independence-bias/financial-advisors-are-cheating-you/

26 **The Marketing of Closed-end Fund IPOs** This study investigates a well-documented puzzle in finance literature: the anomalous aftermarket behavior of closed-end fund initial public offerings (IPOs)... While industrial IPOs have an average initial day return of approximately 16 percent, closed-end fund IPOs show zero first-day returns. Furthermore, while the short-term price of industrial IPOs increases, the short-term price of closed end funds decreases. After five months of trading, industrial IPOs provide a cumulative market adjusted return of 18.5 percent (Ritter (1987)), compared to a -12.6 percent return for closed-end funds (Weiss (1989)).http://fic.wharton.upenn.edu/fic/papers/94/9421.pdf

24. **Financial Advisors: A Case of Babysitters?** http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1360440&rec=1&srcabs=1009196&alg=1&pos=2 **Abstract:** We use two data sets, one from a large brokerage and another from a major bank, to ask: (i) whether financial advisors are more likely to be matched with poorer, uninformed investors or with richer and experienced investors; (ii) how advised accounts actually perform relative to self-managed accounts; (iii) whether the contribution of independent and bank advisors is similar. We find that advised accounts offer on average lower net returns and inferior risk-return tradeoffs (Sharpe ratios). Trading costs contribute to outcomes, as advised accounts feature higher turnover, consistent with commissions being the main source of advisor income. Results are robust to controlling for investor and local area characteristics. The results apply with stronger force to bank advisors than to independent financial advisors, consistent with greater limitations on bank advisory services.

25. **Is Unbiased Financial Advice To Retail Investors Sufficient?** (2011) http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1669015&rec=1&srcabs=1360440&alg=1&pos=1 Answers from a Large Field Study **Abstract:** Working with one of the largest brokerages in Germany, we record what happens when unbiased investment advice is offered to a random set of roughly 8,000 of the brokerage's several hundred thousand active retail customers. We find that investors who most need the financial advice are least likely to obtain it. The investors who do obtain the advice (about 5%), however, hardly follow the advice, and so do not improve their portfolio efficiency much. Overall, our results imply that the mere availability of unbiased financial advice is a necessary but not sufficient condition for benefiting retail investors.

26. A Review of Financial Advice Models and the Take-Up of Financial Advice (2010) http://www.cfs.wisc.edu/papers/Collins2010_FinancialAdvicePaper.pdf **Abstract: Financial** advice can complement educational interventions for individuals with technical financial issues or acute financial problems; it may also help clients apply knowledge gained from education and adhere to financial goals. This paper reviews the literature on financial advice and develops a taxonomy of financial advice models. Empirical research suggests financial advice has modest or no effects on investment returns and that financial counseling has weak impacts on financial behavior. Using data from the 2009 FINRA Financial Capability Survey, the paper presents evidence that individuals with higher incomes, educational attainment, and financial literacy are most likely to receive financial advice. "

27 **Standard of Care Harmonization** Impact Assessment for SEC http://www.sifma.org/workarea/downloadasset.aspx?id=21999 -"Small investor with commission based accounts" Pays 94 bps (basis points 0.94% of assets)??? We seriously doubt that this study took into

account the "average" small investor's account holding. It is more likely that it took into account the "average small investors "stock" account holding, ignoring the high cost products most often used with small investors. Nevertheless, the study does provide food for thought regarding different business models. In any event, fees in Canada tend to be higher for comparable services.

28 **The Marketing of Closed-end Fund IPOs**

This study investigates a well-documented puzzle in finance literature: the anomalous aftermarket behavior of closed-end fund initial public offerings (IPOs)... While industrial IPOs have an average initial day return of approximately 16 percent, closed-end fund IPOs show zero first-day returns. Furthermore, while the short-term price of industrial IPOs increases, the short-term price of closed-end funds decreases. After five months of trading, industrial IPOs provide a cumulative market-adjusted return of 18.5 percent (Ritter (1987)), compared to a -12.6 percent return for closed-end funds (Weiss (1989)).http://fic.wharton.upenn.edu/fic/papers/94/9421.pdf

29 **The $25 billion annual mutual fund rip-off**
http://cupe.ca/pensions/The_25_billion_annua
A comprehensive study by Canadian pension fund expert Keith Ambachsheer has found that defined benefit pension plans in Canada achieved annual average returns at least 3.8% higher than mutual funds with comparable investments. Defined Benefit pension funds outperformed the market by 1.23% per year, while mutual funds had average returns that were 2.6% below the market during the 1996 to 2004 period. Returns for most mutual investors were even less than this, as a result of sales fees and consistently poor selection of mutual funds by misinformed investors: buying high and selling low. This means that those with savings in mutual funds lost a total of about $25 billion a year from the higher management fees and lower returns compared to workplace pension funds. Higher management fees are responsible for about $15 billion of this.

30 **CSA 2012 Investor Index**
Key findings show that almost 30 %t of Canadians surveyed believe they have been approached with an investment fraud at some point in their life. Over half agreed they were just as likely to be a victim of investment fraud as anyone else. However, just 29 % of those who believe they have been approached with a fraudulent investment said they reported the most recent occurrence to the authorities.The *Investor Index* also shows that the overall investment knowledge of Canadians is low, with 40 per cent of Canadians failing a general investment knowledge test. According to the findings, 57 % of Canadians say they are confident when it comes to making investment decisions. Yet most Canadians have unrealistic expectations of market returns. When asked what they think the annual rate of return on the average investment portfolio is today, only 12 % of Canadians gave a realistic estimate, while 29 % provided an unrealistic estimate and 59 % explicitly chose not to hazard a guess. Nearly half of Canadians (49 per cent) say they have a financial advisor, up from 46 % in 2009 and 42 per cent in 2006. However, 60 % of those with a financial advisor have not ever completed any form of background check on their advisor. Thirty-one per cent of Canadians say they have a formal written financial plan, up from 25 % in 2009. Although more Canadians have a financial plan, they are reviewing it less frequently (78 % say they reviewed their plan in the past 12 months, down from 83 % in 2009). http://www.securities-administrators.ca/investortools.aspx?id=1011

31 **2012 Investment Executive Brokerage Report Card**
This chart provides an overview of key advisor statistics

2012 BROKERAGE REPORT CARD

The average investment advisor

	OVERALL 2012	OVERALL 2011	TOP 20% 2012	TOP 20% 2011	REMAINING 80% 2012	REMAINING 80% 2011
Average						
Size of book ($mil.)	84.9	81.6	169.3	149.1	63.6	64.0
Number of client households	211	212	137	121	230	236
AUM/client household ($)	534,814	522,237	1,343,103	1,339,947	331,451	308,847
% of client account with assets of*						
Less than $100,000	12.9	10.2	4.7	3.6	15.0	11.9
$100,000 to $250,000	17.9	16.4	8.1	8.4	20.3	18.4
$250,000 to $500,000	23.3	24.7	15.9	17.1	25.1	26.6
$500,000 to $1 million	23.0	25.0	27.8	28.0	21.8	24.3
$1 million to $2 million	13.6	14.2	23.1	24.0	11.2	11.7
More than $2 million	9.4	9.4	20.4	18.9	6.6	7.0
Average % of revenue by source*						
Fee for service	1.6	1.6	1.3	0.7	1.7	1.7
Fee/asset-based	49.1	50.1	54.1	54.5	48.1	49.1
Transaction-based	46.8	43.3	40.2	37.0	48.2	44.9
Deal-based	1.8	3.1	2.7	4.0	1.7	2.9
Branch manager override	0.7	1.9	1.7	3.8	0.4	1.4

*NUMBERS MAY NOT ALWAYS TOTAL 100% BECAUSE OF ROUNDING
SOURCE: INVESTMENT EXECUTIVE RESEARCH
INVESTMENT EXECUTIVE CHART

Source of Chart: Investment Executive 2012 Brokerage Report Card

Note that nearly half of investment advisor revenue is derived from transactions and only 1.6 % from fee-based accounts. Just 12.9 % of households have assets totaling less than $100,000 – the average is $535 K. The vast majority (80%) of advisors have 230 client households which means that on average they can expend at most one working day (7.5 hours typically) per client household per year. At say $150.00/hr. the average retail client household should expect to incur annual advice fees of no more than $1125 , give or take. A client household with $534 K in actively-managed mutual fund assets would be charged about $3204 assuming a 60 bps trailing fee for a balanced portfolio of funds.

APPENDIX II Small investors will not be disenfranchised

The industry argument here is that there will be reduced access to the preferred 'investment and advisory model' for small retail investors (<$150,000 say) , reduced access to products distributed primarily through mutual fund dealers and reduced access to the most affordable investment option (embedded commissions). The argument being made is that business models will change and the poor consumer client will get shafted with higher costs. Well, the plain fact is that the client is already getting shafted as the hugely profitable financial / investing advice industry extracts much of the wealth through its present business models and practices. For most investors and most present-day advice, the conflicted advice being provided is not merely biased, it is detrimental (see research in Appendix). To say it will get worse with proposed changes is pure chutzpa.

Let's hypothesize for a moment that there may be an issue if these small investors really received sound advice. The reality is that they certainly don't know the cost of "advice" ; many believe it is free due to industry positioning. Several surveys have concluded that investors believe "advisors" have their Best interests at heart when in fact they do not. What we actually find is that these small investors are sold expensive actively- managed mutual funds often on a DSC basis. Investor engagement is rare and basically limited to sales transactions . Selling is not advice AND Advice is not selling. What we don't see are financial plans, attempts to dissuade investors from investing until they pay down 20 % credit card balances or recommendations for cheaper products. Any advice on taxes is very basic such as valuing Canadian corporate dividends above interest . Some advice on taxes has been indiscriminate such as pushing low income earners into RRSP's and outright advice errors on TFSA withdrawal rights.

If anything, regulators should consider looking at proficiency requirements of salespersons (aka "advisors"). We should also mention that we see evidence of churning, portfolios skewed to equities (which pay higher trailers) and persistent attempts to have investors utilize leverage without regard to need , risk or loss capacity. These misbehaviours are driven by commission-driven compensation models. As indicated in the referenced research reports, this kind of "advice" actually is a net negative for investors. And that doesn't include cases where "advisors" have made unauthorized trades,breached contracts , failed to follow instructions,were negligent or outright misappropriated investor assets.,

In ant event, if retail investors really value as much as is inserted by industry participants, surely they will pay for it even when they see the cost in dollars and cents. If they choose not to, that is their decision - maybe it will lead them to becoming more financially literate, which is a good thing.

Even if we accept that what is provided is actually financial advice , we feel the innovative financial services industry will come up with business models that will address the market. It could be as simple as a fee -based account at a bank branch utilizing F Class funds. An evolving approach is intelligent advice software services. We're starting to see this transformation in Canada, but other countries around the world are way ahead of us. Just take a look at the concept behind MoneyVista, where full blown financial plans can be created online. Clients can tweak the variables yourself to see what would happen if they got a raise, or if they had an unexpected large emergency purchase to make, and how that would impact their retirement date.

In the U.S. ,two services called Betterment and Flat Fee Portfolios try to address the small investor market . Betterment is notable for an almost radical simplicity and its insistence that even someone with just $1,000 is welcome. The Flat Fee Portfolios model is built around a fixed price for advice no matter how big your portfolio is - a far cry from the usual method of having customers pay, say, 1 percent of their assets each year in fees to the adviser. There will always be a place for expert - human - advice, especially for those with more complex estates. But for those with less complex financial situations , these new approaches might fill the bill.

In 2012, BMO Investorline introduced an innovative new service adviceDirect- the first service of its kind in Canada to offer investing advice to online investors .adviceDirect puts investors in control by providing specific investment recommendations to help them manage their portfolios. It targets people with at least $100,000 in assets. It works on a fee-based model where clients pay up to 1 % of the value of their account - adviceDirect is strictly about investing and doesn't offer comprehensive financial planning. The new service has been recognized for innovation, effectiveness and presentation of technology. The technology was judged to be easy-to-use, intuitive and efficient - not only enhancing the experience of the end user but also enhancing the online investing process for the industry. The approach received a special exemption from regulators which suggests that advice delivery innovations will be considered by regulators in the future .More details at https://www.bmo.com/advicedirect

For investors wanting a second opinion on their portfolios, several firms exist that can perform this function for a fixed fee. They are professional and have no product biases.

For those who are willing to try DIY investing , a simple portfolio using a discount broker is an alternative. Discounters offer an incredible number of useful tools and calculators.

It is now cheap to build an inexpensive ETF portfolio. A number of ETF's are available on a zero commission basis. Scotia iTrade began offering a select group of commission-free ETFs back in September of 2011, and they now have 50 eligible ETFs. Two other online discount brokerages also offer commission-free ETFs. Currently, Virtual Brokers has 100 eligible funds and QTrade Investor has 59 eligible funds. Questrade apart offers a vast list of ETFs. There are no minimum purchases. Any North American ETF can be purchased commission-free, although standard commissions will still apply an ETF s sold with Questrade. Commission-free ETF trading is a huge win for small investors who are looking to reduce their fees. Not only can they get the benefit of lower MERs on ETF products, but now they can take advantage of dollar cost averaging and make more frequent contributions without the burden of paying a fee every time a purchase is made. The savings using this approach can be applied to buying fee-only advice if needed.

ING DIRECT Streetwise Portfolios are a possible choice for long-term investing, Streetwise Portfolios™ are diversified investments with a proven, index-based investment strategy . Streetwise Portfolios offer a choice of investment portfolios to suit a client's needs and investment goals, appetite for risk and time frame . Their index-based investment strategy is a simple,straightforward approach. Users get a basic, comprehensive and effective investment solution that delivers long-term performance. (80% of actively-managed mutual funds can't best the indexes consistently over the long term). Rather than picking individual stocks and hoping those companies are winners, Streetwise Portfolios create tailored portfolios of market indexes, giving exposure to thousands of the largest companies in North America and around the world at a cost of 1.07 %.

Firms like Steadyhand currently provide low-cost (ranging from 0.65% to 1.78%) top performing mutual funds . The low base fees that are all-inclusive and transparent. Even better, the more invested, and the longer an investment is held , the lower the fees will be thanks to their Fee Reduction Program .If help is needed deciding which funds are best suited for you, they offer simple,effective tools. Or, investors can speak to an investment professional about asset mix or portfolio strategy . In other words they offer offer qualified, clear-cut advice (at no additional charge).The initial minimum investment is $10,000 per fund but this is waived if aggregate investment exceeds $50,000 .No disenfranchisement here.

Investors-aid co-op is Canada wide, founded by an ex CIBC broker, and owned by its members. Members band together (like Mountain Equipment Co-op membership) to benefit from the strengths of the group. They (for a reasonable membership fee) promote the idea of how to invest wisely, without the predatory nature of most commission based "advisors" etc.They have nothing to sell you and no conflicts of interest. http://www.investors-aid.coop/

Recently ,Canadian Couch Potato announced their new investment advisory service. The description of the service can be found at http://canadiancouchpotato.com/diy-investor-service/ We expect more such innovations to come forward as investors realize the high costs and low returns of existing advisory services.

If the industry is truly worried about the fate of small investors , fund manufacturers would reduce price breakpoints, introduce D Series funds such as RBC has done, make F class funds available to retail investors , eliminate DSC money market funds and reduce management fees .Brokers would stop raising minimum account sizes , establishing minimum annual commission volume and charging $2.00 for a paper copy of account statements.

While there's been some give on fees by the fund companies , the distributors' share of clients' returns hasn't yet budged, and seems to go unnoticed. For example, trailer fees have not been reduced, and in some cases have been increased to promote the sale of new products or dealers' in-house funds. .This is not indicative of an industry that "gets it". It seems odd that investor advocates, bloggers and personal finance journalists promote TD's low cost eFunds more than TD does. This is an industry that treats " advisors" better than customers. The advice industry has too many soft spots – high fees, compensation conflicts, a focus on chasing short-term trends and opaque reporting. The planned regulatory reforms would address these issues and put investor interests first. In the end, that will be a WIN-WIN for all stakeholders.

Kenmar Associates
The Voice of the retail investor