

INVESTOR ADVISORY PANEL

OSC Investor Advisory Panel
c/o Ursula Menke, Chair
iap@osc.gov.on.ca

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Mail to:

Josée Turcotte, Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, Ontario
M5H 3S8
Fax: 416-593-2318
E-mail: comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec
H4Z 1G3
Fax: 514-864-6381
E-mail: consultation-en-cours@lautorite.qc.ca

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Autorité des marchés financiers
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Re: Canadian Securities Administrators Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients

The Investor Advisory Panel is pleased to comment on the CSA proposals for targeted reforms to enhance the obligations of advisers, dealers and representatives toward their clients as well as the introduction of a regulatory best interest standard as supported by

the Ontario Securities Commission and the Financial Consumer Services Commission of New Brunswick.

In the consultation document, the CSA acknowledges that the “status quo must change” -- that the current regulatory framework requires enhancements to better align the interests of registrants with the interests of their clients, to improve outcomes for clients, and to clarify the nature of the client-registrant relationship.

We are, therefore, dismayed by the lack of consensus among securities regulators on the introduction of a best interest standard. While the Panel has in the past called on regulators to address the issues that are the focus of the targeted reforms (conflicts of interest, know-your-client/know-your-product, titles, proficiency and designations) we believe that an overarching change is needed to definitively reset the relationship between investors and registrants. The proposed targeted reform package alone is unlikely to provide investors with the protection that has been shown to be required.

Much has been made recently of the Client Relationship Model and the Point-of-Sale Disclosure initiatives in which conflicts of interest are acceptable so long as they are disclosed to investors. In our view, treating conflicts of interest as something that can be managed is wrong headed – what is needed is a regulatory model where they are no longer allowed. Providing information on performance and (partial) costs is not a substitute for a sound and effective investor protection regime.

The introduction of a best interest standard would give rise to a regulatory regime that puts the interests of investors first. It would change the status quo and reflect the realities retail investors today are grappling with.

More than ever before, Canadians are expected to act independently to ensure they have adequate savings at retirement – they have been increasingly pushed to seek financial advice to compensate for a lack of employer-sponsored pension plans and to take advantage of government-sponsored savings programs for individual savers such as the registered retirement savings plan (RRSP) and the tax-free savings account (TFSA). As the needs of investors have changed, so too has the retail investment business, which now offers new and complex products and services. More and more, investors have come to rely on advice to navigate this landscape and they must be confident that the advice they are given is actually in their best interest.

Evidence the current approach is broken

Given this reality, there is ample evidence by both regulators and third-party researchers to show that the current model is failing Canadian investors – and badly. The CSA Consultation document does a good job of laying out much of the research that shows how focusing on product suitability and disclosure as key regulatory tools is a poor substitute

for real investor protection. Here are just a few of the research papers and reports cited by the CSA in the consultation document.

- Professor Douglas Cumming's paper, [*A Dissection of Mutual Fund Fees, Flows and Performance*](#) (2015) found that conflicted compensation in the form of sales and trailing commissions paid by fund companies, dealer affiliation and the use of deferred sales charge arrangements materially affects representative/dealer behaviour to the detriment of investor outcomes and market efficiency.
- In its 2015 report, [*Current Practices for Risk Profiling in Canada and Review of Global Best Practices*](#), PlanPlus found many gaps and inconsistencies in how firms approach client risk profiling, the cornerstone of suitability. Specifically, only 11% of firms could confirm that their questionnaires (where they had one) were 'validated' in some manner and only 16.7% of questionnaires reviewed would be considered 'fit for purpose' -- they have too few questions, poorly worded or confusing questions, arbitrary scoring models or outright poor scoring models.
- In the OSC's 2015 [*Mystery Shopping Report*](#), it was found that, when first meeting with a representative, investors were likely to hear about products and services offered (78%) and discuss their investment goals (89%), but less likely to hear about product fees (56%), the risk/return relationship (52%) or registrant compensation (25%), making it difficult to comparison shop for financial advice, especially on important aspects such as fees and costs.
- Professor Stephen Foerster's 2014 paper [*Retail Financial Advice: Does One Size Fit All?*](#) showed that mutual fund advice is relatively costly and leads to performance drag: "the typical investor who begins saving for retirement with a [representative] hands over a quarter of the present value of his or her retirement savings on day one."
- A paper from the Executive Office of the President of the United States - [*The Effects of Conflicted Investment Advice on Retirement Savings \(2015\)*](#) - "found that conflicted advice leads to lower investment returns"; "savers receiving conflicted advice earn returns roughly 1 percentage point lower each year (for example, conflicted advice reduces what would be a 6 percent return to a 5 percent return)."
- Several articles and papers (Morningstar, The Economist, Financial Analysts Journal) find that the current suitability process places too little emphasis on product cost despite a number of studies supporting the general position that "in virtually every single time period and data point tested, low-cost funds beat high-cost funds and costs are still the most dependable predictor of performance."
- Cain et al in *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest* (2005) finds that conflict disclosure, by itself, is generally an ineffective

conflict mitigation strategy and may have counter-intuitive results, such as increasing reliance on conflicted advice, which results in sub-optimal outcomes for investors.

The research clearly shows that the current regulatory approach in Canada, focused as it is on suitability and disclosure, is harming Canadian investors. This is particularly important given the extent to which Canadians rely on financial advice and the asymmetry in the advisor-client relationship.

What is needed now more than ever before is a coordinated and comprehensive approach to regulating investment advice and practices. Top of mind for all regulators should be a regulatory regime focused on a best interest standard that governs all interactions with investors.

Why it's time for a best interest standard

The benefits of a best interest standard are clear and have been embraced by G20 governments. As Principle 6 of the G20 High Level Principles on Financial Consumer Protection states: *"[f]inancial services providers and authorised agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection... the remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest."*

Moreover, a best interest standard would match the expectations consumers already have about the advice they are being given – indeed, most investors believe that their advisors operate under a regime that puts their interests first. A 2012 study done by the Brondesbury Group for the Investor Education Fund ([Investor Behaviour and Beliefs: Advisor Relationships and Investor Decision-Making](#)) showed that 7 out of 10 investors believe their advisor has a legal duty to put their clients' best interest ahead of their own.

This fundamental misunderstanding underscores the asymmetry that exists in the client-advisor relationship today. It is particularly distressing given the heavy reliance clients have on advisor recommendations. A [2009 report](#) to the Joint Standing Committee on Retail Investor Issues highlighted research on how investors in Canada use advisors when making investment decisions found that 45% of investors made their decision to invest based almost solely on their advisor's verbal recommendation and 66% made their decision based primarily on their advisor's verbal recommendation.

Conflicted compensation can undermine the trust that is an integral part of the advisor-client relationship. The Panel's own 2013 [Survey Findings on Adviser/Investor Relationship](#) found that only 20% of investors strongly agree that they trust their financial advisor's advice while 64% overall believe that how a financial advisor is paid impacts the recommendations they receive. Furthermore, a majority (58%) rely on their financial

advisor as their main source of information and yet more than 4 in 10 don't know how their advisor is being paid. We also saw strong support for a statutory best interest duty – 93% agree that is needed.

A best interest standard for dealers and advisors would address many of the issues highlighted in the Targeted Reforms, including:

Conflicts of interest – Conflicted compensation and inducements which result in investors' interests being subordinated to those of the registrant would not be compatible with a best interest standard.

Suitability (Know-Your-Client) – Suitability, which is fundamental to the current regulatory regime, doesn't explicitly require the advisor to make recommendations that offer a fair price/cost for the investor, based upon the complexity of the product and/or service being offered. As noted by the CSA, there is "No explicit requirement to consider product/account costs against the client's investment needs and objectives." Yet cost is one of the most consistent predictors of performance, especially long-term performance, for investors.

Within a suitability-driven regime, an advisor can still put his or her commercial interests ahead of the investors. As evidenced by the numerous research papers cited by the CSA in the consultation paper (with a few more noted above) an advisor can recommend to clients that which is the most expensive and the most remunerative to him or her.

Introducing a best interest standard would eliminate this issue provided that fee structures and compensation methods are fully consistent with the duty of care and conduct established by a best interest standard. Embedded fee structures and other drivers of conflicts of interest would be eliminated within a best interest framework. It would shift the conversation between advisors and clients from one that is focused on a sales transaction to one that is driven by professional standards of financial advice that is in the client's best interest.

Proficiency – Given the above, a best interest standard would facilitate the shift of investment advice from a sales focused industry to a profession, where investors are well-served by individuals with the expertise and training to meet their needs and consider their interests first and foremost. Proficiency and standards of education would be consistent with what is needed to provide a professional standard of care to clients -- a standard that will lead to trustworthy advice for investors.

It should also be noted that the demographic shift towards a larger population of seniors in Canada will require competent advice on issues uniquely related to retirees' accounts.

Titles –Title reform across the industry must occur as we note further down. Within the context of a best interest standard, there would be no benefit to using a title created to mislead investors about what advice an advisor is authorized to or can provide. The penalty for giving advice that is not in the best interest of the investor might well be more severe in cases where a title implies more competence and expertise than the advisor possesses.

Positive experiences in other jurisdictions

Other jurisdictions have moved toward a best interest standard – Australia and the UK have already adopted this approach and the U.S. is on its way. There is ample evidence emerging from these jurisdictions that a best interest standard benefits investors. Contrary to arguments against a best interest standard (i.e., it will reduce consumer choice/access/affordability), the Financial Conduct Authority’s independent [“Post-implementation review of the Retail Distribution Review” \(2014\)](#) in the UK showed some marked changes for the better from the standpoint of consumers. Notably, *“the removal of commission paid by providers to advisers and platforms has reduced product bias from adviser recommendations reflected in a decline in the sale of products which paid higher commissions pre-RDR.”* It has also led to falling product prices due to more competitive pressure. In addition, professional standards have also improved: *“The vast majority of advisers are now qualified to the new minimum standards and there has been an increase in the number of advisers going beyond these minimum standards.”*

At the same time, firms were reported to be benefiting from increases in average revenues and profitability while experiencing lower-than-expected costs of compliance with the new regime.

The advice gap

There are those who believe that a best interest standard will lead to an advice gap – a situation in which Canadian investors would be unable or unwilling to pay for financial advice because it is priced out of their reach.

This argument is misguided. In the Panel’s view, the gap already exists in Canada -- the [Canadian Securities Administrators 2016 Investor Education Survey](#) revealed that while there has been a steady increase in the number of Canadians working with a financial advisor, the number is still just 56%. Hence, almost half of Canadians don’t use financial advice today.

A best interest standard would strengthen the quality and breadth of financial advice in Canada and provide it with a much stronger platform to grow on.

In a [December 2015 comment letter](#) from the UK’s Financial Services Consumer Panel on the topic of the financial advice market, Chairperson, Sue Lewis, notes “we have not seen any evidence to show the existence of a gap in the supply of professional advice...” In the

letter, she adds that “consumers don’t always seek professional advice, even when they could benefit from it.”

The UK experience reflects research done by Michael Finke and Thomas Langdon, in [*The Impact of Broker-Dealer Fiduciary Standard on Financial Advice*](#) (2009), where the authors find that the presence of a fiduciary standard does not lead to an advice gap in the US. Moreover, in comparing advisors in the States with either a strict fiduciary standard or no fiduciary standard, they “find no statistical difference between the two groups in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance.”

What is needed to bridge the existing advice gap is greater consumer awareness of the value of advice and a better emphasis on providing professional advice that Canadians can trust. This should be the focus for industry and regulators.

At the same time, the emergence of disruptive fintech models such as robo-advisors will further challenge the industry to provide low cost and transparent wealth management to all Canadians – a change the Panel welcomes, with the appropriate regulatory oversight.

Our recommendation

The Investor Advisory Panel believes that a fundamental change has to happen in the current regulatory regime in Canada. Canadian investors urgently need a best interest standard that will truly support and professionalize financial planning and financial and investment advice. The current suitability and disclosure regime is out of date and not working – retrofitting it with patches and tweaks will not change that.

We note that the BCSC argues against the best interest standard and in favour of fixing some of the problems that have resulted in an uneven advisor-investor playing field. As it notes: “*The proposed targeted reforms are geared to the realities of our current registrant categories and conflicted business models.*” The Panel believes that all regulators should be asking why the present rules are so skewed in favour of industry realities rather than those of the investor. Their role is to protect investors and the CSA should act on the fact that the realities of the current registration categories and business models are harming investors.

The Panel commends the OSC and the NBSC on proposing a best interest standard as a regulatory conduct standard. The Panel shares their belief that a best interest standard would materially enhance the effectiveness of the proposed targeted reforms and strengthen the principle foundation of the client/registrant relationship. Harmonization, including with insurance regulators, would foster standardization and enhance consistency, clarity, and efficiency for all industry participants.

Therefore, we strongly support the introduction of a best interest standard as outlined in the consultation document as the first step towards professionalizing the financial

planning, financial advising and investment advising business. The Panel also expects industry participants who have been saying the time has come to recognize financial advisors as professionals will support this as a significant move towards that goal.

At the same time, the Panel also notes the absence of a fundamental ingredient for change in these proposals: enhanced enforcement. Without a renewed commitment to ongoing enforcement of the rules by firms, SROs and regulators, we find it difficult to see how these reforms will lead to meaningful change. These proposals – particularly the introduction of a best interest standard -- signal the need for a profound and sweeping culture change across the industry and at the firm level. This will not happen unless regulators and SROs commit to holding the industry to account through rigorous oversight, enforcement and sanctions. Without this, nothing will change.

As the CSA observes in the consultation document:

“The self-regulatory and industry organization investor complaint experience shows there is consistent and ongoing non-compliance with many of the current key regulatory requirements, with the unsuitability of investment recommendations being the primary basis for complaints to OBSI for the past five years, case assessment files for IIROC for the past three years and allegations in MFDA enforcement cases for the past three years”.

The Panel would question a regulatory regime that has allowed this to go on for years at a time. We have repeatedly expressed concerns about OBSI, whose recommendations have been ignored by the industry for far too long.

The independent assessor’s report on OBSI states that “OBSI is not a true industry ombudsman, it is a dispute-resolution service.” The assessor made a number of recommendations which we urge the CSA to accept, especially the one recommending binding authority for OBSI. Perhaps just as importantly, the report recommends that OBSI move beyond case dispute resolution and instead take a strategic approach, using intelligence from casework to help prevent and reduce complaints, empower customers and firms to resolve complaints more effectively, improve the provision of financial services, and make proactive contributions to government policy.

Without a renewed commitment to an effective dispute resolution regime, we cannot claim to have an effective investor protection regime.

Specific Comments on Proposed Reforms

PART 8:

PROPOSED FRAMEWORK FOR A REGULATORY BEST INTEREST STANDARD

Reasons certain CSA jurisdictions have concerns with the potential regulatory best interest standard.

36. Please indicate whether a regulatory best interest standard would be required or beneficial, over and above the proposed targeted reforms, to address the identified regulatory concerns.

Much evidence from around the world shows that dealing "fairly, honestly and in good faith" with the client, the standard to which advisors and dealers are held under existing requirements, is not sufficient to today's needs for investor protection.

The best interest standard is about integrity, professionalism, culture and values in the industry. The debate about whether or not to introduce such a standard is not simply about regulation -- it is a debate over the future of the wealth management industry and over what activities are or are not in the public interest. While the targeted reforms are useful, they are mostly elaborations of today's requirements. We understand that securities regulators can't create detailed rules to cover every possible client-advisor interaction. That is why we support the imposition of an overarching best interest standard to govern the relationship between clients and their advisors. The standard would confirm a fundamental principle for professionals and assist in the interpretation of specified requirements. It would also act as a guide in addressing unique situations, new products and ever-changing market conditions.

A best interest standard will force considerable change to the existing rules. For example, suitability will no longer be the test applied to a recommendation – rather, recommendations will be based on what is in the investor's best interest. The test will be objective. It will require the industry and its players to focus on the spirit as well as the letter of the rules.

We expect the best interest standard will be clearly defined, and subject to a code of conduct that establishes standards for client care and advisor competence.

38. Please indicate whether there are any other key arguments in support of, or against, the introduction of a regulatory best interest standard that have not been identified above.

A best interest standard is in the public interest. The Panel anticipates fewer complaints, less litigation, more professional and less biased advice, higher likelihood of better investor outcomes, and hopes the retail investor will regain confidence and trust in the capital markets.

Appendix H – Description of Potential Guidance – Proposed Regulatory Best Interest Standard

65. Should the Standard of Care apply to unregistered firms (e.g., international advisers and international dealers) that are not required to be registered by reason of a statutory or discretionary exemption from registration, unless the Standard of Care is expressly waived by the regulator?

Yes. All investors within the jurisdiction are entitled to the same protections and standards of care regardless of who their service provider is.

66. Do you believe that the Standard of Care is inconsistent with any current element of securities legislation? If so, please explain.

Not to our knowledge. If it is, the element should be amended

68. Do you think this expectation is appropriate when the level of sophistication of the firm and its clients is similar, such as when firms deal with institutional clients?

The Panel believes it is appropriate. It is not at all clear that the industry is able to accurately judge the level of sophistication of its clients, if the results of our [Risk Profiling Research](#) is any indication of firms' abilities to assess their clients.

PART 9 –

IMPACT ON INVESTORS, REGISTRANTS AND CAPITAL MARKETS

40. What impact would the introduction of the proposed targeted reforms and/or a regulatory best interest standard have on outcomes for investors?

Investors would be better protected and should have better outcomes from their investments with the implementation of a best interest standard because their investments and portfolios will be much better aligned with their investment objectives and needs. There should be a dramatic reduction in investor complaints and increased trust in the industry.

43. Do the proposals go far enough in enhancing the obligations of dealers, advisers and their representatives toward their clients?

The proposal to introduce a best interest standard is a good start. Robust, regular and decisive enforcement will go a long way to ensuring the benefits of the proposal are achieved. Investor protection enhancements have not kept up with changes in the industry. It will take much more than the proposed targeted reforms to create real changes that level the playing field for investors. Rather, the status quo itself must change.

We reiterate our previously stated concerns about enforcement and the need for reform, particularly with regard to OBSI's mandate.

Part 7 –

Proposed Framework for the Proposed Targeted Reforms

The available research has convinced the Panel of the need for a best interest standard. We also strongly believe that certain of the targeted reforms must be acted upon; for example, proficiency and titles need to be regulated in the interests of investors. The following

comments on the targeted reforms should not be misinterpreted to mean that, if our comments were acted upon, we would find the targeted reforms to be an acceptable substitute for the imposition of a best interest standard.

Proposed Targeted Reforms - Conflicts of Interests

Overall comments:

Too often the guidance in the appendices related to targeted reforms uses conditional language – firms “should” rather than “must.” In our view, this implies too much leeway to maintain the status quo. The proposed changes cannot be optional: language should be direct and decisive about firms’ obligations and conduct. For most of the proposed changes, the Panel would prefer “rule” over “guidance”. We also expect the industry to avoid rather than “control” or “manage” material conflicts. Ultimately, investors need a regime where client interests are paramount. Aligning investors’ and registrants’ interests by making those of investors paramount will result in more confidence in registrants and better results for all.

The guidance also appears to assume that disclosure and/or control are the first measures that should be tried when faced with a conflict, rather than avoidance. Furthermore, the existing regime for dealing with conflicts has been remarkably unsuccessful in diminishing their impact.

Responses to specific questions:

Conflicts of interest – General Obligation

1. Is this general approach to regulating how registrants should respond to conflicts optimal? If not, what alternative approach would you recommend?

We do not believe it is optimal. The proposed approach is founded on the existing conflicts and suitability regimes, which have not been successful. The best way to reduce material conflicts is to avoid them.

Moreover, the Panel is apprehensive about the use of disclosure -- how many retail investors will fully understand it and how will their level of comprehension be measured?

2. Is the requirement to respond to conflicts “in a manner that prioritizes the interest of the client ahead of the interests of the firm and/or representative” clear enough to provide a meaningful code of conduct? If not, how could the requirement be clarified?

It appears to be adequate, however the Panel would like to know how regulators will interpret, monitor and/or test the application and effectiveness of the guideline.

3. Will this requirement present any particular challenges for specific registration categories or business models?

To the extent that particular challenges arise, the registration category or business model should be modified, not the underlying principle of avoiding material conflicts.

Appendix A - Description of Potential Guidance -- Conflicts of Interest

48. Are there other specific examples of sales practices that should be included in the list of sales practices above?

Firms' and registrants' duties to clients should prohibit them from accepting compensation and inducements from third parties, even without a best interest standard in place. The duty to act fairly, honestly and in good faith should always run counter to the acceptance of any third party compensation. Research shows that third-party compensation has a negative effect on investors' outcomes. The old adage that "he who pays the piper calls the tune" rings true in this case -- when the dealer and product provider call the tune (by offering compensation to make specific recommendations) rather than the client being given an unbiased recommendation, the client is not receiving fair, honest and in good faith service from the registrant or firm.

The expectation that "registrants consider how sales practices that may arise in the distribution of any type of product may impact their ability to meet their client-facing registrant obligations..." ignores the reality of how conflicts of interest affect the conflicted party. Registrants are unlikely to be able to ignore sales incentives/practices that benefit them, and unless forced, are unlikely to alter existing sales practices that negatively affect investors.

The prohibition of any third party compensation should be made explicit. Conflicts arising from incentive practices may be controllable by the suggested approaches, but that must be tested and there must be regular and rigorous enforcement of the requirements of the policy.

49. Are specific prohibitions and limitations on sales practices, such as those found in NI 81-105, appropriate for products outside of the mutual fund context? Is guidance in this area sufficient?

NI 81-105 is more than ten years old and probably needs to be updated to reflect the latest practices used to induce sales. Enforcement with meaningful sanctions is essential to make the rules against unsavoury sales practices real.

50. Are limitations on the use of sales practices more relevant to the distribution of certain types of products, such as pooled investment vehicles, or should they be considered more generally for all types of products?

The Panel's comments in Q.48 apply to all products. There is no reason to limit good sales practices to mutual funds.

51. Are there other requirements that should be imposed to limit sales practices currently used to incentivize representatives to sell certain products?

See Q.48 and 49 responses. The preference is that all incentives that may affect the objectivity of advice be prohibited.

52. What type of disclosure should be required for sales practices involving the distribution of securities that are not those of a publicly offered mutual fund, which are already subject to specific disclosure requirements?

All and any type of compensation must be comprehensively disclosed, at time of account opening and on each year-end account statement. Further, incentives for specific products must be disclosed when a recommendation is made.

53. Should further guidance be provided regarding specific sales practices and how they should be evaluated in light of a registrant's general duties to his/her/its clients? If so, please provide detailed examples.

A compensation structure that is fair to the client and the investment advisor, objective and not based on advice-skewing sales incentives is the only acceptable structure. To the extent that commission grids interfere with the objectivity of recommendations, they should be eliminated.

Proposed Targeted Reforms - Know Your Client

Overall comments:

It is not clear what the new requirements add to the status quo. The OSC's own mystery shop research showed that in shops leading to a recommendation, 29% did not gather KYC information. Moreover, KYC information was only gathered in 32% of all shops. At best, this targeted reform merely makes explicit an existing requirement which is not routinely followed.

We feel the real investor protection improvement is the introduction of a Best Interest standard.

Responses to specific questions

4. Do all registrants currently have the proficiency to understand their client's basic tax position? Would requiring collection of this information raise any issues or challenges for registrants or clients?

It is unlikely that all registrants currently have the proficiency to understand their client's tax position, but they should have a basic understanding if they purport to be a financial adviser. By clearly assigning the appropriate proficiency requirements to each registration category, the regulator can influence who is required to have this proficiency.

Some clients may not wish to provide their tax information. Signing a waiver to be held on file by the advisor should be prescribed for such situations.

5. Should the CSA also codify the specific form of the document, or new account application form, that is used to collect the prescribed KYC content?

Given the consensus that appropriate information is not presently being collected in all cases, it would make sense for the CSA to codify the minimum content and form of the document, or new account application form, that is used to collect the prescribed KYC information. This would enhance standardization and consistency. The form should make it clear the purposes for which the information provided will be used. The form itself should be written in plain language and there should be a section where the client can state his/her objectives.

The Panel recommends a periodic review to ensure that information requirements are appropriate.

Should the KYC form also be signed by the representative's supervisor?

Yes. That will ensure the firm is satisfied that the registrant has collected the information necessary to understand the client's needs and to be able to act upon them.

Appendix B - Description of Potential Guidance -- Know Your Client

54. To what extent should the KYC obligation require registrants to collect tax information about the client? For example, what role should basic tax strategies have in respect of the suitability analysis conducted by registrants in respect of their clients?

See response to Q. 4.

It is very important that tax strategies be understood adequately by the registrant. If the registrant purports to "advise" then that registrant should have knowledge and comprehension of tax matters and implications. Even if the registrant is not the tax adviser/consultant of the client he/she should be competent enough to work with the client's tax adviser, and should collect tax information. The advisor should also be able to recommend investments that optimize the tax treatment given to a particular account where the investor has more than one type of investment account with the registrant.

55. To what extent should a representative be allowed to open a new client account or move forward with a securities transaction if he or she is missing some or all of the client's KYC information? Should there be certain minimum elements of the KYC information that must be provided by the client without which a representative cannot open an account or process a securities transaction?

The registrant needs the KYC information. Depending on the client, some questions may elicit responses that are inapplicable in appropriate circumstances, but the registrant will

be able to demonstrate that he/she sought the KYC information and that the client understood the importance of the questions and their responses.

56. Should additional guidance be provided in respect of risk profiles?

Last year, the Panel commissioned research which revealed that investor risk profiling across most of the industry is inadequate, not validated, lacking consistent scoring methodology, and subjective. The Panel expects that the [Risk Profiling Research report](#), conducted by PlanPlus, will spark discussion and, ultimately, improvements.

We recommend that regulators and registrants work to harmonize and standardize risk profiling forms and scoring requirements to enhance consistency and validity. Representatives who interpret risk profiles must also have the necessary expertise and proficiency to do so.

57. Are there circumstances where it may be appropriate for a representative to collect less detailed KYC information? If so, should there be additional guidance about whether more or less detailed KYC information may need to be collected, depending on the context?

See response to Q, 55. As a result of going through the KYC requirements, some clients will probably have less elaborate profiles than others. But the importance of asking all the questions cannot be understated. Clients will likely be faced with questions they have never considered, but should have or will have to consider in the future.

Target Area - Know your Product – Representative

Is this general approach to regulating how representatives should meet their KYP obligation optimal? If not, what alternative approach would you recommend?

Again, it is not clear what the proposed new requirements add to the status quo. However, requiring a registrant to understand and consider the impact of costs does not impose an obligation to recommend based on them. Investors require an approach that objectively factors in the costs. Research has shown many times that the most important factor in determining outcomes of investments are costs to the investor, yet the reforms do not require any action based on this factor. When two products are reasonably similar, the cost to the investor should become a determining factor in a recommendation.

Also, using Fund Facts as a basis for KYP can result in incorrect product risk assessment. The Panel believes that using volatility as a disclosure of risk is misleading, incomplete and will not be understood by most retail investors. Mutual funds are the most popular investment vehicle in Canada with over \$1.2 trillion in assets. That creates a lot of scope for poor advice based on inadequate risk assessment of the product.

Appendix C does not include a requirement to assess the impact of a product on the client's portfolio. Product recommendation in isolation may not be suitable for the client. The reforms should address more explicitly the need for holistic portfolio level advice.

Proposed Targeted Reforms – Suitability

Overall comments

The Panel believes “suitability” is not an effective practice and should be replaced with a regulatory best interest standard. However, for the purposes of this consultation, we provide the following comment on the issue.

Overall, the Panel believes it is not sufficient to conclude that an investment is suitable to merely “...take into account the impact...of any compensation paid to the registrant...”. All costs borne by the client directly or indirectly, through a reduced return on the product or otherwise, must be factored into a suitability determination. Furthermore, registrants should be required to explain their suitability recommendation to clients by discussing other products and why they were not recommended.

To properly fulfil the requirements regarding suitability will require additional and ongoing training on the part of registrants and firms to ensure they comply with both the letter and the spirit of the requirements.

Absent such training, it is unlikely that the full extent of the requirements for suitability will be met.

Responses to specific questions:

16. Do you agree with the requirement to consider other basic financial strategies?

Yes. This is a basic requirement for anyone who purports to give financial advice.

17. Will there be challenges in complying with the requirement to ensure that a purchase, sale, hold or exchange of a product is the “most likely” to achieve the client’s investment needs and objectives?

It is not obvious why the requirement will create compliance challenges. A product must be “most likely” to achieve investment objectives or it is not suitable. The real issue is the number and quality of the investment products the registrant has to choose from. If the suite of products the registrant is able to offer is insufficient, it is quite possible that none of the products will be “most likely” to achieve the client’s needs and objectives.

18. Should there be more specific requirements around what makes an investment “suitable”?

That would probably be helpful, especially in the context of a portfolio of investments where suitability must also be looked at from a portfolio perspective rather than merely the transaction perspective. A signed-off rationale may also protect the client as well as the advisor. Investment strategies involving leverage must be documented and signed off by the client, the advisor, and a supervisor.

Will the requirement to perform a suitability assessment when accepting an instruction to hold a security raise any challenges for registrants?

An appropriate assessment should always be performed when a client gives an instruction. If clients decide to hold a security that the registrant deems inappropriate, it will be up to the registrant to document such instruction appropriately and ensure it is duly signed-off by the client.

The Panel, however, favours a best interest standard over a suitability standard.

19. Will the requirement to perform a suitability analysis at least once every 12 months raise challenges for specific registrant categories or business models? For example, a client may only have a transactional relationship with a firm. In such cases, what would be a reasonable approach to determining whether a firm should perform ongoing suitability assessments?

Unless the firm or registrant is a pure order taker, they need to determine whether the client's investment(s) remain appropriate. A limited business model or registration category should not remove this obligation to the client. After all, the client is paying for such a service under most existing compensation arrangements by way of embedded commissions.

The Panel, however, favours a best interest standard over a suitability standard.

21. Should clients receive a copy of the representative's analysis regarding the client's target rate of return and his or her investment needs and objectives?

Yes – signed off by both

22. Will the requirement to perform a suitability review for a recommendation not to purchase, sell, hold or exchange a security be problematic for registrants?

See response to Q. 17 and 19. The decision not to act is still a decision -- we recommend sign-off by the client indicating the client has understood and agreed.

Proposed Targeted Reform – Relationship Disclosure

23. Do you agree with the proposed disclosure required for firms registered in restricted categories of registration? Why or why not?

Yes. Clients need to understand the type of firm they are dealing with and whether or not that type of firm is or is not likely to meet their investment needs.

24. Do you agree with the proposed disclosure required for firms that offer only proprietary products? Why or why not?

Clients must clearly understand the limited nature of the product offering, its limitations and the conflict inherent in such an arrangement. It is not clear why institutional clients

should not also be informed. Also, if there are no exceptions to disclosure, there is less likelihood of an oversight occurring.

25. Is the proposed disclosure for restricted registration categories workable for all categories identified?

The required disclosure does not appear to be onerous for the firms identified. Again, it is not obvious why there would not be disclosure to institutional clients.

26. Should there be similar disclosure for investment dealers or portfolio managers?

Yes, the Panel favours consistency throughout.

27. Would additional guidance about how to make disclosure about the relationship easier to understand for clients be helpful?

Undoubtedly. At a minimum, the language used should be tested to ensure that it is clear, simple and easy to understand, and that the consequences of the nature of the registrant's business model be clearly explained to the investor. For example, illustrations of restrictions should be given so that the client understands what services he/she cannot expect of the registrant.

Appendix E Description of Potential Guidance -- Suitability

62. What, if any, unintended consequences could result from setting an expectation in the context of the suitability obligation that registrants must identify products both that are suitable and that are the most likely to achieve the investment needs and objectives of the client? If unintended consequences exist, do the benefits of this proposal outweigh such consequences?

We do not foresee unintended consequences, but should they occur, they can be minimized by training and enforcement activities.

63. Should we provide further guidance on the suitability requirement in connection with ongoing decisions to hold a position?

It is unclear why a decision to hold is different from a decision to invest in the first place. If additional guidance is required for hold decisions, it would also be required for invest or divest decisions.

64. Should we provide further guidance on the frequency of the suitability analysis in connection with those registrant business models that may be based on one-time transactions? For example, when should a person or entity in such a relationship no longer be a client of the registrant for purposes of this ongoing obligation to conduct suitability reviews of the client's account?

As long as the registrant continues to hold investments on behalf of a client, the registrant should be obliged to conduct the review of the client's account at the same frequency as for all other clients.

Proposed Targeted Reforms - Proficiency

Overall comments

The Panel views proficiency, designations, and titles as interrelated. Titles must be supported by the appropriate level of education and demonstrated competency in putting that knowledge to work properly.

In our opinion, the level of professionalism for individuals who provide financial advice must be raised to that of other professions (e.g., the medical, legal, and accounting professions). Professionalism implies superior levels of ethics, integrity and moral values as well as true expertise in the subject matter. Given the complexity of investing in today's environment and the need for advice that is unbiased and in the best interests of the investor, investment advisors must be true professionals on a par with other recognized professions. For most registration categories, this will imply considerably more education and training than is presently required.

The registration classification must clearly describe the scope and authorizations of the registrant and their representatives, as well as the associated proficiency requirements. Prescribed titles must link to and be reflective of the respective registration category. This information must be easily accessible by the investor. The Panel recommends that advice and the use of the terms advisor and adviser or financial planner be regulated.

Response to specific questions

28. To what extent should the CSA explicitly heighten the proficiency requirements set out under Canadian securities legislation?

It is important that proficiency requirements be reviewed periodically to ensure they meet the needs of the profession and investors. This has not been done for some time, despite significant changes to products and approaches to the business (e.g. the rise of wealth management over investment management). The current proficiency requirements for some of the registration categories are insufficient given the level and depth of knowledge required to do the job, including the advertised services, properly.

Proficiency requisites must be commensurate with the responsibility and knowledge and understanding required to advise clients on the planning and management of their investments.

The Panel recommends registration categories be reviewed and associated proficiency requirements be updated and upgraded. We also recommend a review of the current

course material, including industry-specific courses, requisite to meet proficiency requirements. We specifically wish to draw attention to the current proficiency requirement for registration as a mutual funds dealing representative under NI 31-103, which requires one of the following five options:

1. CIF (90-140 hours course) OR
2. CSC (135 – 200 hours of study) OR
3. IFIC (90-140 hours course) OR
4. CFA Charter and 12 months of relevant securities industry experience in the 36 month period before applying for registration OR
5. Advising representative requirements -- portfolio manager or exempt from these under section 16.10(1)

The above implies that the IFIC course and the CFA Charter with 12 months of relevant securities industry experience are equal in value and depth of understanding for the purpose of advising investors regarding mutual funds. This is clearly not the case. Most investors may not know the difference.

Given that “seniors” is the fastest growing demographic, and will remain so for the next 20 years, the CSA may wish to consider a registration category with prescribed proficiency requirement for advice for seniors, retirees and vulnerable investors.

29. Should any heightening of the proficiency requirements for representatives be accompanied by a heightening of the proficiency requirements for CCOs and UDPs?

Yes. CCOs and UDPs should have a proficiency level commensurate with their responsibilities with respect to oversight and compliance enterprise wide.

Proposed Targeted Reforms – Titles

Overall comments

We are pleased to see the Panel’s recommendation for business title reform reflected in these proposals. The OSC’s [Mystery Shop](#) research found no fewer than 48 titles in use today. This reveals how firms and SROs have failed investors in managing the evolution of (often misleading) titles and “title inflation” over the past decade or so.

The Panel sees an immediate need for the CSA to step in and prescribe titles that are simple, relevant and transparent, that reflect the registration category, and that apply across the industry. The prescribed title for the respective registration categories should be the only title for that category that may be used for all forms of documentation and communication. Adherence must be strictly enforced, i.e. non-compliance must result in disciplinary action. Use of “vice-president” as a marketing tool must be stopped. The difference between an “advisor” (dealers and dealing reps – no fiduciary duty) and “adviser” (Portfolio Manager – fiduciary duty) must be made much clearer than a difference

in spelling by one letter. Many investors do not know the difference and are under the impression that both work under a best interest standard. The Panel recommends that an “advisor” be held to the same professional standard as an “adviser”.

At the same time, the Panel believes that adding two broad tiers, “independent” and “dependent” may be helpful to investors, where *Independent* stands for the ability to consider all products and providers that could meet an investor’s needs and is thus free from any restrictions or bias when making recommendations. Firms providing such advice must (a) consider a broader range of products (retail investment products), (b) provide unbiased and unrestricted advice based on a comprehensive and fair analysis of the relevant market, and (c) inform its clients, before providing advice, that it provides independent advice (i.e. advice without restrictions or qualifications); and *Dependent* stands for being restricted in some way (e.g., by offering only proprietary products, a limited suite of products or only certain kinds of products). Firms providing restricted advice must disclose in writing and orally, before providing advice, that they provide restricted advice and explain the nature of the restriction.

Responses to specific questions

30. Will more strictly regulating titles raise any issues or challenges for registrants or clients?

We think not. It is important that clients get a good sense of the nature of the services provided by a registrant. Registrants should be just as interested in clear titles as their clients are. Currently, many titles are misleading and confusing. Prescribing titles would achieve standardization, consistency and comparability.

31. Do you prefer any of the proposed alternatives or do you have another suggestion, other than the status quo, to address the concern with client confusion around representatives’ roles and responsibilities?

Alternative 2 seems most straight forward. See also our overall comments above.

32. Should there be additional guidance regarding the use of titles by representatives who are “dually licensed” (or equivalent)?

Yes. The investor should be provided clarity on what “dual licensing” means and the regulatory implications for each license. Presently, such an advisor can recommend a suitable product, but not necessarily in the investor’s best interests from among insurance products that the advisor sells. As long as advisors are only held to meet the test of suitability, product arbitrage remains possible. However, with regard to dual-licensing, we believe titles should reflect the registration category and apply across the industry.

Proposed Targeted Reforms - Designations

33. Should we regulate the use of specific designations or create a requirement for firms to review and validate the designations used by their representatives?

Regulating the use of specific designations will ensure that only meaningful, established designations be permitted. Two- or 3-month course designations should not be eligible – rather, such courses should be treated as product information.

Proposed Targeted Reforms: Role of UDP and CCO

35. Is there any reason not to introduce a statutory fiduciary duty on these terms?

Presently, the law recognizes a fiduciary duty for discretionary accounts. If the statutory fiduciary duty is only a recognition of the existing common law, there does not seem to be much point in the proposed amendments. If there is to be some form of codification, it would be preferable to see the proposal before commenting further.

Summary and Conclusion

There is overwhelming evidence that the current approach to providing financial advice to retail investors is costing those investors dearly. The root cause can be traced to permitted conflicts of interest and the transaction-based suitability approach supported by inadequate compliance, enforcement and complaint handling procedures. As Vanguard founder John Bogle has noted "The scandal is not what's illegal, it's what's legal." The prevailing practices are adversely impacting the retirement security of millions of Canadians. The targeted reforms may make some improvements at the margin but by themselves they will prove inadequate.

As to the impact of CRM2 and Point of Sale reforms, it is unlikely that they will have any significant effect upon the key investor protection concerns identified in the consultation paper, particularly since fundamental conflicts will be allowed to persist under the targeted reforms regime. The research shows that disclosure is not very effective in changing investors' behaviour so it is important to change the behaviour of representatives and firms to ensure better outcomes for investors.

There has never been a time when trustworthy financial advice is needed more. Increased product complexity, the decline of defined benefit pension plans, demographics, higher taxes, low interest rates and increased longevity have created the perfect storm. Regulators simply cannot permit the status quo to prevail.

The Panel recommends the introduction of a best interest standard without delay. Moreover, if other provinces are unwilling to get on board, we recommend that Ontario and New Brunswick act alone to protect their own investors and continue to raise the bar for regulators across the country.

At the same time, regulators must also bear in mind that a key to any proposed change is enforcement of the change. There is no point in making rules if they are not enforced. The CSA has recognized the status quo must change. It will not do so without much greater

attention to enforcement. It is equally important to give investors the tools they need to obtain redress when their registrant has not complied with the rules. The present regime is broken and needs to be fixed. The evidence is in about OBSI. It is up to the CSA to act on that evidence.