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Via Email

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September 30, 2016

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Nova Scotia Securities Commission

Attention: Robert Blair, Secretary (Acting)
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
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Dear Sirs / Mesdames:

Re: Canadian Securities Administrators (CSA) Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients

The Investment Industry Association of Canada (IIAC) appreciates the opportunity to comment on behalf of our members in response to the above-captioned request for comment (the "Consultation Paper") related to certain targeted reforms and the adoption of a regulatory best interest standard.

The IIAC is the national association representing the position of 132 IIROC-regulated Dealer Member firms on securities regulation, public policy and industry issues. We work to foster a vibrant investment industry driven by strong and efficient capital markets. Our response to the request for comment was prepared with the input of an IIAC Working Group that was comprised of 19 member firms of different sizes across Canada and which included professionals in compliance, legal, operations and business. The Working Group's views were consistent in both the concerns expressed and its approach to the questions posed in the Consultation Paper.

An Executive Summary of the IIAC's comments on the proposals is set out in Appendix A. Our response to the CSA's specific questions is contained in Appendix B. Appendix C is an analysis of the expected costs of implementing these proposals. As we already indicated to the CSA, we were unable to complete this analysis by the September 30, 2016 deadline. The IIAC will submit the survey results shortly and hope the CSA will consider them as part of its review of all submissions as we believe the results will have a significant bearing on informing the CSA's next steps. Finally, Appendix D is a conflicts of interest self-assessment tool, developed by the IIAC in 2012 as CRM1 was being implemented. It sets out over 100 examples of conflicts of interests identified by our members.

<u>Overview</u>

The IIAC and its member firms applaud the CSA's ongoing review and consultation concerning the Canadian registrant regulatory framework. We remain supportive of measures that enhance the client-advisor relationship and we are committed to working with the CSA in respect of its regulatory objectives. The IIAC appreciates the engagement of both industry and investors on this issue and we make the following observations about the general thrust of the CSA Consultation Paper and proposals.

We understand that the Consultation Paper was intended to outline the proposed reforms at a high level, however, our members were left with numerous questions due to uncertainty about how the targeted reforms and the regulatory best interest standard, described in broad strokes, would be interpreted, operate and be enforced in practice. Accordingly, given a general lack of detail and parameters on the proposals, we found it challenging to respond with greater particularity. Our responses to the questions often request clarification, pose questions concerning application in various scenarios or provide alternative suggestions for consideration that we believe may provide a more focused and effective means to enhance registrants' obligations to their clients.

In addition, the Consultation Paper does not distinguish between registration categories or reflect the differences between the rules under which registrants are currently governed. Notably, certain registrants already are subject to robust obligations under the various rules of self-regulatory organizations (SROs) such as IIROC. We have cited in our responses numerous examples of existing IIROC Rules that in our view, already appropriately meet the CSA's regulatory objectives respecting the client-advisor relationship.

Specifically, we are concerned that the Consultation Paper contemplates sweeping changes for all registrants without regard to the substance and structure of the existing rules that govern IIAC members, and for which they have developed sophisticated compliance regimes at significant cost. We wonder whether the CSA's concerns are predominantly related to select registration categories with lower standards than IIROC registrants adhere to. If that is so, then we encourage the CSA to focus its attention on those registrants.

The Consultation Paper fails to address the diversity of business models and products offered by our members. For example, the Consultation Paper does not discuss how the targeted reforms and a best interest standard would be applied to those members with discount brokerage operations, "online" advisors known as "robo-advisors", or member firms that deal in over-the-counter (OTC) derivative products. Absence of clarity in these areas creates further uncertainty and makes it challenging to address the potential impact of the proposed reforms.

We expand upon our high level concerns about the CSA's proposals, below.

A. *Premature and Contradictory Reform Proposals*

The IIAC and its member firms share in the CSA's objective to ensure that the client-advisor relationship is generally a harmonious one that provides value to clients. In that vein, we believe that the recent "client-focused" Point of Sale (POS) and Client Relationship Model - Phase 2 (CRM2) reforms which are still being implemented, align well with these objectives and have been supported by the industry. We look forward to the recently announced multi-year research project by the CSA of the POS and CRM initiatives and their effectiveness in addressing the concerns outlined by the CSA in the Consultation Paper. This will include the conduct by the BCSC, on behalf of the CSA, of a survey to obtain data on how firms are compensated for their services, how they compensate their representatives and how they manage conflicts of interest. This survey will establish a baseline of practices to compare to when the CSA repeats this study in 2019.

We fully agree with the BCSC that this review should be completed before considering not only the best interest standard which is intended to have "immediate impact", but also many of the proposed targeted reforms. At this juncture, we believe it is premature to impose the proposed reforms that in application may detract from the objectives and anticipated results of the POS and CRM2 initiatives which the industry has significantly invested in. We are concerned that such measures may risk outcomes for clients that do not actually serve their interests, without having considered the potential unintended consequences.

We do not agree with the characterization of the CRM and POS reforms as mere disclosure initiatives. The CRM initiative, which covers rules related to conflicts management, has already resulted in significant changes to business conduct and models and increased the rigor of conflicts management, including through movement to fee-based accounts when suitable for clients and enhanced product vetting. We believe that studying the impact of CRM and POS will confirm these positive developments for the CSA.

Moreover, the CSA's review of the POS and CRM2 initiatives will clarify which, if any, gaps must be addressed so that any further reforms can be targeted and do not introduce unnecessary complexity or obfuscation of existing regulatory reforms.

Additionally, we question why additional disclosure measures are prescribed in the targeted reforms when it appears that the CSA has lost confidence in disclosure-based investor protection policies which had previously been consistently advanced over numerous years. Given the apparent shift in policy by the regulators concerning the use of disclosure, we seek clarification of the reason for additional proposed disclosure obligations at this time. We are concerned that the inconsistent structure and substance of the proposed reforms will thwart the objectives of securities regulators to protect investors and to foster fair and efficient capital markets.

B. Failure to Credit the SRO Function

The IIAC's members are providing services of value today to their clients under the highest regulatory standards in the industry and have continuously worked with IIROC to proactively and successfully address investor protection concerns. We note that the Consultation Paper has generally not accounted for IIROC's carefully calibrated rules that have evolved over time, and that already provide a high degree of investor protection for clients dealing with IIROC members.

We are also concerned that the Consultation Paper includes SRO members in conjunction with the CSA's identified concern that clients are not getting the outcomes that the regulatory system is designed to give them. The CSA cites IIROC enforcement statistics to illustrate that there is "consistent and ongoing non-compliance with the current key regulatory requirements" and also cites "barriers to obtaining redress for a registrant breach". We note, however, that there has been a significant declining trend in complaints over the last five years generally from clients and other sources, and we believe this is reflective of the high standards that the SRO and its members maintain.[1] Further, the filing of a complaint is not always indicative that it has merit. The SRO investigative process vets which complaints warrant enforcement, not based on an inability to enforce rules but based rather on whether there is evidence of an infraction. When appropriate, IIROC is able to take action to enforce its rules against registrants through its enforcement proceedings as shown in those statistics. Notably, the review jurisdiction of the securities regulatory authorities is exercised in certain cases to overturn and dismiss IIROC's violation findings. This demonstrates not that the regulatory system is unable to provide clients appropriate outcomes, but rather that the regulatory system is actively engaged through the SROs and the CSA in ensuring that just outcomes result for clients and registrants.

[1] As an illustration, in 2015 according to ComSet data, IIROC received 1,352 customer complaints. To put that in perspective, there were 112 million retail trades in that year, encompassing 11.65 million brokerage accounts. This translates into one customer complaint for every 82,000 trades or every 8,500 accounts. (Source: Investor Economics).

C. Appropriate Enforcement Action and Bases for Client Redress

The IIAC supports effective enforcement and the ability of clients to obtain redress. However, we do not agree that the proposed reforms as structured provide the foundation for meeting these objectives. Rather, in large measure they place unknown expectations and unlimited liability on registrants and, as the BCSC identified, may exacerbate the investor protection issue of misplaced trust and over-reliance by clients on registrants.

The impact of adding rules related to many of the targeted reforms and a uniform best interest standard will likely "assist enforcement" by increasing the number of regulatory proceedings against registrants, due to the numerous new and vague standards that could be employed by the regulator to support an allegation of wrongdoing. However, registrants will generally not know whether and when their conduct crosses the line into a breach. For example, what is a sufficient market investigation and product comparison to ensure that the range of products offered by firms with non-proprietary products is representative of a broad range of products suitable for their client base? How does that apply in the self-directed channel? How would a registrant be able to justify that a recommendation to pay down debt or direct cash into a savings account rather than investing in securities was appropriate, when later the client may find that investing would have generated a return that would have improved her financial condition? How can a registrant achieve both a high rate of return needed by a senior investor to "most likely achieve the client's investment needs" and the low risk necessary to meet suitability requirements? How would a proprietary firm meet the standard of "prioritizing" the best interests of their clients? How would the standard of care of "a prudent and unbiased firm or advisor acting reasonably" be demonstrably met under these new rules?

We disagree with the CSA's view that these changes will result in "effective" enforcement. We do not believe that a regulatory regime which is structured to advance indiscriminate enforcement and bases for redress will effectively result in "changing behaviour". Rather, given the difficulty registrants will face in mitigating the risks associated with the proposed reforms, they are liable to produce unintended consequences such as limiting investment opportunities and availability of advice from a qualified investment advisor. We believe that with the CRM rules, the CSA has appropriately "moved the dial" and promoted the participation of the client in the client-advisor relationship, but we are concerned the proposed reforms frustrate that objective. Rather than layering on new rules of uncertain application and conflicting impact with existing rules, we believe that the CSA should remain on track with enhancement of the existing client-advisor relationship through CRM as an aid for effective enforcement. Before adding any new regulatory obligations, the CSA should examine how they would enhance effective enforcement and improve investor protection.

As such, we believe that the current regulatory and legal regime for IIROC dealers appropriately fulfills the purpose of protecting investor interests. The current range of enforcement and arbitration measures provide a comprehensive investor protection regime that reflects various types of client-advisor relationships. Further, a common law fiduciary standard already applies when a client is vulnerable, places

reliance and trust on the advisor, and the advisor has discretion over the client's account. A regulatory best interest would apply uniformly regardless of the nature of the actual relationship between the client and advisor and whether it is appropriate in fact or not. Thus, it may be misleading to reinforce through this proposal that the same "best interest" standard of care applies regardless of the type of service provided by different types of registrants. For example, in the case of order execution-only dealers or unsolicited orders from clients, we do not believe that this standard can be applied. We therefore question the proposal to apply a uniform best interest standard to the current tiered structure of the registration regime and the variety of business models and when the common law already provides appropriate legal safeguards.

D. Net Benefit Not Demonstrated

Overall, the CSA has not demonstrated that a clear benefit will be achieved through the implementation of a regulatory best interest standard of general application. The Consultation Paper fails to adequately analyze the basis for the reforms put forward and whether there is a net benefit derived. Accordingly, the regulatory proposal cannot be measured against the objectives which it is intended to address.

The additional regulatory burden sought to be imposed through the targeted reforms and best interest standard will result in significant costs which have not been considered in the proposal. It is likely that at least some of these costs will be passed along to clients.

Clients will likely suffer other types of disadvantages as a result of these proposals. As costs continue to rise as a result of the dramatically increasing regulatory burden, many dealers have implemented minimum account size thresholds because it has simply become uneconomic to handle small accounts.

Further, while robo-advice has its place in the spectrum of service offerings, we do not agree that it is an "industry solution" to the growing advice gap resulting from the increased cost of regulatory compliance. Robo-advisors focus narrowly on providing an asset allocation function with the money provided by the client for investing, but do not provide the client with many of the benefits of working with an advisor, such as advice on regular contributions and investment discipline such as with tax advantaged programs that can allow for increased retirement savings and significant additional returns. As such, we are concerned that these "investor protection" measures which are intended to support small investors will instead operate to these investors' detriment if they are implemented.

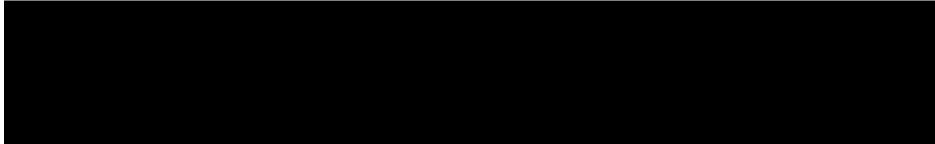
Conclusion

Our members are already subject to the highest regulatory standards in the industry and take investor protection seriously. We urge the CSA to take a careful approach and consider the unintended consequences and costs that we believe are risked with this proposed, sweeping regulatory intervention. We are concerned that certain targeted reforms may be inefficient or unachievable, and the best interest standard may be ineffective, with potential negative impact for small investors. We wholly support the

views of the BCSC and other jurisdictions expressed in respect to concerns over the proposed best interest standard and strongly caution against a fragmented application of this standard in Canada. We suggest in the alternative, that the CSA focus on registrants regulated under different standards than IIROC's, support SROs in enforcing existing rules, and consider the results of the impact study concerning CRM and POS in order to inform the need for any new regulation.

The IIAC would greatly appreciate the opportunity to discuss our submission with you further and provide additional input as required.

Sincerely,



Michelle Alexander *Naomi Solomon*

APPENDIX A: EXECUTIVE SUMMARY

1. Targeted Reforms

A general theme in the IIAC response with respect to many of the targeted reforms, is that the CSA does not seem to acknowledge the spectrum of clients that exist who are seeking different levels of advice and services. Many of the targeted reforms propose one, inflexible standard meant to work for each and every client. Creating a one-size-fits-all solution does not adequately serve Canadian investors.

Another theme raised throughout the IIAC's comments on the targeted reforms is that for many of the proposals, our members are already subject to detailed IIROC rules and guidance that address some of the areas the CSA identified as necessary to better align the interests of registrants to the interests of their clients.

However, there are some aspects of the reform agenda where the CSA has put forward approaches that are not simply a departure from normal industry practice, but will require a significant overhaul of the industry, while offering no real and clear improvements for investors.

Changes that lead to practical and cost-effective rules would have greater receptivity if reinforced by economic analysis of the effective cost burden to be borne by the dealers if the proposed targeted reforms are implemented. Ultimately, many of the costs related to the proposed targeted reforms are likely to be passed on to clients. To illustrate the costs associated with the targeted reforms, the IIAC retained Deloitte to conduct a cost survey and analysis of the targeted reforms. [The Deloitte survey results are forthcoming and will be submitted to the CSA separately, as Appendix C.]

Conflicts of Interest

As part of our examination of the proposed guidance on Conflicts of Interest set out in the Consultation Paper, the IIAC conducted a detailed review of key elements of the CSA's proposed conflict management system and accompanying expectations. Our comments on the specific proposals are detailed in Appendix B.

In general, the IIAC is disappointed that the Consultation Paper fails to acknowledge that the member firms are already subject to high standards of conduct and oversight by IIROC and other SROs. The Conflicts of Interest targeted reforms relating to sales practices and incentivized compensation arrangements fail to distinguish IIROC member firms from others in the industry.

Many existing IIROC rules and guidance already adequately address the areas outlined in the targeted reforms. For example, IIROC Rule 42: Conflicts of Interest imposes obligations that go beyond what is currently required by NI 31-103. IIAC member firms are already required to have in place clear structures and policies to identify conflicts of interest and to clearly delineate firm and advisor responsibilities with respect to identifying and managing conflicts of interest. Furthermore, the *Conduct and Practices Handbook* includes a Code of Ethics and Standards of Conduct that requires registrants to display trustworthiness, honesty and fairness, and to put the client's interest foremost in all business dealings.
Certain of the CSA's proposals would be impractical to implement. For example, the expectation that a firm obtain "informed and specific consent" from a client before entering into each transaction is vague

and unworkable. It is unclear how such a determination of "informed" would be made. In a fast-paced business environment, obtaining such consent before each and every transaction would be problematic from a systems perspective and almost certainly lead to client complaints about the speed of order execution. How the requirement to "prioritize" the interests of the client ahead of the interests of the firm would be satisfied, especially in a for-profit dealer enterprise, is also unclear.

However, IIAC does acknowledge that the management of compensation-related conflicts of interest is certainly an area where improvements can be made, and it looks forward to working with the regulators in this area.

Know Your Client

As with conflicts of interest, the KYC requirements under IIROC Form 2 already exceed what is currently required under NI 31-103. The IIAC is concerned that the CSA's proposal to impose a one-size-fits-all "standard" KYC from effectively subjects all client accounts to the regime applicable to portfolio managed accounts, and ignores the reality that not all accounts and not all clients are the same. Ideally, the content of the KYC obligation should be geared to the type of account, depending upon whether it is a smaller RRSP purchased at a bank branch, a margin account, a discount brokerage account or one with a robo-advisor.

The KYC targeted reform proposing collection of tax information is likely to prove particularly burdensome for both advisors and clients. In the experience of the IIAC's members, clients often resist providing sensitive financial information, making the detailed collection of this additional information a challenging proposition and not appropriate for all clients.

Know Your Product – Firm and Representative

IIAC members are already governed by a detailed regulatory regime under IIROC rules and have the benefit of IIROC guidance related to KYP. As required by IIROC, member firms have in place policies and procedures for vetting new products and objectively evaluating a broad range of products that may be appropriate for their respective clients. Our members also employ effective tools to assist advisors in assessing recommended products.

The CSA's expectation that every advisor will have proficiency with the entire universe of products on the dealer's shelf is unreasonable. Expecting advisors to dedicate the time that would be required in order to maintain proficiency related to all securities, whether relevant for their clients or not, would overwhelm advisors and fail to improve service to clients. If implemented, the effect will be to cause firms to reduce the number of products offered, thereby reducing product options available to investors and potentially having a negative impact upon the capital markets generally.

The proposed requirement for firms to engage in a market investigation, product comparison and optimization process is an inflexible process which fails to efficiently tailor the product due diligence process to the key risks presented in each firm's unique business and clients. The proposed process suggested by the CSA would, in addition to being a costly exercise, quash innovation, product diversity and competitiveness in the industry.

We recommend that before any particular enhancements to the KYP requirements are implemented, the CSA consult with firms regarding their current product due diligence processes, systems and tools, to inform whether any enhancements would be beneficial and if so, at what cost to firms and their clients.

Suitability

The IIAC is not in favour of the proposal that advisors must to conduct a "basic financial suitability" assessment for every client, requiring advisors to provide non-securities product strategies, including whether a client is better off paying down a high interest debt or placing cash in a savings account.

Imposing a financial suitability review akin to financial planning or credit counselling is beyond the expected proficiency required of advisors as is the provision of advice regarding non-securities products. These activities are outside the scope of the existing regulatory framework.

The IIAC also does not agree with a new requirement that advisors identify a "target rate of return". This is not an activity that advisors generally conduct, nor are most trained to provide as is one usually undertaken by a CFA or qualified financial planner. Further, it is not necessarily something all clients need, want or would be willing to pay for. However, we do support the use of a "target savings" rate to help clients' achieve their savings objectives.

The IIAC does not understand how the regulators would assess whether an advisor has met the standard in any given situation, such as whether a particular client would have been better off paying off a debt rather than investing in securities.

Relationship Disclosure

IIROC Rule 3500 already set outs requirements surrounding the nature of the disclosure necessary to ensure that the relationship disclosure is clear and meaningful to clients. While both MFDA and IIROC registrants must ensure that the relationship information clients receive is clearly entitled "Relationship Disclosure", non-SRO registrants do not have the same obligation. The IIAC suggests that the CSA consider amending NI 31-103 to impose this requirement on all registrants.

Proficiency

The IIAC supports potential changes to the proficiency requirements to ensure that not only IIROC advisors, but all registrants, meet minimum education and proficiency standards for the purpose of ensuring a uniformly high standard of professionalism in the wealth management industry.

However, to expect all advisors to understand the structure, strategy, costs and risks associated with all *types of securities* as proposed in the Proficiency targeted reforms is unrealistic and unnecessary. IIROC or MFDA registered advisors, portfolio manager advising representatives, dealing representatives of scholarship plan dealers and exempt market dealers all have different levels of initial and ongoing proficiency requirements as a result of their different types of expertise and offerings. They are not expected to know the entire universe of products that exist.

Implementing a universal level of proficiency is simply not viable under the current regulatory framework, unless the CSA is planning to make significant changes to the individual registration categories in NI 31-103.

Titles

The IIAC is supportive of limiting the range and number of titles currently used in the industry. In lieu of the proposed alternatives outlined in the CSA Consultation Paper, the IIAC proposes titling that more closely aligns with the products that the advisor is registered to offer and does not preclude the use of other regulated titles such as Financial Planner or Chartered Financial Analyst.

Designations

Given that the proposed Designation targeted reforms appears to largely be based on IIROC Guidance Note 14-0073, the IIAC generally supports the proposals outlined.

Role of UDP and CCO

The proposed clarifying reforms appear consistent with typical UDP and CCO practices, as well as applicable IIROC Rules, which set out the duties, requirements and expectations for UDPs and CCOs. We support increased proficiency for non-SRO registrants to ensure they meet the higher proficiency requirements set out in IIROC Rules.

Statutory Fiduciary Duty

The scope of the proposed statutory fiduciary standard and its application is unclear, as is the distinction between the proposed statutory fiduciary duty, the common law fiduciary duty, and an overarching regulatory best interest standard. To impose such overlapping standards on portfolio managers will create uncertainty for them and confuse investors. It is also unclear whether the CSA would apply the fiduciary standard to IIROC dealers who offer temporary discretionary accounts, which are not the same as managed accounts.

2. Regulatory Best Interest Standard

The IIAC and its member firms believe in providing advice that is best for their clients, and we have consistently worked towards improving both the quality and integrity of investment advice. As is evident from the CRM initiative, the securities industry has been proactively advancing a regulatory regime to provide clients with significant investor protections, clear and meaningful disclosure and enhanced communication, and to promote better collaboration and understanding within the client-advisor relationship.

Although we address the questions posed regarding the regulatory best interest standard in Appendix B, we wish to emphasize our support for the clearly articulated arguments set forth by the BCSC in addition to those outlined by the Jurisdictions with Concerns about a Best Interest Standard (“BIS”). This includes the point that the expectation gap will only be widened, not eliminated, by attempting to impose a uniform standard despite the differing nature of business models, registration categories, products, services and client sophistication. This could have the unfortunate result of leading clients to believe that they never have personal responsibility for their investment decisions.

The guidance on the proposed regulatory best interest standard is vague, open-ended and undefined. Many interpretations of what constitutes a best interest standard will arise, creating more uncertainty in the capital markets.

The regulatory best interest standard will simply lead to an increase in confused and unsettled clients (and advisors), an increase in complaints and a greater incidence of legal action. The prospect of these developments will cause advisors and firms to deal more cautiously with investors, limit the scope of advice and investments, scale back proprietary dealings in fixed income products and new offerings of securities, and encourage the shift to discretionary managed accounts. This will lead to an advice gap as those clients with smaller accounts, unable to afford or access managed accounts, will have to find other avenues for investment.

The experiences in other jurisdictions do not lend support to the arguments of those in favour of a best interest standard. Enacting a best interest standard in other countries has not gone as simply and as smoothly as many anticipated. The costs have been high, amendments have been necessary and in many cases, the proposals have led to reduced access, choice and decreased affordability of investment advice.

Before embarking on such an endeavour, we strongly urge the CSA to complete a cost-benefit analysis. The IIAC has been able to provide cost estimates on the targeted reforms, which we believe would represent an operationalization of the regulatory best interest standard. [Appendix C, which contains these cost estimates, is forthcoming and will be submitted to the CSA separately.] Without further clarity concerning the application of this standard and given the limited time available, we were unable to provide further details regarding any additional costs of a regulatory best interest standard as a stand-alone requirement. However, we would be more than willing to work with the CSA in the completion of such an analysis.

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APPENDIX B: RESPONSE TO CONSULTATION QUESTIONS POSED BY CSA

Where certain consultation questions lent themselves to being grouped, we have responded to the series of questions together, or provided high level comments in one section but responded in more detail elsewhere in our response.

CONFLICTS OF INTEREST

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

Question 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?

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

We are responding to these three questions together, below.

In summary, we are of the view that IIROC's existing conflicts of interest rules, developed over many years and as part of the client relationship model (CRM) initiative, already apply an appropriate rigorous standard for conflicts management. The standard is currently being applied by our members and the CSA's approach will present significant challenges to them. We suggest that as a starting point, the regulators consider a framework conforming to the existing IIROC rules and guidance to support their regulatory objectives.

The CSA should also allow the BCSC-led conflicts of interest and compensation review to be completed before any new rules are imposed. It is unproductive for two separate arms of the same regulatory group to be working at cross-purposes on this initiative.

IIROC Rule 42 – Conflicts of Interest

IIROC members have already been subject to IIROC's Conflicts of Interest Rule 42 ("Rule 42") for a considerable period of time and have been operating under a higher standard with respect to conflicts of interest than that existing under NI 31-103. The IIAC considers that existing Rule 42 adequately protects

the interests of client and does not believe that the CSA proposal will result in any significant benefit to them.

In the case of advisors, Rule 42 requires that all existing or potential material conflicts of interest between an advisor and client must be addressed in a "fair, equitable and transparent manner, and *consistent with the best interest of the client or clients* [emphasis added]."

In the case of dealers, Rule 42 requires that all existing or potential material conflicts of interest between a Dealer Member and client must be address "in a fair, equitable and transparent manner, and *considering the best interests of the client or clients* [emphasis added]." This is in recognition of the reality that "it is not always possible or practical for a Dealer Member to address all conflicts of interest in the best interests of each client when the conflict of interest situation involves multiple clients with competing interests."[1]

The general statement set out in the proposed Conflicts of Interest obligation fails to recognize this challenge. The IIAC believes that the CSA should capture this distinction in any new proposed rules.

We are very concerned with any proposed change in NI 31-103 that would expand or alter the already well-established IIROC requirements that our member firms have adopted, as an exercise that will not result in a significant benefit for clients. In particular, the requirement to "prioritize" the interests of the client is an unworkable standard and impracticable in a for-profit dealer enterprise. It is overbroad in scope of application to dealers and representatives. Meeting the standard could be interpreted to mean that the dealer would have to avoid "for-profit" business as that "conflict" could not be controlled "in a manner that prioritizes the interests of the client". Our members expressed confusion over the proposed language "ahead of the interests" and what that might mean in specific circumstances, as opposed to not being detrimental to the interests of clients[2].

We also wish to draw the CSA's attention to Appendix D attached to this submission. With the introduction of CRM1, the IIAC developed a self-assessment tool, which sets out over 100 examples of conflicts of interests identified by our members. Appendix D lists all of these conflicts in a table which enables members to not only identify conflicts of interest that may exist, but also the materiality of the conflict and whether it should be avoided, managed or disclosed. In working diligently to satisfy the conflicts of interest requirements under Rule 42, many of our members have indicated that they used this tool to assist them. This further demonstrates the consideration given to creating well-established policies and procedures by our member firms to address conflicts of interests.

The IIAC Working Group examined the proposed guidance on Conflicts of Interest set out in Appendix A to the CSA Consultation Paper to determine whether it might clearly and specifically inform what the

[1] See IIROC Guidance Note **12-0108** – *Client Relationship Model* (March 26, 2012).

[2] For example, in the case of a proprietary firm, how will conflicts be able to be managed so that client interests are prioritized? We would advocate that a safe harbour provision be implemented for management of conflicts in the case of proprietary products given the inability otherwise to meet the "unbiased assessment" standard of care.

proposed requirement would mean in practice. We provide more detailed comments below on Appendix A to the CSA Consultation Paper.

Controlling conflicts of interest

Current IIROC Rules that govern our members together with IIROC's guidance is reasonable and sufficient to meet the objectives articulated by the CSA. For example, Rule 42 and IIROC Rule 38 on Compliance and Supervision ("Rule 38"), together with IIROC's Guidance Note 12-0379 on the Role of Compliance and Supervision, already effectively articulate that the UDP is responsible to "maintain a tone from the top" and promote integrity, including as relates to conflicts management under Rule 42, as the UDP's role is to:

- promote compliance by the Dealer Member, and individuals acting on its behalf, with IIROC's requirements and all applicable securities laws,
- communicate and reinforce the importance of compliance within the firm on an ongoing basis,
- ensure that all staff understand the importance of consulting with the Compliance Department on all relevant matters,
- ensure that there are effective procedures for identifying and escalating all instances of noncompliance, and
- ensure all instances of non-compliance are resolved in a timely and effective manner. (The dealer can take steps to promote the importance of compliance, including by promoting a culture of compliance by clearly identifying, prioritizing and communicating compliance goals and insisting on compliance with high ethical standards throughout the Dealer Member with Executives leading by example.)

Further, under Rules 38 and 42 our members already have in place established structures, policies and procedures to identify conflicts of interests and to clearly delineate firm and representatives' responsibilities with respect to identifying and managing conflicts of interest. Our firms point out that they all have internal requirements to report material conflicts of interest and employees can face discipline if conflicts are not reported, including for activities such as personal financial dealings or outside business activities. Moreover, a defined escalation procedure is currently required under Rule 42. The firm must adequately supervise how existing or potential material conflicts of interest between the advisor and client are addressed. Registrants made aware of an existing or potential material conflict of interest, must report it immediately to the Dealer Member. It is generally understood that the firm and the advisor work hand in hand and one cannot pass on responsibility for identifying and managing conflicts to the other.

Elements of the proposed guidance on controlling conflicts are concerning as they are not consistent with IIROC's rules. In particular:

1) As noted above, "adoption of a 'prioritization of the client's interest' or 'client's interest first' standard in a firm's code of conduct", is unworkable and inconsistent with existing IIROC Rules, including Rule 42.

2) The example of creation of a "conflicts inventory" does not refer to a materiality threshold which other elements are linked to. At the very least, a materiality test should be articulated. Furthermore, the creation of such an inventory would be a massive and extremely expensive, imprecise and complicated exercise. For many firms, this would encompass thousands of advisors multiplied by the number of potential conflicts and a completely new technology and systems build.

3) A similar burden would be incurred with respect to “regular reporting” of material conflicts of interest by the CCO to the UDP and board. We suggest it would be more practical and relevant to periodically report at a higher level on the effectiveness of the systems to manage and control conflicts of interest.

4) In keeping with existing requirements and as part of any regulatory compliance management systems, firms already conduct testing which would include conflicts of interest. However, the IIAC anticipates that the current proposals would also require new systems and technology.

5) The requirement to include “material conflict avoidance” in the firm's compliance system is not supported with examples. CP 31-103 already provides that conflicts of interest that are prohibited by law and conflicts posing a high risk of harm to clients or to markets must be avoided.

We suggest that examples consistent with those set out in IIROC Guidance Note 12-0108 be included in the proposed guidance to clarify for the industry the types of situations contemplated where the only reasonable response is avoidance. For instance, the Guidance Notice reminds representatives of specific rules that requires conflict avoidance such as Outside Business Activities (IIROC Rule 18.14), Pro Order requirements (Rule 29.3A), Restricted List trading policies, and restrictions on issuing research reports (Rule 3400.14).

6) The IIAC also supports hiring practices that carefully review a representative’s history and compliance, and it is notable that in addition to existing proficiency requirements, IIAC member firms undertake a rigorous process when hiring individuals who are otherwise subject to the “fit and proper” requirements under IIROC Rule 20.18 and as expressed in IIROC’s Administrative Notice 09-0192 on IIROC Registration – The Fit and Proper Test for Approved Persons, referencing best practices for firm hiring due diligence. The due diligence conducted by firms is limited, however, by the third-party information they can access through non-confidential or public channels especially when the representative is still employed at another firm. Thus, such a provision should include a “best efforts” qualifier that recognizes the limitations on the scope of due diligence that firms can reasonably conduct and that in the case of our members, IIROC already conducts fit and proper evaluations for registration of individuals which the SRO can do in greater depth.

Disclosing conflicts of interest

The IIAC supports providing effective disclosure to clients. This is currently set out in both CP31-103 and IIROC Guidance Note 12-0108.

Our members do ensure that new and existing clients receive appropriate and timely disclosure of conflicts and such disclosure is prominent, specific and clear pursuant to IIROC Rule 3500 on Relationship

Disclosure (Rule 3500) and under Rule 42. However, we have concerns with some of the elements included in the proposed guidance as they are not consistent with IIROC Rules:

1) The expectation that representatives have a "reasonable basis for believing that clients fully understand" the implications and consequences of the conflict is a standard that is effectively subjective to the client and that cannot easily be met by advisors. We are unclear as to how this can be interpreted as an objective standard. Advisors would have the onus to prove that the client understood the disclosure which would be impossible to meet if the client claims, after the fact, that they did not understand the disclosure, whether it was the case or not. IIROC **Guidance Note 12-0108** already has articulated an appropriate standard for disclosure of conflicts to clients which requires that "disclosure should be sufficient to provide clients with an understanding of the specific conflict." This is more objective as the content of the disclosure itself will evidence whether it is sufficient for a reasonable client to understand it.

   In regard to the expectation that the firm obtain "informed and specific consent" from the client before the transaction is entered into, we are not clear how one would demonstrate that the consent was in fact "informed". Would this entail a checklist of any applicable disclosure such as Fund Facts, for the specific transaction, or otherwise retaining evidence of advice on why a recommendation for a specific security was recommended? The tools and systems that would be necessary to evidence this requirement, track it and ensure compliance with it would be quite onerous.

   At the very least, the IIAC recommends that this requirement be applied only to material conflicts impacting a specific set of transactions which can be objectively identified so that firms can document client consent via advisor notes at the time of the transaction and which can be confirmed in a subsequent enhanced supervisory review.

2) We are also concerned with the expectation that after consent is received, the firm demonstrates that the transaction prioritizes the interests of the client. We again refer to IIROC Rule 42 and believe that the appropriate standard is that conflicts of interest must be addressed in a fair, equitable and transparent manner rather than "demonstrated to be prioritized" which is another potentially unattainable standard. It is not clear how that can be done and would lead to after-the fact reviews.

Guidance on specific conflict of interest situations

Compensation

The IIAC recognizes that its members should be focusing upon compensation-related conflicts of interest. This was specifically addressed by IIROC in its existing CRM **Guidance Note 12-0108**. While our member firms have general frameworks in place to examine incentive practices with respect to fee-based and commission-based accounts that align with IIROC's guidance[3], they are working toward further

[3] IIROC has indicated that for compensation-related conflicts:

strengthening management of compensation-related conflicts. IIROC has promoted this objective in IIROC Guidance Note 16-0068 issued on April 6, 2016.

In that notice IIROC indicated that it plans to enhance its compliance test procedures to more closely examine compensation grids, supervisory oversight of advisors recommending products with high commissions, and the monitoring of advisors approaching compensation thresholds. Many of these areas are mirrored in Appendix A to the CSA Consultation Paper. The IIAC and our members look forward to working with IIROC through the course of its targeted examinations and comprehensive survey related to practices concerning the oversight and monitoring of compensation-related conflicts to assist firms and their representatives to reasonably identify, manage and supervise compensation-related conflicts.

It is important to note, however, that with respect to the issue of incentive practices in commission-based accounts, the commission does not vary based on the product sold and as such, this type of "compensation arrangement" does not create an incentive for advisors to recommend one product over another. Rather, it is the frequency of trading that can generate higher commissions.

We do not agree that the following measures proposed in Appendix A to the CSA Consultation Paper should be adopted:

1) "Ensuring that where a compensation grid is used, incentives are not created to prioritize the interests of the firm or representative ahead of the interest of the client" is inconsistent with the standard currently articulated in the IIROC guidance that the transaction, account and service fees and costs to be charged are fair and consistent with the overall wealth building objectives of its clientele. The standard should not be based solely on a comparison of costs related to transaction fees charged under a commission-based account, which the CSA appears to endorse. In our view, the IIROC standard is appropriate and preferable as it does not dictate that only the lowest cost product or service must be recommended, especially given the transparent disclosure regime under CRM, or that firms never use incentives on the basis that this would contravene priority of client interests. Given the variety and dynamics of clients and products to invest in, the proposed CSA guidance may instill a chilling effect such that products and services available to clients will be much more limited by cost considerations than by suitability for the client. That would not be in clients' interests.

2) "Include a mechanism that reduces compensation as a result of compliance issues (such as justified client complaints, internal non-compliant practices, regulatory or disciplinary action)". As previously indicated, we believe it is important that the appropriate tone from the top from the UDP helps to ensure a culture of compliance. We are concerned that the regulators are contemplating implementing detailed rules for an issue that is more appropriate for the human resources management team of

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- The Dealer Member should ensure its product and service offerings, including the fees associated with such offerings, are consistent with the overall wealth building objectives of its clientele; and
- The Approved Person should, in addition to determining, where applicable, whether a certain product or service is suitable for the client, ensure that the transaction, account and service fees and costs to be charged are fair and are properly disclosed to the client."

each member firm. It should be left to the members to determine how to address these issues, be it compensation-related, possible termination or other mechanisms such as close and strict supervision to address performance conduct issues.

We also caution that it is not appropriate or practical to apply a standard of compensation conflicts management that would cause the cost structure of each client's account-type to be subject to hindsight review as this is not possible to manage given the "second-guessing" that would be required over clients' preference and future activity. Rather, the focus should be, consistent with CRM, on transparent disclosure of all fees for services so that the client can make an informed selection.

Questions 44 to 47: The IIAC has not provided responses to these questions given that the focus relates to the definition of institutional clients, which we believe warrants a separate discussion and not form part of the Consultation Paper.

Sales practices

The IIAC examined the material set out in Appendix A to the Consultation Paper relating to sales practices and reviewed NI 81-105 *Mutual Fund Sales Practices*.

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

No. The sales practices identified appear to sufficiently cover off a wide range of possible compensation or benefits that could give rise to conflicts of interests.

Question 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?

Our member firms agreed that they have never seen the sales practice activities that the CSA listed in Appendix A to the Consultation Paper occur outside of the selling of mutual funds. As members have not seen examples of this in the business, we query whether the CSA's proposal is a solution in search of a problem.

As mutual funds are in always continuous distribution, we recognize the possibility of these sales practices occurring in that business in order to incentivize the selling of one mutual fund over another.

However, such a situation will not normally arise in an initial public offering (IPO) or secondary offering which only occur at a limited point in time. In addition, other than the use of road shows, there would be no similar sort of education seminar in connection with a securities distribution. It simply would not work for this business.

Question 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?

For pooled investment vehicles in continuous distribution, a limitation on the use of sales practices that may be employed may be useful for such a business model, when economic incentives may arise.

In addition, when these products are being targeted to retail investors, there should definitely be some controls with respect to educational seminars used to market these products.

Accordingly, it may be beneficial to review NI 81-105 and expand its application beyond strictly mutual funds to other investment funds such as pooled investment funds and applicable structured products. However, limitations on sales practices for all types of products are not necessary.

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

No, not outside the mutual fund context.

Members have not seen examples of compensation arrangements that create incentives for advisors to recommend one product over another. In a non-fee-based account, the commission does not vary based on the product sold. A fixed income product sold would receive a certain fixed commission as would an equity fund sold. Similarly, in fee-based accounts, the fee is established and would not change based on the product sold within that account. Even with respect to proprietary products as opposed to third-party products, there is little variance in the commission received that would create incentives for advisors to recommend proprietary products over third-party ones.

Obviously, this is different for mutual fund products that can have varying sales charges and trailing commissions based on the product sold.

We reiterate that we have seen no evidence of this problem occurring with our members and would therefore stress that there is no need to introduce requirements to limit sales practices that currently do not exist. There are no incentives (be it direct compensation, non-monetary benefits or cost reimbursements) to cause advisors to recommend one product over another.

Question 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?

None. As stated above, we do not believe that the issue of sales practices is applicable to our industry.

Question 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?

Not applicable.

KNOW YOUR CLIENT

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

Question 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?

While all IIROC advisors are required to complete the Canadian Securities Course (CSC), this course only provides an outline of the fundamentals of taxation in Canada and tax strategies, but tax issues are not examined in any depth. Tax treatment of different securities and other investment products is discussed as well as basic tax position as it relates to a client's marginal tax rate, taxation on dividends, tax deductible items related to investment income, calculation of capital losses and gains, tax deferral products and vehicles such as RRSPs, TFSAs, RESPs, RRIFs, etc. However, as the CSA has acknowledged, this level of "proficiency" is not that of a representative engaged in tax planning services, who would necessarily provide those services at a cost.

To the extent that financial information related to a client's "basic tax position" is collected, it is effectively for the purpose of complementing other "know your client" (KYC) information collected respecting investment knowledge and account objectives in order to satisfy the suitability obligation. In particular, "total net worth" and "annual income from all sources" is mandated financial information to be disclosed by the client under IIROC's **Form 2** New Client Application Form (NCAF).

Our members caution that the collection of client personal financial information can be challenging. Clients often resist providing confidential information concerning income and "net worth". This is particularly so if the client brings in assets sufficient to commence trading in an account and believes that disclosing other financial information that is extraneous to the activity in the account violates their privacy. Consequently, obtaining complete financial information from clients is already at times problematic. As such, we query what other financial information would be contemplated to be collected apart from what is already mandated under Form 2, and why collecting it is desirable, given that sophisticated tax strategies would only be in the financial/tax planner's purview and would not even be applicable for many clients.

We are also unclear as to what is meant by "basic tax strategies". To the extent that this means whether, for example, it is preferable for a client to generate dividend income as opposed to triggering a capital gain, these issues would already form part of a suitability analysis. However, formulation of client specific tax strategies should be left to tax experts.

Question 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?

No. IROC has already codified the minimum new account application form requirements in Form 2. Other KYC requirements relating to client identity are set out in IIROC **Rule 1300**, and supplement Form 2, for

the purpose of requiring compliance with federal anti-money laundering regulations when opening a new account. Disclosure, such as the Relationship Disclosure Document (RDD) required under CRM, further supplements the NCAF on account opening. The documentation involved in the opening of a new account thus comprises considerably more than the Form 2 but has also already been mandated under other well-established rules.

Firms have engaged in considerable efforts to comply with these multiple requirements and customized their own internal documents. Many firms have married their forms with questionnaires and Investment Policy Statement (IPS) documents which are ultimately streamlined into one account opening package which may be delivered through an on-line system. To impose a standard KYC form will result in further cost and system enhancements for the dealer and require the re-papering of hundreds of thousands of client documents notwithstanding that the KYC information is currently being appropriately collected from clients.

We also have concerns with the proposed guidance in Appendix B to the Consultation Paper which suggested that the KYC form, both at initial account opening and upon material changes occurring, must be signed and dated by both the client and the representative. Most IIAC member firms have procedures requiring that clients sign and date the entire new account opening package but, not necessarily a specific "KYC form". Some firms have a separate KYC form while others incorporate the required KYC information in the NCAF package.

While signing at account opening is a common practice, to impose this requirement upon a material change occurring would present significant challenges. Indeed, IIROC Rules do not require that a client sign and date when a material change occurs in acknowledgement of its impracticality given the number of clients at any firm and the fact that there is also the requirement for supervisory approval.

While we acknowledge the importance of having up-to-date KYC information, we suggest that the proposed requirement that KYC information (in whatever form it takes) must be refreshed every 12 months would lead to an unnecessary administrative burden for advisors. As structured, the requirement would significantly detract from advisors' primary responsibility of advising their clients and managing their accounts to instead focus on completing documentation and pursuing clients for signatures.

In recognition of this impracticality, the standard under IIROC Rule 2500 requires that the advisor update the information on the application appropriately "where there is a material change in client information". This standard is well-established and works well. **IIROC Guidance Note 12-0109** indicates that the account information must be updated at any time there is a material change in a client's circumstances and provides best practices to satisfy this requirement, suggesting that this inquiry can occur when the advisor meets a client to review his/her portfolio, otherwise corresponds with the client to discuss other account related matters, or annually contacts the client to verify the accuracy of the account information. In addition, the Guidance Note states that it is expected that clients are clearly informed of their obligation to notify their respective advisor any time there is a material change in their circumstances.

While the CSA states that adequate and timely KYC information is important for registrants in meeting their suitability obligation to clients, the suitability obligation under IIROC Rules already aligns with that principle, as suitability is reviewed upon certain trigger events as prescribed in IIROC Rule 1300, including

when there has been a material change to the client's information that resulted in revisions to the client's "know your client" information as maintained by the Dealer Member.

It should also be noted that the primary purpose of CRM is to enhance communication and improve the advisor-client relationship in order to better inform the client of the nature of the account relationship, including client obligations. As such, it would be expected that material changes in the client's information would be discussed and addressed based on those ongoing communications rather than through an administrative process which is also burdensome to clients. IIROC's best practices guidance in this regard is aligned with the intent of CRM, including that the advisor periodically inquires with each client as to whether there are any material changes in the client's circumstances with some flexibility as to when and how it is done, with the corresponding expectation that clients are clearly informed of their obligation to notify their respective advisor any time there is a material change in their circumstances. The Relationship Disclosure Information, provided under the CRM rules, assists the client to understand the advisor and client obligations in regard to the operation of the account; including that the client has a responsibility to ensure that they advise and update the advisor when there has been a material change in the account information. This is aligned with CRM's principle to ensure that the client also participates in the opening and operations of their account.

These long-standing IIROC standards are consistent with CRM, reasonable for clients and advisors and have proven to be effective in meeting the suitability obligation. As an additional measure, however, we would not be opposed to mirroring the U.S. requirements, whereby firms solicit clients for updated account record information every 36 months, generally by sending a standard letter to all clients with a copy of their application advising the client to inform the dealer of any material changes. Unless informed otherwise, the client profile is permitted to be taken as current. As acknowledged by the Securities and Exchange Commission (SEC), the rule as structured mitigates the administrative burden that would be associated with this exercise, particularly if mandated on a yearly basis. To further alleviate administrative burden and increase efficiency and flexibility for firms and clients, electronic delivery methods should be permitted in the alternative to mailing of documents, including email, statement messages or pop up screens. Electronic delivery is a means to increase client contact given that most clients today find a paper-intensive process far more burdensome.

Question 55) To what extent should a representative be allowed to open a new account or move forward with a securities transaction if he or she is missing some or all of the 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? and

Question 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?

IIROC Dealer Member Rule 2500 currently mandates that a "fully completed" new account application must be completed no later than the business day after the initial trade. If this does not occur, a firm must restrict the account to liquidating trades only until a fully completed application has been approved. "Fully completed" is defined as meaning "that all information necessary to assess suitability, creditworthiness

and risk has been obtained but does not mean that the client must have signed the application if the Dealer member requires that the client do so."

We advocate a similar approach be adopted in the CSA targeted reforms. However, we do not support an approach that would require the collection of additional "tax information" before an application would be accepted as "fully completed". This would be excessive given confidentiality issues, and the fact that the current standard already requires that income and "net worth" be disclosed. Furthermore, we believe that it would be contrary to regulatory registration requirements for an advisor to hold him or herself out as a tax expert when they are not licensed to give advice in such subject areas. Rather, as is currently the case depending on account-type that is opened e.g. cash versus margin, our members reserve the right to undertake a credit check of the client prior to opening a margin account. Clearly, additional details such as client indebtedness are much more relevant when a client wishes to open a margin account.

The amount of detailed information that the CSA is proposing to satisfy the KYC obligation appears to rise to the level of that expected in a portfolio managed account. Requiring such detail may not be necessary or beneficial for all accounts of all clients. Smaller accounts serviced by robo-advisors or clients solely purchasing RRSP eligible securities at a bank branch, for example, would not require this detailed and comprehensive level of information when opening an account. Such accounts would also have less need for a detailed Investment Policy Questionnaire (IPQ), with its intricate analysis of their risk profile. All these steps in the collection of what the CSA deems to be necessary KYC information, requires the expenditure of resources by firms.

The CSA has already effectively endorsed the gradation of requirements based upon the differing service offerings (i.e. order-execution only account, cash account, trust account, margin account, joint account, option account, managed account, etc.) having approved the IIROC Rules that apply in this manner. This approach has reasonably recognized that "one-size" does not fit all types of clients and accounts, and that regulatory requirements should be proportional to the risks.

The benefits of this approach is that an advisor is provided with all the relevant information necessary to satisfy the suitability obligation, without the need for additional time and resources that are spent when for example, a portfolio manager that is engaged in discretionary trading opens an account for a new client. Further, this allows firms to provide services to smaller investors without additionally triggering the requirements associated with a managed account. Firms are continually raising the minimal levels necessary to open accounts as it is becoming increasingly uneconomical to service smaller investors, given the rapid rise in regulatory costs.

Question 6) Should the KYC form also be signed by the representative's supervisor?

The IIAC has no objection with such a requirement, provided that the signature is not necessarily required on a KYC "form" but somewhere within account opening package or, alternatively, the supervisor's approval can be evidenced electronically. IIROC Dealer Member Rule 2500 already requires that a supervisor, such as a branch manager, sign a new account application. IIROC Rule 1300.2 also states that the supervisor is responsible for the opening of new accounts and for establishing and maintaining acceptable procedures for account supervision to ensure that the handling of client business is within the

bounds of ethical conduct, consistent with just and equitable principles of trade and not detrimental to the interest of the securities industry.

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

Given that most IIAC members have clients complete an IPQ that assists in the determination of a client's risk profile, we welcome additional guidance regarding the risk profile exercise undertaken by firms and their advisors. We would, however, request that any changes to the risk profiling of client accounts should be subject to grandfathering provisions, as having to re-paper thousands of accounts with new risk profiles would be an extremely large undertaking.

KNOW YOUR PRODUCT (KYP) – REPRESENTATIVE AND FIRM

Question 7) Is this general approach to regulating how representatives should meet their KYP obligation optimal? If not, what alternative approach would you recommend?

This approach is not optimal. Our members already have a long-standing regulatory regime in place through IIROC rules and guidance which recognizes that the registered representative must understand and be able to explain to the client the reasons that a specific security is suitable for the client. We support this principle. Unfortunately, the approach taken under the CSA's proposed requirements for advisors to comply with their KYP obligation is overly-broad and prescriptive, and it would be neither manageable for firms and their advisors nor optimal for clients.

In particular, we have difficulty with the proposed requirement that the advisor must understand and consider the structure, product strategy, features, costs and risks of each security on their firm's product list, and as indicated in the proposed guidance in Appendix C to the Consultation Paper, that the advisor understand the specific structure, features, product strategy, costs and risks of each product their firm trades or advises on, including an understanding of how the products compare to each other.

Our members currently employ effective tools to assist advisors in assessing the products recommended. These tools include the Risk Rating System offered by various service providers. In addition, many firms offer training about certain product classes, assistance in constructing/selecting products, etc. Some firms use designated teams that provide information on specific products on a firm's approved product list. Overall, advisors have access to sufficient information to understand the structure, fees, costs, strategy and risk of any particular product on a firm's shelf, without the requirement to understand all products at all times.

However, it is impossible for firms to ensure that their advisors have proficiency with the entire universe of products on the shelf of a firm on the IIROC platform. This can include tens of thousands of mutual funds and structured products. It is all the more problematic given the prescriptive provisions the CSA

proposes, which would include understanding the specific structure, features, product strategy, costs and risks of each product their firm trades or advises on, including an understanding of how the products compare to each other.

This standard would require the creation or sourcing of new or additional tools and resources for advisors at a significant cost, on all aspects of the products offered to facilitate comparisons, to demonstrate KYP compliance. This may introduce an artificial competitive advantage for firms with the resources to support compliance with the broad proposed requirements, as only those firms will have the ability to sustain more product offerings. The requirements will pose a competitive barrier to other firms. We question why this would be an appropriate regulatory objective.

Furthermore, the KYP requirements as proposed by the CSA, are largely unrelated to the clear suitability triggers that advisors respect under the IIROC regime which apply specifically to client transactions and all products in a client's account, as referenced in established **guidance**. The new KYP requirements would thus require a significant diversion in the advisor's focus to deal with the entire universe of products. The CSA is setting an unrealistic standard that would overwhelm advisors who will no longer be able to devote time to servicing their clients but would, by necessity, be primarily dedicated to maintaining proficiency related to all securities whether relevant for their clients or not.

As an example, with over 18,000 mutual funds, if an advisor spent even a cursory 10 minutes on each mutual fund to get a high level understanding of the products (and then documents their studies of the relevant products for evidence if necessary), that would require approximately 3,000 hours invested in preparation before an advisor could even begin to advise clients (and earn any compensation). Combined with the tens of thousands of products overall on a firm shelf, the proposed requirement presents an insurmountable burden. However, if the CSA's intention was, in fact a more circumscribed obligation that advisors know specifically the products that they sell to their clients, this would be consistent with IIROC's established standards.

The introduction of a requirement for advisors to know and understand every product on a firm's shelf would likely result in a reduction in the products firms choose to offer. This narrowing of products could have significant detrimental consequences. These may include:

- reduced diversification in client portfolios which would no longer reflect the diversity of client sophistication, risk appetite, etc.;
- reduced portfolio options available to clients;
- a widening of the advice gap for clients with the imposition of an increased minimum account size and/or only accepting "low risk" clients;
- minimizing risk by offering only low risk/low cost products;
- higher fees to offset the reduced sales of firm proprietary products by their competitors;

- diminished access to products that benefit small and medium size investors, a trend which has already begun with CRM2 and POS3 as the mutual fund product category has been abandoned by some representatives all together;
- a reduced reaction time for advisors in changing market conditions as product innovation may lag;
- removal of competitive products from firm shelves;
- creation of a non-competitive marketplace impacting many smaller firms and manufacturers;
- hindered idea generation in investor products in Canada; and
- diminished capital raising ability in the Canadian marketplace.

As recognized on the IIROC platform, the cost of a product is only one of the considerations in a suitability assessment. A narrowed shelf may likely include only the lowest cost/risk products, while other products, including what the most suitable option for client actually is, may by default, have to be excluded. We note that this impractical standard has been proposed despite its obvious significant costs to client service, product availability and a competitive market, without a clear rationale demonstrating any benefit that would outweigh those costs. Under the circumstances, we recommend that the current relevant IIROC rules and guidance continue to remain in place for the purpose of advisor KYP obligations.

8) The intended outcome of the requirement for mixed/non-proprietary firms to engage in a market investigation and product comparison is to ensure the range of products offered by firms that present themselves as offering more than proprietary products is representative of a broad range of products suitable for their client base. Do you agree or disagree with this intended outcome? Please provide an explanation.

In respect to the firm's KYP obligations, we note that there is already an established regime pursuant to IIROC **guidance** (modelled on FINRA guidance) under which our member firms have appropriate KYP processes in place, including **IIROC Guidance Note 12-0109** which states that the suitability assessment obligations include "a requirement to know and understand the characteristics and risks associated with any investment product approved or recommended to clients." The Guidance Note goes on to outline that advisors should understand, and be able to clearly explain to the client, the reasons that a specific security is appropriate and suitable for the client. Section 3.4 of NI 31-103 further requires understanding the structures, features and risks of each security recommended to a client.

Product due diligence under IIROC guidance is directed not in respect of equities and fixed income products, but at complex and non-transparent products having features such as embedded derivatives, variable maturities, complex fee structures and opaque assets. This distinction has not been made in the CSA proposal which appears to cover the entire universe of securities. We question the rationale for the proposal, which would take the focus off the key risks relating to products with complex characteristics. The IIAC also questions what problem the CSA is addressing with the objective of "ensuring that the range of products offered by firms is representative of a broad range of products suitable for their client base".

We note that the CSA has not acknowledged that the extent of product due diligence required should vary with the regulatory obligations of the dealer to its clients, nor that execution-only firms should be exempt from the “market investigation” process proposed. There are obvious challenges with conducting such market investigation for products that are chosen solely by the client at the time that they are transferred to the firm or purchased. Such a process will introduce greater cost and inefficiencies for order-execution only firms. An order execution-only firm should not be required to carry out such a review as these are all suitability exempt products which are chosen and executed entirely upon the client’s instructions.

As noted in Question 7, the proposal’s requirements, including to conduct a market investigation by “mixed/non-proprietary” labelled firms will inevitably lead to a narrowing of the product shelf as the proposal favours simply selling only proprietary products, since these firms would not need to conduct a market investigation or product list optimization.

We believe this proposal produces an inefficient solution to a currently unknown problem in the marketplace. The CSA states that the “intended outcome” of this this market investigation and product comparison is to ensure the range of products offered by firms that present themselves as offering more than proprietary products is representative of a broad range of products suitable for their client base. The IIAC believes that the opposite of the “intended outcome” will result if this proposal is implemented. The industry’s current business practices and the need to remain competitive, already produces the “intended outcome”.

9) Do you think that requiring mixed/non-proprietary firms to select the products they offer in the manner described will contribute to this outcome? If not, why not? And

10) Are there other policy approaches that might better achieve this outcome?

Please see the responses above.

11) Will this requirement raise challenges for firms in general or for specific registration categories or business models? If so, please describe the challenges.

Yes. There are a variety of registration categories, business models, client types and firm sizes supported on the IIROC platform. This diversity has already been taken into account in the development of the KYP requirements for our members. As such, the standard now in effect is not “a fair and unbiased market investigation, a product comparison and an optimization process based on the investment needs and objectives of its clients” which assumes that there is a special type of client and a very limited or specialized product niche, (e.g. mutual fund dealer), but rather provides flexibility to firms to efficiently tailor the product due diligence process to the key risks presented to their businesses and their clients. This approach allows the firm to vet products appropriately for its business, including from a cost perspective, without quashing innovation, product diversity and competition in the industry generally. It also ensures that the investment needs and objectives of its clients can be met. We note that the current process works well for our members and has established a high standard of product due diligence.

In our view, the requirements outlined in the guidance in Appendix D to the CSA Consultation Paper are overly prescriptive and unworkable for the IIROC platform. As our member firms already engage in a regular product approval process through which relevant products are scrutinized, combined with the KYP obligation of the advisor specific to his or her client-base (except in the case of the order-execution only channel), it would be redundant and unwieldy to also require that an exercise in identification of client profiles at least annually at the firm level, given the breadth of clients and business models. We disagree that this should apply at all to the order-execution only channel which the current guidance recognizes operates under a different regulatory standard. The current KYP model is based on key risks of complex products to the particular business and its clients. The order-execution only channel has dealt with this appropriately through the existing KYP process.

While we do not agree with the CSA's proposed structure for a firm's KYP process, we suggest that the CSA should consult with firms to gain a better understanding regarding their product due diligence processes and systems and tools in place to assess product suitability. We believe these already align with the proposed requirement in Appendix D to the Consultation Paper that the firm should objectively evaluate a broad range of products with active and passive investment strategies, higher and lower costs, and proprietary and non-proprietary funds, so as to inform whether any enhancements would in fact be beneficial and if so, to ensure fit within the existing supervisory structure under IIROC Rules.

We are also concerned with the new burdens that would be imposed in order to "demonstrate" that the firm "conducted a meaningful market investigation" and why this would be necessary. Firms already have policies and procedures in place for vetting new products and engage practices for KYP that are tailored to and work best for their firm. The proposal introduces numerous additional new bureaucratic and costly processes, namely:

- using research reports produced by external research report providers to identify products that may meet the investment needs and objectives of the firm's client profiles;
- conducting initial and ongoing due diligence on the research report providers they intend to rely on;
- "product comparison" conducted by benchmarking, at least annually, the shelf of products against the products identified in the market investigation to establish their competitiveness against key criteria, such as the history of risk-adjusted outperformance or underperformance over an appropriate period; features; fees, costs and other charges related to the product or being invested in the product; and risk factors that apply to the security or investment strategy (benchmarking criteria);
- product list "optimization";
- product list "compliance report" approved by the firm's UDP and board of directors (or equivalent) before finalization and implementation; and
- "prioritizing the interests of the client" in the event of a conflict of interest between the firm and its clients resulting from its product list analysis, the firm must prioritize the interests of its clients ahead of the interests of the firm (or its representatives).

As previously noted, we are of the view that these processes are proposed to validate an outcome that will be detrimental to industry competitiveness and client service and should not be adopted. We are unclear how a regulator will determine whether a product list is optimal and how they are better placed to make these assessments. We believe rather that this regime will place regulators in the position of picking "winners" and "losers" and frustrate the role of the dealer as gatekeeper and provider of products and solutions for their clients. We strongly advocate that the competitive market forces between firms and within the industry should dictate what products are on the firm shelf, subject to the already effective product due diligence process in place.

Another potential consequence of imposing this new requirement may be that dealers ask the regulators for product pre-approval in order to ensure compliance. Related to this, we submit that the CSA should at least consider making these questionable processes more efficient. For example, to the extent that the CSA is concerned that products manufactured currently are not appropriate or inadequate for the investing public, given the position of the securities regulatory authorities who review and approve prospectus-based products, the CSA may wish to consider engaging in a centralized undertaking to review prospectus-based products to ensure that the fees are justified by the target performance. This would certainly bring greater efficiency to the due diligence process rather than having each individual firm make its own assessment through a massive commitment of resources that will be required for the "demonstration" required, and which will incentivize firms to contract product shelves, sell proprietary products only or close down altogether. Similarly, we suggest that if the optimization process is deemed desirable, any comparison process should be centrally driven through the regulators, who can invest in a system to provide product comparison information to all firms rather than drive those costs down to each registrant and having a patchwork of inconsistent standards.

12) Will this requirement cause any unintended consequences? For example, could this requirement result in firms offering fewer products? Could it result in firms offering more products? And

13) Could these requirements create incentives for firms to stop offering non-proprietary products so that they can fit the definition of proprietary firm?

Yes, please see responses to preceding questions.

14) Should proprietary firms be required to engage in a market investigation and product comparison process or to offer non-proprietary products?

As we do not see the benefit of the structure of the KYP proposal, we are not supportive of requiring proprietary firms to engage in a market investigation and product comparison process or to offer non-proprietary products. We believe that firms should be free to compete under different business models.

15) Do you think that categorizing product lists as either proprietary and mixed/non-proprietary is an optimal distinction amongst firm types? Should there be other characteristics that differentiate firms

that should be identified or taken into account in the requirements relating to product list development?

The labelling of product lists as proposed is not an optimal distinction nor required at all. The Relationship Disclosure Document under CRM already requires a description of the type of products and services offered by a firm. We are also of the view that the current state wherein all firms have product lists is sufficient and effective. Firms engage in a rigorous approval process before products are included in their product list. We are not clear as to what rationale supports this distinction which is the underpinning of the KYP proposal. We have already identified, in the preceding answers, the numerous pitfalls with this distinction. The characteristics that differentiate firms are already taken into account in the current product due diligence process as previously described, without negatively impacting product list development.

58) Should we explicitly allow firms that do not have a product list to create a product review procedure instead of a shelf or would it be preferable to require such firms to create a product list?

Our member firms already *de facto* maintain product lists that are the by-product of the product due diligence process. As such, we are not clear that there would be much of a distinction in what is proposed with this question.

59) Would additional guidance with respect to conducting a "fair and unbiased market investigation" be helpful or appreciated? If so, please provide any substantive suggestions you have in this regard.

As we do not see the benefit of the structure of the KYP proposal, we do not believe additional guidance is required. We advocate that the proposal be abandoned as ineffective, especially given the lack of clear benefits intended to remedy unknown problems.

60) Would labels other than "proprietary product list" and "mixed/non-proprietary product list" be more effective? If so, please provide suggestions.

No, please see the response to question 15.

61) Is the expectation that firms complete a market investigation, product comparison or product list optimization in a manner that is "most likely to meet the investment needs and objectives of its clients based on its client profiles" reasonable? If not, please explain your concern.

We refer back to our answers to the preceding questions. As well, we note that product lists are dynamic, changing over time, and the process proposed does not provide sufficient flexibility for firms on the IIROC platform, such as by requiring a compliance report that is approved by the UDP. The current process is more practical, engaging the requisite subject matter experts from, *inter alia*, compliance, legal, finance, marketing, sales and operations. Decisions that are made include the firm's senior management, not just the UDP.

These proposed regulatory obligations, which appear to be modelled on the UK standards that label firms or advisors based on products sold, have revealed significant weaknesses as conveyed in the recent Financial Advice Market Review issued by the Financial Conduct Authority in March, 2016, such as lack of affordability of financial advice, and the curtailing of streamlined advice services to meet simple consumer needs. We therefore caution that the CSA's approach should be reconsidered in order to avoid unintended consequences in our marketplace.

SUITABILITY

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

No. The basic financial suitability obligation is premised on the assumption that all clients need or want such advice. That is not necessarily the case. A sophisticated investor may not want to engage in a discussion regarding the advantages of paying down a debt. Similarly, a client with limited resources wishing to set up pre-authorized contributions to a mutual fund may not warrant a detailed review of potential other strategies beyond the purchase of this mutual fund. This obligation fails to acknowledge the spectrum of clients out there and what may or may not be appropriate for certain clients. This is supported by the Financial Advice Market Review (FAMR) issued by the Financial Conduct Authority (FCA) in March, 2016, where one of the conclusions reached is that "not everyone wants or needs a personal recommendation in respect of every decision, nor do they always need a comprehensive assessment of all of their financial circumstances and requirements."[4]

Additionally, FAMR also found that clients tend to seek advice at specific trigger points in their life when they have a specific need. This means, "they often do not want or need full advice involving a comprehensive fact find and assessment across all of their financial circumstances and needs." [5]

This obligation also assumes that investors have all their assets at one investment dealer, rather than the common scenario where investors have business at multiple dealers. In many circumstances, clients will open an account for a particular product or service from a dealer, such as a new issue or private placement investment. The activity may only be a one-time event and the client is only visiting those dealers for that particular advice and product. This type of situation would make it extremely difficult to apply a "portfolio manager" type relationship as the client did not request this type of service. It would be impossible to satisfy this requirement without a full picture of all the client's investments.

Although section 13.2 of NI 31-103 and IIROC Rule 1300 both state that a suitability obligation requires an advisor to examine a client's current financial situation or circumstances, revising the suitability requirement to include the element of "basic financial suitability" would be a wholesale shift from the current requirement and industry best practices.

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[4] https://www.fca.org.uk/static/fca/documents/famr-final-report.pdf at p. 6.
[5] *Ibid*. at p.33.

Clearly advisors have discussions regarding their clients' current financial situation during the "onboarding" process, which this proposed rule appears to target. However, a rule mandating that an advisor decline to provide investment advice to a client and instead provide other "advice" that a client would be better off paying down a high interest debt, or directing a client to a banking product such as a savings account or suggesting that an insurance product may better fit their needs, is ill-conceived as beyond the scope of the regulator's jurisdiction and contrary to the role and expectations of an IIROC-regulated advisor.

We are not clear as to why, and on what basis, an advisor would be subject to a requirement to "determine that non-securities product strategies are more aligned with the client's needs and objectives" as outlined in Appendix E to the Consultation Paper. To impose a basic financial suitability review requirement involving non-securities product strategies would require that advisors *de facto* provide services beyond their competencies such as in the realm of financial planning or credit counselling, the regulation of which is unsettled. IIROC-regulated advisors are required to have licensing, proficiency and experience with respect to financial products, not proficiency regarding the development of a comprehensive financial plan and financial management. Expecting advisors to provide advice as it relates to non-securities products and strategies would require advisors to provide advice outside of the existing regulatory framework and require additional proficiency and expertise.

The current regulatory framework that IIROC-regulated advisors are subject to is premised upon advising and trading in securities. A requirement for advisors to conduct an investigation into "basic financial strategies", including "strategies beyond transacting in securities" that clients could use, completely shifts advisors away from the current framework where advisors are engaged in the registrable activity of advising clients on the buying or selling of, and investing in, securities.

In the circumstances, we question how the regulatory gap that will result in respect to policies, procedures, proficiency and supervision over a completely new type of activity that is purported to be mandated, will be addressed and under the governance of which regulator(s). For example, how would a review of such a standard be documented and supervised? Would advisors be expected to a keep a list of potential clients that they turned away if the advisor suggested that rather than an investment in securities products, a client would be better off directing cash into a savings account? In what manner would the advisor's basic financial suitability obligation be reviewed and against what standard?

In that regard, we also question the practicability of the proposed standard and how it could ever be met. How would this obligation be enforced by the regulator? Would the regulator, in reviewing clients that were accepted or declined, forensically audit after-the-fact whether the person with debt would have been better off actually investing in some measure so as to accumulate funds to pay off debt in the future or vice versa? We presume that it would be equally open to a regulator to determine that not having

invested was in fact detrimental to the person[6] and that an advisor could be subject to sanction in that scenario. In addition, would the assessment require an analysis of what is “good” versus “bad” debt for a person to carry, against what standard? We submit the new standard proposed is convoluted and impossible for any advisor to meet. In our view, such new standard would clearly add significant additional complexity, uncertainty and cost to the established regulatory framework, for no known or articulated benefit.

Finally, the fact that the CSA is proposing to introduce titling requirements that greatly limit the titles advisors can use to ones such as, “securities salesperson” and “restricted securities advisor”, runs contrary to the proposed basic suitability strategies obligation that would require these individuals to expand the advice they offer to essentially act as a financial planner or credit counsellor. This will ultimately also increase the cost to the investor who will have to pay for additional advice that will be mandated but that they may not even need or want.

Question 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 needs and objectives?

Given that IIROC Rule 1300 requires that registrants use due diligence to ensure a purchase, sale, exchange or holding of any security is suitable for a client based on factors including the client’s current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts' current investment portfolio composition and risk level, we do not see challenges in complying with this requirement, but only to the extent that an advisor would be making this determination based on an examination of the products contained on the firm’s product list and which they believe are suitable for the client and not the entire universe of securities and non-securities products.

The guidance provided in Appendix E to the CSA Consultation Paper under the heading General Suitability Guidance is useful when considering how the suitability obligation may be satisfied.

However, we would like clarification as to what the “most likely” standard entails, and whether that should be interpreted to mean that it is the lowest cost or “least risky” product among a variety of products that may serve to achieve the client’s needs and objectives. As previously noted in our submission, cost is just one of the factors that form part of the suitability assessment under the current regulatory framework. We also question whether regulators are better-placed to determine which product is “most likely” to meet the investment needs of clients and we have serious reservations that such a standard would impose a speculative hindsight test that would open review to an indefinite period. This is unmanageable for IIROC registrants and we advocate that the standard instead conforms to that in IIROC’s Rules.

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[6] See for example calculation of benefit of investing versus high debt load: **http://www.theglobeandmail.com/globe-investor/advisers-view/student-debt-shouldnt-stop-graduates-from-investing/article30755369/**

18) Should there be more specific requirements around what makes an investment suitable?

The IIAC is of the view that both IIROC Rule 1300 in addition to **IIROC Guidance Note 12-0109** which provides detailed guidance on KYC and suitability are enhancements that meet the CSA's regulatory objectives.

While the CSA did not specifically pose a question regarding the requirement to consider the "investment strategy" suitability requirement, the IIAC believes it is important to highlight our concerns here.

The IIAC disagrees with the proposal to require advisors and firms to identify a "target rate of return" that a client would need in order to achieve his or her investment needs and objectives, assess the target rate again the client's risk profile, and resolve any mismatches. Further, if the risk required to achieve the investment needs and objectives is higher than the client's risk tolerance, the registrant must revisit the investment needs and objectives with the client.

IIAC member firms indicate that many advisors generally do not perform target rate of return calculations. This activity is one that requires education and training applicable to either a Certified Financial Analyst or financial planner. A number of advisors do not have this proficiency level, nor are they required to. As a result, a requirement to conduct a target rate of return analysis for all clients is not possible to satisfy.

Furthermore, in order to calculate a risk-adjusted rate of return, a financial plan would be necessary as it would include a cash flow analysis. If the CSA expects advisors to provide a target rate of return, then clients would be required to pay for the preparation of a financial plan, thereby increasing the cost to clients. This may not be appropriate for all or most clients and not something clients may be willing to pay for. Some clients may not wish to spend the time necessary to track their expenditures, which is a part of the development of a financial plan. Furthermore, for those clients with limited assets, it may not be cost-effective for the advisor and/or firm to offer this service. An unintended consequence may be that firms only service wealthier clients who can afford a financial plan. As a result, an advice gap could arise whereby those clients who need advice the most, are turned away.[7]

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[7] The FAMR report stated that:

> [T]he costs of supplying face-to-face advice are significant, meaning most firms are unable to provide advice at a price many consumers would consider reasonable. As a result, many consumers who want to receive this kind of support are left without it unless they are able and willing to pay for advice. (*Ibid. at* p. 6).

FAMR also emphasized that clients with less wealth would be willing to pay some amount for advice, but are put off by its current price. As number of responses also suggested that there is a segment of the population that is unwilling to pay for advice.

Additionally, FAMR found that 45% of firms very rarely advise customers on retirement income options, if those customers have small funds (i.e. less than £30,000) to invest. (page 19). Furthermore, the proportion of firms who ask for a minimum portfolio of more than £100,000 has more than doubled, from around 13% in 2013 to 32% in 2015. (*Ibid.* at *p.* 19)

Members also pointed out that this investment strategy suitability obligation is based on the underlying assumption that if an advisor identifies a target rate of return that clients need to meet their investment needs and objectives, such a rate of return is achievable. In today's low interest rate environment, many seniors need a rate of return that will not align with their risk profile. As a result, the investment products that are deemed suitable to purchase will fail to satisfy their targeted rate of return. This puts advisors in a position where they will likely be offside the target rate of return requirement where it clashes with suitability requirements. Such a requirement will be counterproductive as it will unnecessarily increase potential complaints and confusion of clients, contrary to the objectives of CRM2 which are to bring enhanced communication and harmony to the advisor-client relationship. As an alternative that would better align with CRM2 principles, we would not oppose guidance revised to indicate a best practice of establishing "target savings" or a "contribution rate", to work toward building any necessary savings.

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

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

The IIAC and our members were somewhat confused as to what precisely the CSA was asking when posing these two questions.

If the CSA is asking if there is a suitability obligation to examine whether an instruction to hold a security exists, then we believe the current requirements set out the expectation that an advisor use due diligence to ensure a hold position is suitable for a client based on the factors set out in Rule 1300.

If the CSA is asking about a suitability obligation when a client wishes to hold an *unsuitable* security, both subsection 13.3(2) of NI 31-103 and **IIROC Guidance Note 12-0109** set out the necessary steps that an advisor should take regarding unsuitable investments, including the suggestion to dispose of the investment or recommend changes to other investments within the account to ensure the suitability of the overall portfolio. The IIAC requests additional clarification regarding the information the CSA is seeking.

20) Will the requirements 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 determine whether a firm should perform ongoing suitability assessments?

FAMR also noted that a 2016 survey, conducted on behalf of the Association of Professional Financial Advisers found 69% of advisers said they had turned away potential clients over the last 12 months. The "most common reason for this was affordability, with 43% of advisers turning away clients stating the advice services offered would not have been economic given the circumstances of those clients." (*ibid.* at p. 6)

The IIAC wishes to reiterate our concerns regarding the challenges surrounding satisfying a basic financial suitability assessment and the investment strategy suitability assessment as proposed by the CSA.

As a result, such an analysis at all, let alone every 12 months would be next to impossible.

IIROC does not require a suitability analysis at least every 12 months. The suitability analysis is predicated on clear trigger events enumerated in Rule 1300. The structure of this suitability regime facilitates enhanced supervision based on clear triggers rather than an arbitrary temporal requirement which is vague in application (given that nothing may need to be reviewed at that time in fact), and may be superseded by the other established trigger events in any event. As such, our members questioned what in fact the proposed annual suitability review would involve and what significant benefit it would purport to provide, given the stringent suitability regime in place that our members must abide by currently.

IIAC members would not oppose an annual suitability analysis on top of the rigorous regime already in place if the advisor were permitted to verbally contact the client annually to discuss and update any material changes to suitability factors such as financial situation, time horizon, risk tolerance, investment objectives and account portfolio composition. It would be expected that advisors would take careful notes of such conversations in order to properly document that such a conversation has occurred. To reiterate points made with respect under the KYC targeted reforms, we would expect the CSA to ensure flexibility for this requirement by permitting firms to use electronic methods to conduct an annual suitability analysis, including negative consent options.

However, as outlined in the IIAC comments related to a similar requirement with respect to the proposal for annual updates to the client's KYC information, extensive client documentation and signatures on an annual basis would be overly cumbersome, inefficient and costly. Again, this sort of time commitment would make it challenging from a cost perspective to service those clients with less investable assets.

Consideration should also be given to different business models, including robo-advisors without dedicated advisors available to conduct an annual suitability assessment. If such a requirement is not varied for this type of business line, it would make robo-advising less viable, further disenfranchising those clients (mostly millennials) who are primarily being targeted as potential robo-advisor clients. We would also expect that these requirements would not apply to order execution-only dealers, and we ask the CSA for specific carve-outs from all of these proposed requirements.

An annual suitability analysis that becomes a full-blown KYP analysis involving not only those products on a firm's product list but other securities as well, would be an excessively expensive and time consuming exercise. Further, the technology piece to ensure advisors are notified when an annual analysis is required for each client, and to track and confirm that these annual reviews did occur would be extremely costly.

As the FAMR report has stated, "providing high quality, professional financial advice is costly. It therefore will be expensive for consumers, particularly compared to the amount most people have to invest or

save."[8] This cost is highlighted by the FCA reporting that financial advice costs on average, £150 per hour, with an adviser typically spending nine hours giving advice on a pension.[9]

It is also important to note that a successful suitability analysis is dependent upon the client-advisor relationship and as part of that relationship, clients would have an obligation to be a willing participant in an annual suitability review. Many clients are not necessary willing to invest the time in such an exercise. The CSA should be cognizant of this issue when contemplating mandating a requirement that advisors may not always be able to satisfy in all circumstances as it is dependent on the client being an active participant.

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?

Please see our comments under Question 18 as to why advisors do not, cannot and should not be required to conduct a target rate of return analysis.

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?

No. IIROC rules currently contemplate that a suitability review will occur when recommendations to buy, sell, hold or exchange are made. The analysis of not purchasing, selling, holding or exchanging is simply the opposite of purchasing, selling, holding or exchanging - recommending any one of these actions automatically necessitates contemplating the opposite action. When an advisor is contemplating a recommendation not to sell a security, that would necessarily include an analysis of whether it is more advantageous to hold that security. Similarly, a recommendation not to hold a security, would necessarily include an analysis of whether it is more advantageous to sell that security.

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 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.

When an advisor identifies a product that is suitable, he or she must make that determination using factors including the investment objectives of the client as set out in IIROC Rule 1300 and paragraph 13.2(2)(c) of NI 31-103. We are concerned however, to the extent that this would be changed under a "most likely" standard, as discussed in question 17, to lower the advice given to the lowest common denominators being lowest cost or risk products only rather than undertaking a full and complete suitability analysis that actually meets the client's needs and objectives. This harms investors in a number of ways from narrowing of the product shelf, limitation in range of advice and untenable costs of having

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[8] *Ibid.* at p. 13.
[9] *Ibid.* at p.19.

to know and compare the entire universe of products as described in the KYP submission. We also note again that CRM2 disclosure is intended to bring transparency to product costs as well.

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?

The IIAC does not believe this question is applicable to our members. It appears more applicable to MFDA, scholarship plans and EMD registrants.

RELATIONSHIP DISCLOSURE

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

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

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

These questions are not applicable to IIAC member firms offering both mixed/non-proprietary products.

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

The IIAC is unclear about what "similar" disclosure the CSA is referring to. IIROC Rule 3500 - Relationship Disclosure already clearly sets out that members must provide clients with a description of the types of products and services offered, a description of the account relationship as well as a description of the process used to assess investment suitability. We believe that the disclosure provided pursuant to IIROC's existing rule is robust and we question the rationale for any additional disclosure requirement given the systems changes and costs that would be necessary to engage in reframing and re-issuing the disclosure to clients after extensive work by the industry to comply with the existing rule has been completed. In addition, we expect that the CSA's proposed titling reforms would enhance clarity respecting the products and services that an advisor can provide.

We do, however, support changes to the existing regime to the extent that the relationship disclosure requirements for non-IIROC firms would be raised to the level already adhered to by investment dealers and portfolio managers on the IIROC platform.

We would suggest that the CSA rephrase Question 26 to clarify its intent.

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

No. The IIAC does not believe that additional guidance is necessary. IIROC Rule 3500.4 clearly requires that firms ensure that the relationship disclosure is written in plain language that communicates the information to the client in a meaningful way. In addition, Companion Policy 31-103 states that advisors should spend sufficient time with clients to adequately explain the information that is delivered to them. We believe these existing standards are appropriate and have already provided sufficient guidance to firms in the development and delivery of their relationship disclosure documents. Moreover, we do not know of any significant problems in respect of the relationship disclosure information that has been provided to clients under the IIROC Rule that demonstrates any issue with the quality of the disclosure.

We wish to note that the SROs require the RDD content to be separately labelled as such. We believe this enhances the ability to make relationship disclosure to clients clear. In that regard, we would suggest that as this is not required for other registrants, this should be mandated rather than simply suggested guidance, to conform to the higher SRO standard.

We are however concerned with the proposed *General Disclosure Guidance* under Appendix F on this matter which states that registrants "should have a reasonable basis for concluding that a client fully understands the implications and consequences for the client of the content being disclosed." As we have outlined with respect to a similar expectation under the Conflicts of Interest targeted reforms, this is effectively a standard subjective to the client that cannot possibly be met by advisors. Advisors would have the impossible onus to prove that the client understood the disclosure which will never be met if the client claims that they did not understand the disclosure, whether it was the case or not. We submit that this standard will increase client complaints unnecessarily and this guidance should be deleted as unnecessary and contrary to the CRM2 initiative which supports enhanced and harmonious client and advisor communications.

Additional Concerns

The IIAC has some concerns with the language set out in the Relationship Disclosure targeted reforms as well as Appendix F to the Consultation Paper.

The policy rationale for the proposed requirement that firms offering a mixed/non-proprietary list of products disclose the proportion of proprietary products they offer is unclear. Any potential conflicts that may exist with the offering of proprietary products would already be properly addressed through the conflicts of interest requirements. We question what is intended to be achieved through disclosure of the proportion of proprietary products a firm offers. We are unaware of any impact on clients related to whether 20 percent of products which are proprietary. We are unclear as to any impact on clients related to whether 20 percent or 90 percent of the firm's products are proprietary. It is unlikely to change client behaviour.

We urge the CSA to articulate what, if any, gap is proposed to be addressed with this new disclosure, which would require firms to incur costs to put systems in place to track inventory changes in their products and to amend and re-issue the relationship disclosure document which was recently introduced in March 2013 for new clients and in March 2014 for existing clients.

We also wish to clarify a point not expressly addressed in the proposed guidance, namely that IIROC provides firms with flexibility regarding whether tailored relationship disclosure is provided for each and every client. We would expect the same standard be maintained by the CSA. While IIROC members may choose to provide customized relationship disclosure to each client, firms also have the option to provide appropriate standardized relationship disclosure to separate classes of clients – for example, advisory account, order-execution service account or managed account categories. The same flexibility of how disclosure is provided to each client also applies to the description of the process to assess suitability and the suitability triggers. Accordingly, we expect these disclosures would not be explicitly tailored such that, for example, the increased frequency of managed account suitability reviews does not need to be specifically included. We caution that the relationship disclosure document will otherwise become overly lengthy and detailed and consequently, not meaningful to clients.

Finally, both Appendix F to the Consultation Paper and IIROC Rule 3500 require the relationship disclosure to include a description of the firm's conflicts of interest. However, Appendix F suggests that the firm provide clear disclosure that the firm "has been retained by third party issuers to find buyers for their securities." We question whether the CSA actually expects firms to individually list all issuers that fall into this group in their relationship disclosure document.

PROFICIENCY

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

The IIAC supports of the need for advisors to have the requisite proficiency, skills and training to advise clients in the financial services industry. The IIAC has always maintained that IIROC advisors are professionals who must satisfy rigorous education and proficiency requirements in order to become IIROC approved registrants.

However, we are concerned by the statement under the Proficiency targeted reforms (1) that "all representatives must generally understand the basic structure, features, product strategy, costs and risks of all types of securities, such as equities, fixed income, mutual funds, other investment funds, exempt products, and scholarship plan securities", and (2) that representatives should have "increased proficiency regarding how product costs and investment strategies (e.g. active vs passive) can impact investment outcomes for clients."

These universal proficiency expectations appear contrary to the current registration regime based on distinct individual categories of registration as set out in NI 31-103. NI 31-103 recognizes that different categories of registration such as IIROC or MFDA registered advisors, portfolio manager advising representatives, and dealing representatives of scholarship plan dealers and exempt market dealers, have different levels of initial and ongoing proficiency requirements due to their different types of expertise and offerings. None is expected to know the entire universe of products that exist. The category of registration determines the registrant's ability to advise clients in all or certain products only, so we question why has the CSA now required that all registrants understand the basic structure, features, product strategy, costs and risks of all products? For example, why would a scholarship plan dealer have to learn the details of a fixed income products? Is the CSA expecting a mutual fund advisor to have the same level of proficiency as a portfolio manager?

If a universal level of proficiency is required, the individual registration categories in the regulatory framework would not be viable. This would represent a significant change to the current registration regime in NI 31-103 and impact the SRO platforms which currently have different mandates given service limitations for mutual fund dealers. We also note this structural change could lead to product arbitrage if advisors abandon their securities licenses and move to a less onerous platform like insurance products.

We have concerns with the level of knowledge the CSA is expecting of advisors. As we indicated above in relation to the KYP targeted reforms, while tools may be available to advisors within their firms to assist them in understanding products on their firms' shelves, (including security risk ratings, internal teams designated to provide product education, or subscriptions to third-party investment research publications which may also provide comparative information on products including strategies and fees), this does not mean that they have knowledge of every security that the firm may trade or advise on, nor is this currently mandated. Such a requirement would be unreasonable and unachievable.

The proposed Proficiency targeted reforms as currently framed are far too broad and unworkable given the individual registration categories that exist today and the practical limitations on the scope of product knowledge reasonably achievable by advisors.

For the CSA to consider such a broad change to the expected skills, experience and education of registrants, a fulsome cost-benefit exercise should be undertaken to consider the impact of such a change and the actual benefits to flow to clients. Furthermore, this proposal fails to recognize the range of services currently offered to help service the wide spectrum of clients who do not all want the same products and advice. As we have previously described, a one-size-fits-all model will lead to unintended consequences - mostly notably, the impact of the cost of providing such advice to all clients will necessarily increase the costs borne by all clients, thereby forcing many into "DIY" solutions that may not be the most appropriate.

However, the IIAC is committed to increased professionalism in the investment industry and is willing to work with the securities commissions, SROs and education providers such as the Canadian Securities Institute to offer increased proficiency in areas such as conflicts of interest and suitability. The timing of

such an initiative would dovetail well with IIROC's recent initiatives regarding a review of proficiency requirements, competency standards and course content for many of its mandated courses and examinations.

We believe that increased professionalism in the industry will help to decrease the need for new regulation. Notably, under **Rule 2900**, IIROC already has stringent proficiency standards under which registered representatives, investment representatives and supervisors must pass the Conduct and Practices Handbook (CPH) course, which includes instruction on the Code of Ethics and Standards of Conduct. This evidences the importance and focus our members' training has on professionalism. Higher standards for registrants at the time of entry and qualification for work in the industry generally may diminish the need to increase regulatory burden and layer on requirements after the fact. This would shift the focus from regulation to proficiency and professionalism, offering greater up front rigor and clarity for advisors or other registrants as to expectations for appropriate conduct.

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

The IIAC fully supports increased proficiency requirements for CCOs to bring other non-SRO registrants in line with IIROC's higher standard set in **Rule 2900**. IIROC currently requires CCOs to pass both the Chief Compliance Officers Qualifying Examination and the Partners, Directors and Senior Officers Qualifying Examination. However, the proficiency standard in NI 31-103 only requires CCOs to pass one of these two exams.

We do not see the necessity or benefit of increased UDP proficiency requirements. The UDP is either the CEO, sole proprietor or senior officer in charge of a division of a member firm, and is, by definition, an experienced and seasoned professional with a high degree of knowledge and expertise in their field. The UDP holds primary responsibility for supervision and compliance of the firm, including holding employees accountable. Moreover, the personal liability they bear reinforces the UDP's accountability in performing these duties and expectations

The IIAC is unaware of any issues or problems with respect to CCOs and UDPs at IIROC member firms and as such, we do not recommend further changes to the current expectations for these individuals.

TITLES

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

This depends upon how the titles are regulated. See the response to Question 31.

Question 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?

The IIAC supports limiting the range and number of titles currently used in the industry to the extent that this in fact enhances clarity for investors. We agree on the need to diminish confusion around representatives' roles and responsibilities.

However, we are of the view that the alternatives presented by the CSA are overly prescriptive or generic and have the potential to be misleading. As a result, contrary to intention, this would not necessarily alleviate client confusion.

For example, we believe that many of the titles should refer to the products being offered to help provide more clarity. For example, the title "restricted securities advisor" is ambiguous but could be clarified if changed to "mutual fund advisor" or "scholarship plan advisor" so that clients would be aware of what product the advisor is "restricted" to.

In addition, we have concerns with the requirement that a representative of any firm that offers only a proprietary list of products be referred to a "securities salesperson". That would mean that a portfolio manager who works for a firm selling only proprietary products, could only use the title "securities salesperson". Such a restriction on titles is misleading and this constitutes a disservice to clients. Furthermore, we are concerned that characterizing registrants as "salespersons" is incompatible with holding registrants to a best interest standard.

The titles proposed further fail to recognize the unique challenges of our integrated dealers who offer independent channels with separate offerings. Such dealers want to ensure that any new title restrictions can be appropriately used among their different channels and adequately reflect the services their advisors offer.

The proposals also neglect to address Investment Representatives and other registrants in assistant roles. It is also unclear if a portfolio manager that has both discretionary and non-discretionary clients would require two different business cards and two different titles.

The IIAC also suggests that the CSA permit the use of the qualifying term "senior" for title categories in order to recognize and distinguish those advisors who have significant experience and expertise. We believe this is very informative for clients when choosing an appropriate advisor.

Given these challenges, the IIAC would be pleased to work with the CSA and SROs to develop rules respecting the usage of titles that would account for these issues and be helpful to investors.

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

Yes. The IIAC supports additional guidance regarding the use of titles by those who are dually licensed. This would include those that may sell insurance or who have met the requisite proficiency requirements for a Financial Planner or CFA. This would help clients gain further clarity regarding the nature of the products and services offered by their advisor.

DESIGNATIONS

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

Yes. The IIAC supports the proposed Designation targeted reforms, including the language set out in Appendix G to the Consultation Paper. It appears that Appendix G is based upon **IIROC Guidance Note 14-0073 *Use of Business Titles and Financial Designations***. The IIAC recommends that the Guidance Note be adopted by the CSA to provide clarity regarding the responsibilities of firms and their registrants who deal with retail clients with respect to the use of both titles and financial designations.

The Guidance Note sets out best practices that firms should use to properly supervise the use of titles and designations. This includes the use of a pre-approval process for any titles or designations. This practice is employed by all IIAC member firms today.

ROLE OF UDP AND CCO

Question 34) Are these proposed clarifying reforms consistent with typical current UDP and CCO practices? If not, please explain.

The IIAC is of the view that these clarifying reforms are generally consistent with typical UDP and CCO practices. However, with respect to the actual language in the proposed Conflicts of Interest targeted reforms, we reiterate our concern with the proposed requirement to act in a manner that "prioritizes the interests of the client."

We agree with the description of the role of the UDP who supervises the activities of the member and is directed towards ensuring compliance with SRO regulatory requirements and securities laws as well as promoting compliance within the firm. The CCO, on the other hand, has the responsibility to establish and maintain policies and procedures for assessing compliance by the member with applicable SRO regulatory requirements and securities laws.

It should also be noted that in addition to **IIROC Rule 38 *Compliance and Supervision***, which sets out the duties and requirements for supervisors, UDPs and CCOs, IIROC **Guidance Note 12-0379 *The Role of***

Compliance and Supervision, further describes IIROC's expectations with respect to the compliance function at member firms as well as the role, responsibility and accountability of firms, and their management and compliance departments, including specifics regarding both the CCO and UDP roles.

STATUTORY FIDUCIARY DUTY

Question 35) Is there any reason not to introduce a statutory fiduciary duty on these terms? (client grants discretionary authority)

Yes. The IIAC questions the purpose and impact of amendments to provincial securities legislation to include a statutory fiduciary duty for registrants when they manage the investment portfolio of a client through discretionary authority granted by the client. The proposal references the term "fiduciary duty" as distinct from the regulatory "best interest" standard which is also proposed for registered dealers and advisors, and in contrast to the best interest language already in place in those few jurisdictions that have a statutory provision. Under the proposed framework, advisor and dealer registrants who are portfolio managers would appear to be subject to a statutory "best interest" standard that the Jurisdictions with Concerns about a BIS indicated is intended to establish a "true fiduciary duty" and a regulatory best interest standard that is indicated not to be a restatement or formulation of a fiduciary duty.

The CSA has not articulated what, if any, problem exists with the existing civil liability standard in the majority of provinces without the statutory standard, why only a minority of provinces adopted a best interest statutory provision originally, and what the impact will be of imposing multiple standards that in some cases employ the same terminology but mean different things, which appears to increase complexity needlessly.

The IIAC is unclear as to the difference between the fiduciary standard for civil liability, the statutory fiduciary duty and the regulatory best interest standard in the case of portfolio discretionary management and how they would be interpreted and applied together. At the very least, the proposed overlapping standards for portfolio managers would create uncertainty for these registrants as well as confuse investors respecting what they can expect.

We are also unclear if the CSA intended to capture those advisors who are granted discretionary authority on a temporary basis, as permitted under IIROC Rule 1300.3. These accounts are not "managed accounts" overseen by a portfolio manager, and generally will not have a term of more than 12 months, and are only be renewable in writing. Would such advisors also be subject to this proposed statutory fiduciary duty as they technically have been granted discretionary authority by the client.

We believe this proposal will likely bring about an environment of increased legal and regulatory complexity, client complaints and discord, contrary to the objective of CRM2 to promote better collaboration and understanding within the client-advisor relationship. In the circumstances, we do not

see anything that would be gained with the inclusion of regulatory liability, and believe the consistency of the application of the civil standard is preferable.

REGULATORY BEST INTEREST STANDARD

Question 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 concerns.

The IIAC does not believe a regulatory best interest standard is either required or beneficial. The current statutory duty to act 'honestly, fairly and in good faith', together with SRO rules and the potential adoption of relevant targeted reforms are sufficient to meet regulatory objectives while accommodating a variety of business models for the distribution of securities in Canada. We support the high standards already set by IIROC which are consistent with the objectives of the targeted reforms, aligned with the CRM2 initiative, and which work practicably with the diverse business models of our members on the IIROC platform across all jurisdictions.

We are very concerned that introducing a best interest standard in certain jurisdictions will further compound unintended consequences of increased complexity, costs and regulatory arbitrage between jurisdictions. It is unclear how IIROC would have to structure its rules in these undesirable circumstances. We question why certain regulators have proposed to proceed despite the lack of consensus among CSA members regarding the best interest proposal and given that consensus was acknowledged as necessary for this reform to proceed; and when other significant "client-focused" regulatory initiatives, namely POS and CRM2, that have only recently been implemented fully or in part, have not been analysed to determine their effectiveness.

We agree with the BCSC that the application of a best interest standard is incompatible with the fundamental conflicts of interest that are permitted, such as selling proprietary products, and which the CSA clearly intends to continue to allow. As such, we maintain that the best outcomes for investors are able to be achieved currently by our members under the robust requirements set by IIROC. We look forward to working closely with IIROC where the SRO has identified certain areas of improvement for its registrants, such as noted in IIROC **Guidance Note 16-0068,** to assist firms with effectively managing compensation-related conflicts of interest. We believe IIROC is better placed to identify and address any specific gaps affecting IIROC registrants and can provide workable, meaningful and targeted measures to support any desired further alignment of our members' interests with those of their clients.

Question 37) Please indicate whether you agree or disagree with any of the points raised in support of or against, the introduction of a regulatory best interest standard and explain why.

Cost-Benefit Analysis Needed

While the BIS Consulting Jurisdictions have provided their view of the benefits of adopting a regulatory best interest standard, they have not examined the anticipated costs of that proposal (nor of the targeted reforms). The IIAC recognizes that a regulatory best interest standard has not yet been proposed as a rule, however the complete absence of a cost-benefit analysis [10] undermines the effectiveness of the consultation on the adoption of such a "governing principle" together with targeted reforms. The IIAC has previously asked the securities regulators to conduct such an analysis in order to provide the necessary objective analysis concerning the proposed reforms.

The CSA noted in its original consultation paper issued in October 2012 (the "Original Consultation Paper") that, "a cost-benefit analysis and/or market impact analysis has been conducted to varying extents on the proposed reforms in each of the U.S., U.K., Australia and the E.U.[11]". We question why the CSA has failed to conduct a similar analysis in the Original Consultation Paper or, with the benefit of time and the comments received in the close to four years since, in the current consultation on the same subject. This analysis should be conducted and articulated in advance of rule formulations. Otherwise, this proposed regulatory initiative cannot be measured against the objective which it is intended to address.

The Jurisdictions with Concerns about a BIS contend that it is uncertain whether the proposed standard will drive better behaviour by registrants and at what cost any changes in behaviour will come. We urge the BIS Consulting Jurisdictions to complete a cost-benefit study before any reforms are contemplated. As a starting point, the IIAC has gathered cost information from its members relating to the targeted reforms in order to provide some context related to impacts associated with such "reforms", a summary of which is attached at Appendix C. The IIAC looks forward to continuing this discussion with the CSA to determine the complete costs and benefits of this initiative.

Expectation Gap

As the Jurisdictions with Concerns about a BIS point out, a best interest standard would not, in fact, close an expectation gap that some regulators assert exists but would rather unintentionally create one given the incongruity between the actual nature of activities engaged in the investment industry and the expectation that would be created with the uniform imposition of the highest legal standard to all those activities.

Given the range of business models and registration categories, including proprietary business models, it is not feasible for registrants to meet a "best interest" regulatory standard in all circumstances. This challenge also exists in firms that are affiliated with businesses that create the investment products that

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10 See, for example, as set out in section 143.2(2) of the *Securities Act (Ontario)*. This section requires that a notice include a "description of the anticipated costs and benefits of the proposed rule."

11 See Question 20 of the Original Consultation Paper.

they sell. Furthermore, such a standard disregards the transaction-based relationships in which advisors act solely as order takers. In these situations, there is no reliance and clients expect their advisors to simply execute orders. The standard in that case cannot be as high as when there is reliance on an advisor for advice. Even if the client relies on the advice, the client retains ultimate decision-making authority. The relationship cannot be elevated to the same standard that would apply when the advisor exercises discretion.

The current registration regime aligns with a graded standards structure, practically recognizing that expectations and protections must be commensurate with the type of relationship the advisor actually has with the client. While it is asserted that the standard of care is not intended to interfere with the registration categories under securities legislation, we again question the practical viability of the current registration regime in an environment where there would be one standard imposed on all registrants regardless of their proficiency and relationship to the client. We believe that this may lead to the elimination of other existing transaction-based business models in favour of portfolio management, which may be contrary to the best interests of clients as it reduces choices and cost-effective models to fit client needs.

The regulators fail to recognize that clients vary in terms of their level of participation, sophistication and needs regarding the services for which they seek an advisor. The spectrum is extremely wide and thus a model that assumes a common standard can or should be applied to all clients is misguided.

In the non-managed account business, client participation and sophistication can vary dramatically. The advisor may only minimally be providing recommendations and the client will direct what is purchased or sold. Often, these clients have a number of non-managed accounts at different firms that are mostly transaction-based. These clients are looking for access to capital markets rather than seeking advice and take interest in making their own decisions.[12]

With the context of the varying degrees of client sophistication and self-direction, it appears that certain regulators have also failed to account for the fact that a non-managed account (where a new best interest standard would apply), the advisor makes recommendations but the client retains final discretion as to whether or not to purchase, sell or hold an investment. For these accounts where clients retain ultimate discretion and decision making authority, a best interest standard in fact creates greater uncertainty as to the degree of reliance a client can and should have with respect to his/her advisor. Some clients would therefore believe that a best interest standard alleviates the requirement that the client make the final decision with respect to their account. Clients' responsibility cannot be eliminated for this type of account.

[12] In addition, the order execution-only model contemplates no recommendations as client orders are unsolicited and the client is fully in control of the orders and transactions that they execute in their accounts. The order-execution only business should be carved out of these requirements due to its self-directed nature and that the client has no expectation of advice or an assessment being performed.

This is different from the managed account or portfolio manager model where the client places complete reliance on the advisor and is not involved in the day-to-day managing of the account, including determining what investments are in the account at a given time. The advisor has complete discretion over the account, subject to the client's risk tolerance and objectives.

Imposing a best interest standard for all accounts would create a situation where clients may claim absolute reliance on advisors, despite the fact that the client has the ultimate discretion over, and responsibility for, their non-managed account and investments. Contrary to the assertion that such a standard is "more objective", resolving any suggested expectation gap in the client's favour in all cases through a uniform best interest standard provides clients with an unrealistic level of protection which may absolve them inappropriately of any responsibility and puts dealers and registrants who necessarily are not entirely free of conflicts of interest, offside.

The best interest standard does not therefore enhance the client's relationship with their advisor but distorts it by imposing an artificial trust relationship. We agree completely with the observation of the Jurisdictions with Concerns about a BIS that the proposed best interest standard may cause "investors to completely absolve themselves of any responsibility for their investment decisions."

We are concerned that the regulators seeking to impose a uniform best interest standard may be fostering such an outcome and we question their policy rationale for doing so.

We also question the foundation for the assertion that this would close a gap respecting advisors who feel they already adhere to the best interest standard of conduct. There is no evidence cited to corroborate that what these advisors "feel" they are providing would actually meet the proposed standard if applied. It appears rather that those advisors may simply be applying the standard of care, which includes the obligation to act "honestly, fairly and in good faith". By following the existing standard, these advisors already maintain "high standards of integrity" which they are credited with, but this does not validate that they are achieving the best interest standard.

Vagueness of Best Interest Standard and Legal Uncertainty

We support the points raised by the Jurisdictions with Concerns about a BIS concerning the vagueness and legal uncertainty that would be created by the proposed regulatory best interest standard. To mitigate confusion and legal risk when employing best interest as a "governing principle", existing transaction-based advice business models may be abandoned leaving only portfolio management as a business that may align with the standard of care.

Most of the five guiding principles for compliance with the best interest standard of care are already addressed in practice through clear IIROC Rules such as the requirement to provide relationship disclosure, a conflicts rule that requires registrants to address conflicts of interest in a manner consistent with the best interests of the client and a standard of care rule that does not permit negligent or

unbecoming business conduct. These rules are actionable by our members and achieve regulatory objectives reasonably without a best interest standard.

The principles to "act in the best interest of the clients", and "prioritize the client's best interest" would, however, create significant uncertainty for registrants. Notably, there is an absence of language in the proposal to fully explain what these principles mean and how they would be applied by the regulator.

Principle 1, which is the cornerstone of the proposed standard of care, provides a scant 8-line paragraph of interpretation that is generalized and virtually meaningless. In particular, how can registrants "monitor their clients' outcomes to confirm that their dealings with their clients are in fact achieving what is best for the client"? Who determines that a registrant actually achieved what is "best" for the client? This language fails to assist registrants in understanding the potential operational implications and factors that would determine non-compliance. Moreover, regarding Principle 2, how are clients' interests to be "prioritized" when disclosure is deemed inadequate and it is necessary thus to always avoid conflicts? Would a firm specialized in proprietary products have to terminate its business because it cannot put the client's interest first by recommending a non-proprietary product?

As the CSA Consultation Paper indicates, other regulators that have implemented a best interest standard have faced challenges with the uncertainty it creates. The Australian experience with a "catch-all" provision, similar to Principle 1, was considered costly, subjective in nature and too open-ended, creating uncertainty for advisors. Industry expressed concerns that the provision was unclear due to its open-ended nature and created significant legal uncertainty on how advisors can actually satisfy the best interest duty. Stakeholders also argued that the proviso renders their "safe-harbour" protection unworkable[13].

These views are contrary to the position of some of the CSA jurisdictions that a regulatory best interest standard would be more "objective" than the current standard of care to deal fairly, honestly and in good faith. The standard is not more "concrete", despite the assertion of the BIS Consulting Jurisdictions that securities regulators can appropriately express a regulatory best interest standard. To date globally, there has been no effective expression of what that standard means and how it applies to the entire universe of businesses and client relationships that would be covered in the Canadian market, nor have the BIS Consulting Jurisdictions clearly resolved this issue with this proposal. To the extent that certain professional associations or global standard setters have alluded to a best interest standard, this does not inform the imposition of a regulatory standard to be defined by the regulator at the time an assessment of a breach of rules is being considered – a "we will know what the problem is when see it" approach, a risk which registrants will not be able to mitigate.

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[13] See Australian Government **Options-Stage Regulation Impact Statement** (November 2013) at p.7.

We further agree with the jurisdictions that stated that there are tensions between the proposed standard and the more specific requirements, which may create uncertainty for registrants. The conflicts between the proposed standard and requirements for firms that sell only proprietary products cannot be reconciled and could only cause increased confusion for clients.

This experience also contradicts the assertion made by the BIS Consulting Jurisdictions that the content of the regulatory best interest standard is "more tailored to the client-registrant relationship than a statutory fiduciary duty would be". The uniform application of an open-ended best interest standard to all registrant relationships cannot be characterized as "tailored" to the client-registrant relationship.

The application of fiduciary duty standard to discrete registrant relationships, however, does constitute an appropriately tailored standard. It is also contrary to the assertion of the BIS Consulting Jurisdictions that a best interest standard has the "upfront clarity and specificity we require, and that registrants expect, regarding registrant conduct standards that apply on a day to-day basis". We query the foundation for this view given that registrants will be subjected to the ongoing uncertainty related to the unclear evolution of the nebulous standard, opposite to their expectations.

It was also remarked that it is unclear how the courts or regulators will enforce such an ambiguous standard and how registrants might modify their behaviour to comply with differing interpretation of what the standard requires. Given this vagueness, firms and registrants will seek to comply in a variety of ways with little consistency from firm to firm, further demonstrating that an objective standard of care cannot be achieved.

CRM2 and Point of Sale Initiatives Intended to Improve Communication

As previously stated in this response, we echo the view of the Jurisdictions with Concerns about a BIS that there should be a determination of whether the CRM2 and POS reforms are effective before proceeding with consideration of a best interest standard. Effort should be made to ensure that any new reforms be considered in the context of whether they would align with, or detract from, these other client-focussed initiatives. To the extent that, as noted, there is a significant risk of added complexity, cost, client complaints and other obfuscation of the client-registrant relationship that would detract from the objectives and success of CRM2 and POS, we believe that they are counterproductive and should be rejected given the significant effort and costs that have been expended as well as buy-in garnered with the industry. We believe that it is not appropriate to engage in regulatory initiatives that contradict or degrade the underpinning of these other recent client-centred regulatory initiatives in the circumstances.

Question 38) Please indicate whether there are any other key arguments in support of or against, the introduction of a regulatory best interest standard.

Question 39) What impact would the introduction of the proposed targeted reforms and/or a regulatory best interest standard have on compliance costs for registrants?

Given that the CSA has stated that the regulatory best interest standard is intended as a governing principle, meant to govern the interpretation of the more specific targeted reforms, which in fact operationalizes the best interest standard, we have not commented on the specific compliance costs related to a best interest standard. We refer to our cost of compliance study, attached as Appendix C.

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

Our response below focuses only on the regulatory best interest standard as we have discussed the potential outcomes for investors in our responses to the targeted reforms.

Question 41) What challenges and opportunities could registrants face in operationalizing:

(i) the proposed targeted reforms?

Our response below focuses only on the regulatory best interest standard as we have discussed the operational challenges for registrants in our responses to the specific targeted reforms.

(ii) a regulatory best interest standard?

Question 42) How might the proposals impact existing business models? If significant impact is predicted, will other (new or pre-existing) business models gain more prominence? and

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

We are responding to Questions 38 through 43 together.

As the IIAC has stated previously, the industry should provide high quality advice to clients and we support the robust standards already existing on the IIROC platform which align with that objective. In general, the securities industry in Canada has proactively advanced a regulatory regime to provide clients with appropriate investor protections and high standards of service and professionalism. A regulatory best interest standard should not be implemented by the CSA nor any particular jurisdiction(s) within the CSA if there has not been full implementation and evaluation of the most recent changes in the securities regulatory regime (i.e. CRM2 and POS) and consideration given to the negative consequences for both investors and the industry, including: reduced choice among business models, reduced access to financial products, decreased affordability of financial advice, uncertainty regarding the obligations with the client-advisor relationship, subjective compliance and operational requirements, and increased exposure to risk and liability for firms and advisors.

<u>Reduced Choice</u>

A best interest standard would reduce client choice among products and services that may be needed to fulfil the specific needs and objectives of clients. The industry has developed a variety of different business models to provide services to different types of clients, with different needs, some of which would be inconsistent with a best interest standard.

For example, as the CSA has identified, certain dealers and advisors offer proprietary products, or a limited shelf of products. These services are often more appropriate for smaller or less affluent retail investors who do not have the experience or the need to invest in a broad range of products.[14]

It is unclear how the best interest standard is meant to be applied in the context of this business. As the BCSC recognized, there are tensions between the proposed standard and regulatory requirements, such as the suitability requirements that would be applied for a firm selling only proprietary products. How does an advisor meet a best interest standard when it is possible that a non-proprietary product would be in the client's best interest? It is unclear how the courts, regulators and firms will interpret a best interest standard absent jurisprudence in this area. If the CSA's proposed best interest standard is ultimately interpreted as requiring dealers and advisors to offer a broader range of products to clients, this will significantly impact those dealers whose business model is based upon a limited product shelf. Mutual fund dealers in particular would be negatively impacted by such an interpretation.

There will also be a significant impact to investment dealers offering commission-based transactional business models if they are determined not to be in clients' best interests. Given the legal implications and inherent risk associated with a best interest standard, it is likely that many firms would consider simply offering managed accounts to their clients, thereby pushing smaller and middle-class investors out of the advice market. Additionally, those who chose to stay with the advisor relationship and move to a managed account would see reduced choice in products available as most firms limit the shelf of products available in managed accounts.

The proposed best interest standard articulated in the Consultation Paper also fails to clarify how the best interest standard would operate with other business models or the offering of specific products, such as high risk products, principal trading and underwriting (please see detailed discussion under the heading *Reduced Access to Financial Products*). The lack of clarity contained in the proposed Consultation Paper related to a best interest standard, creates uncertainty not only from a business perspective but from a legal one as well.

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[14] The FCA has pointed out in its FAMR report that many clients who are "seeking support through guidance or limited forms of advice are either unable to access support or end up paying the cost of full advice, even when their needs are comparatively simple." FAMR recommended making the regulatory landscape clearer that that firms could develop more streamlined advice services that meet simple consumer needs. (at p. 6).

Without clear details and criteria as to what is in the "best interests" of every client, it will be difficult for advisors and firms to understand how to comply, and the legal implications of a best interest standard are unclear as both the regulators and courts will have to develop new precedents in this area.

Other jurisdictions such as Australia and the U.S. have recognized issues surrounding compliance with a vague best interest standard and as a result, developed "safe harbour" provisions. In Australia, these provisions include identifying the objectives, financial situation and needs of the client, assessing whether the provider has the expertise required to provide the client advice on the subject matter sought, and conducting a reasonable investigation into the financial products that might achieve those objectives, etc. The U.S. Department of Labor (DOL) recognized that almost all compensation received by an advisor would be contrary to a fiduciary duty and developed a best interest contract exemption (BICE), which requires a written contract between the client and financial institution. To rely on this exemption, financial institutions must meet specific criteria (i.e. charge no more than reasonable compensation, make no misleading statements, fairly disclose fees, compensation and material conflicts of interests associated with their recommendations, etc.).

We believe that in the circumstances, better articulation by the regulators is required concerning how a uniform best interest standard would be applied and whether any activity would be exempted, or whether any criteria would be established to allow "safe harbour" to firms and registrants.

Decreased Affordability of Investment Advice

A best interest standard will result in increased and new legal, compliance and supervisory requirements for investment dealers, which will likely result in an increased cost of financial advice for clients. The impact will be borne mostly by investors with less assets - precisely the group of market participants that the OSC and FCNB argue are in greatest need of a best interest standard – and will limit their ability to fund their retirement. Increased liability for advisors and firms from higher potential damages awards and a proliferation of regulatory and litigation proceedings due to the effective "insurance" the standard provides to clients who will be absolved of any meaningful responsibility for their investment decisions, will certainly contribute to the escalation of industry costs that will need to be priced into the cost of advice for clients.

The IIAC made similar comments in response to the Original Consultation Paper in 2012, and we have since seen how the imposition of a fiduciary or best interest standard has increased industry costs in other jurisdictions and impacted investors.

Recently, the DOL made available its final regulation on the definition of "fiduciary" under the Employment Retirement Income Security Act of 1974.[15] While the rule is not yet in force and currently subject to a legal challenge, if implemented, the new rule will have a profound impact on the retirement

[15] See Federal Register, Vol. 81, No. 68, Part V, April 8, 2016.

system and how services are provided throughout the industry. Included in the 1,025 pages of regulatory text is the DOL's description of some of the changes firms will need to make to their supervisory structures in order to comply with the new rule. Policies, procedures and systems would be required to be developed that are designed to avoid a misalignment of the interests of the advisor and they interest of the investors they serve as fiduciaries. These include systems to monitor and supervise advisor recommendations to evaluate the quality of advice clients receive, systems to evaluate whether advisors rely heavily of investment products sold by or through financial institutions, ensuring conflicts are being carefully managed, systems to identify red flags, systems with respect to fee structures and compensation. Additional requirements for firms include the training of advisors and supervisors, amending policies and procedures with respect to conflicts of interest, examination of revenue sharing agreements, etc.

In April 2016, the DOL issued an in-depth Fiduciary Investment Advice **Regulatory Impact Analysis** in which the DOL estimated that the cost to comply with the final rule and exemptions will be between "$10.0 billion and $31.5 billion over 10 years with a primary estimate of $16.1 billion", mostly reflecting the cost incurred by affected fiduciary advisors to satisfy the relevant consumer-protective conditions. The DOL went on to state that "costs generally are estimated to be front-loaded, reflecting a substantial amount of one-time, start-up costs".[16]

The **Options-Stage Regulation Impact Statement** of the Treasury in Australia provided preliminary estimates of costs associated with the Future of Financial Advice amendments. One item examined related to the newly implemented best interest duty and its "catch-all" provision within the safe harbour provided. In recommending the removal of this catch-all provision as "unclear due to its open-ended nature" and for having "created significant legal uncertainty on how advisors can actually satisfy the best interests duty", the Treasury estimated cost savings at $33.3 million.

The U.S. Oliver Wyman study found that operating margins within the financial industry have been continually decreasing and that many firms will not be able to absorb any further increase in operating costs. Canadian firms have experienced a similar trend; profit margins for the industry as a whole decreased approximately 34% since 2007.

In the current economic environment, firms cannot absorb unlimited increases in operating costs without eventual cost increases for their clients. In addition, the Oliver Wyman study demonstrated that an estimated twelve to seventeen million small investors could lose access to current levels of advisory services if even two hours per year of additional services per client are required in order to satisfy the compliance, disclosure and surveillance costs associated with the heightened standard of a fiduciary duty.

The increased legal and compliance costs may result in advisors leaving the industry or becoming more selective in the clients they advise in order to reduce risk. Advisors may refuse to accept new or less wealthy clients based on concerns about costs and increased personal liability. A study conducted in 2010

[16] *Ibid*. at p. 20951

by the U.S. National Association of Insurance and Financial Advisors found that if compliance costs increased by 15%, then 31% of their members would only offer services to affluent clients, and that 20% of the members would no longer offer securities directly to their clients.

A recent study by Oxford Economics on **Economic Consequences of the US Department of Labor's Proposed New Fiduciary Standard** stated that due to the cost burdens implicit in the rules, firms will shift their business model towards fee-based advising and create a minimum balance for client accounts. These account minimums will effectively force smaller investors into self-advised or robo-advice accounts. As a result, "only investors with substantial assets will have access to financial advisors."

Similarly, in the UK, after the Retail Distribution Rule (RDR) was passed, many banks determined that it was too costly to service small investors and created accounts guidelines. These included: HSBC - minimum investment of £50,000 and minimum upfront fee of £950; Lloyds – minimum investment of £100,000 and an upfront fee of 2.5%; Barclays – minimum of £500,000 in assets for investment advice.[17]

Further, a **report by Europe Economics** found that after the RDR rule was implemented, there was a decline in the proportion of adults who opened investment accounts concentrated in the group of investors with pre-existing savings of £50,000 - £99,000 and £20,000 - £49,999 respectively.[18]

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

Reduced Access to Financial Products

Currently, advisors are able to offer clients a range of financial products and services. However, the imposition of a best interest standard on the financial services industry could restrict or prohibit certain products and activities. Unfortunately, while the CSA Consultation Paper does highlight some issues with respect to firms that offer proprietary products, the Paper does not discuss or address certain fundamental conflicts that will continue to exist in the market as between registrants and their clients and fails to articulate how the CSA anticipates a best interest standard would operate in relation to other financial products or business models.

For example, a best interest standard may preclude advisors from being able to act as principal (e.g. providing liquidity through market making and principal trading) or sell securities they have underwritten

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[17] See **http://www.telegraph.co.uk/finance/personalfinance/investing/9793587/Banks-New-feesrevealed-for-cost-of-investment-advice.html**, and **https://wealth.barclays.com/en_gb/home/wealth-management/who-we-help.html**.

[18] See also FSI Briefing (2015) "Foreign Experiences Indicate DOL Fiduciary Rule Proposal Could Have Significant Unintended Consequences."

or offer affiliated issuer products. Principal transactions may also involve trading bonds from inventory and while a firm may make a profit from the mark-up that the firm charges the client, there is no disadvantage to the client as the firm must ensure fair pricing. Principal trading also has the benefit of increasing liquidity, which is beneficial to all investors. The proposed best interest guidance is silent on this type of trading. In addition, it is unclear how satisfying the proposed requirement to "achieve what is best for the client" as outlined in Principle 1 of the best interest standard, would be achieved in regards to a principal trade.

The regulators need to consider how these activities, which are critical to well functioning securities markets, can continue to operate if a best interest standard is imposed.

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

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

There may also be a reduction in non-proprietary products available to clients as firms choose to use their discretion to limit product choice due and shift to offering only proprietary products to limit increased liability and risks under the standard.

It is unclear how the introduction of a best interest standard would intersect with firms or segments of firms that sell "riskier" products such as small or mid-cap IPOs or new issues, the securities of junior resource companies and other venture issuers, structured products and options. The proposed best interest standard remains silent on whether firms could choose to offer clients the opportunity to purchase these types of securities as the risk of loss exists. High-risk investments are, however, suitable and appropriate for certain retail clients. These products may provide opportunities for higher returns and form an important part of a balanced portfolio. Because a best interest standard increases an advisor's potential liability for each recommendation made to a client, firms and/or advisors may choose to no longer offer clients the opportunity to purchase these types of securities. If an advisor, in order to reduce liability exposure, moves to lower risk investments, overall returns will be impacted even if higher risk products are suitable for certain clients.

Negative Impact on Certain Business Models

A best interest standard would negatively impact certain business models and segments of firms that primarily engage in transactional advisory services, new issuances, junior resource or other venture exchange sales, and option sales. It is not clear how an advisor that predominately provides recommendations (often limited in scope) related to transactions, and whose function more closely

resembles an order-taker for the client executing trades, could operate in accordance with a best interest standard at all times. Even if qualifications permitting certain practices are introduced into the best interest standard, firms or segments of firms that sell "riskier" products such as resource company equities, options, and new issuances may not be financially viable due to the increased liability associated with the standard. Clients, if financially able to do so, will have to pay higher transaction fees or if unable to afford the costs will move to the non-advice channel.

Similarly, other firms or segments of firms may be negatively impacted if the best interest standard results in prohibitions of the sale of proprietary products. For firms whose business model is predicated on the sale of proprietary products, if the sale of proprietary products were limited or prohibited, this business model would effectively be eliminated and these firms may have to entirely overhaul their processes, or potentially even cease to exist. This may disproportionately impact smaller or less sophisticated investors who want investments from an institution with which they already have a relationship.

We also note that the trend of smaller firms leaving the industry will be exacerbated with the imposition of a uniform best interest standard. The potential disqualification of products that smaller firms specialize in, combined with the subjective compliance standard that would be imposed, would add enormous cost and burden to the small firm segment that would further limit or eliminate small dealers despite their critical place in the capital markets ecosystem.

Negative Impact on Capital Raising

The Canadian capital markets are an integral part of Canada's economy. The imposition of a best interest standard may significantly negatively impact both debt and equity capital raising in Canada. The market in Canada is concentrated. In many cases the firm underwriting an IPO is the same firm or related to a firm that is selling the IPO to clients. The advisor selling to clients must disclose the conflict and ensure that the product is suitable. However, under a best interest standard, in order for clients to have access to these IPOs, different advisors at different firms would appear to be required in order to access an advisor that would not be in conflict selling the securities to a client.

Generally, liquidity in Canada would be reduced as a consequence of an increase in proprietary firms and resulting decreased foreign capital. Inter-listed securities would move to other markets where liquidity is greater and this in turn will reduce transparency in the Canadian market.

Other countries such as Australia have had to work with their brokerage industry specifically to attempt to create carve-outs from the best interest standard to minimize its impact on the IPO market. Irrespective of any potential permissive qualifications to a best interest standard related to new issues, a best interest standard will create a highly risk averse environment that will impact the ability of small and mid-size firms to raise capital. Similarly, if principal trading is prohibited, the cost of debt capital raising will increase as firms will not be able to provide the corporate bond markets with liquidity or maintain those securities in their inventories.

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

The IIAC believes it is worth highlighting (as first set out in our response to the Original Consultation Paper) the cost implications that would result from the introduction a regulatory best interest standard.

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APPENDIX C: COST OF COMPLIANCE SURVEY RESULTS

[Survey results prepared by Deloitte LLP to be submitted at a later date.]

APPENDIX D

CONFLICTS OF INTEREST EXAMPLES: SELF-ASSESSMENT TOOL TO HELP MEMBERS OF INVESTMENT INDUSTRY ASSOCIATION OF CANADA (IIAC)

Last updated: June 1, 2012

Disclaimer
The information and examples contained in this document are to help IIAC members meet the requirements under Rule 42 of the IIROC Client Relationship Model dealing with conflicts of interest. The conflict of interest examples included in this document are not intended to be all-encompassing, as the types of conflicts that can arise may be unique in each situation. Determining all conflicts of interest that may exist is ultimately the responsibility of each Investment Industry Regulatory Organization of Canada (IIROC) member firm. Members must be in full compliance with regulatory requirements and ensure that written policies and procedures are developed to identify and address material conflict of interest situations and that these policies and procedures are maintained and followed.

The table below lists a series of examples of conflicts of interest collected by PWC Canada, which has kindly agreed to their use in this tool prepared by the Investment Industry Association of Canada (IIAC) for IIAC member conflicts of interest identification and self-assessment purposes.

The table can be used:

i. simply as a list to test the conflicts of interest a firm already identified or
ii. as a simple worksheet to help record which conflicts are material and which are not, as well as why, or how the decision was reached **(Columns 2, 3 and5)** or
iii. as a way to weight certain aspects of the material risks to help prioritize ones that may warrant most attention for purposes of building compliance controls **(Columns 2, 3, 6 and 7)** or identifying where training and communication /reminders may be most needed (for example, where investment advisors may come up against such conflicts rarely **(Columns 2, 3, 6 and 7)**.

For each possible conflict of interest, and for those not captured here that may be identified by an IIAC member firm and recorded in the space provided, a member firm may change the weighting assigned to best suit their purposes **(Columns 4, 6 and 7).** For example, some firms may feel that ongoing conflicts that can be managed by systems or supervision may be less challenging than ones where disclosure is required in the case of a rarely arising conflict. As with any model, members are encouraged to use caution and to test findings under various scenarios.

Conflict	Description	Risk? 1=Yes 0=No	Material? Yes 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May Exist 2	Conflict … Avoid 0 / Manage / Disclose	Weighting *Column 3x4x6x7*
Bundling	1. Retail clients pressured to buy additional services on unfavourable terms to obtain access to particular product (e.g., consumer lending product linked to purchase of the firm's insurance product).	1	2		1	2	**4**
	2. Broker, in return for trading commission, supplies a package of services to a fund manager, such as research, computers, premises, etc. on the basis of an understanding of the level of business.	0					0
Cherry- picking	3. Firm provides new recommendation to a selected group of customers in anticipation of planned revisions to long-standing recommendations.	1	2		2	1	**4**

Note: Firms must obtain their own advice on conflicts of interest matters based on the facts of their business model client base and any other relevant factors.

APPENDIX D

CONFLICT OF INTEREST EXAMPLES AND WORKSHEET

Conflict	Description	Risk? Yes 1 / No 0	Material? Yes 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May exist 2	Conflict … Avoid 0 / Manage / Disclose 2	Weighting *Column 3x4x6x7*
Bundling	1. Retail clients pressured to buy additional services on unfavourable terms to obtain access to particular product (e.g., consumer lending product linked to purchase of the firm's insurance product).						
	2. Broker, in return for trading commission, supplies a package of services to a fund manager, such as research, computers, premises on the basis of an understanding of the level of business.						
Cherry- picking	3. Firm provides new recommendation to a selected group of customers in anticipation of planned revisions to long-standing recommendations.						
	4. Firm chooses to finance its best customers by means of bank loans while underwriting securities for weaker clients.						
Churning	5. Sales agent undertakes multiple (unnecessary/unauthorized) transactions in client's discretionary account to generate commission revenue.						
Competitive syndicate	6. Roles and responsibilities of syndicate members are not defined until later in the process creating pressure points around pre-deal research and marketing activities.						
Conflicting roles	7. Firm represents bond holders of a distressed company while also representing a prospective acquirer of that same company.						
	8. Firm represents both a buyer and a seller in an M&A deal.						
	9. Research department issues positive report after firm appointed lead manager in an IPO.						
	10. Sell-side analyst helps to attract and retain clients of the investment banking department.						

Conflict	Description	Risk?	Material?	Why *Not* Material?	Conflict …	Conflict … Avoid 0	Weighting
		Yes 1	*Ye* *2*		Ongoing *1*	Manage	*Column 3x4x6x7*
		No *0*	*No* *1*		May *2*	Disclose 2	
Fees and commissions	11. Broker pays more to ensure volume of client referrals (soft commissions).						
	12. Management fees charged to funds are disproportionate.						
	13. Inappropriate or inconsistent allocation of costs to funds.						
	14. Financial advisor network remunerated solely through commissions (i.e. does not charge for services).						
	15. Brokers direct customers to selected firms which make special payments (above normal) for volume (contingent commissions).						
	16. Firm offers financial advisor a fee to switch existing clients from a competitor's product to its own.						
	17. Firm pays a fee to financial advisor over and above normal commissions to ensure the inclusion of its products on the advisor's approved products list.						
Fiduciary duty	18. Retail sales agent does not (or is not perceived to) provide best advice to the client based on information available (or believed to be available) within the firm.						
	19. Financial advisor recommends that client replace existing products (e.g., wrap accounts) with similar products of its parent company (or other group company) in order either to reduce administration effort or to generate additional commission.						
	20. Firm adopts inconsistent approach to the selection and monitoring of brokers (potentially showing favour to certain brokers, or incurring additional, unnecessary costs for clients).						
	21. Parent company provides asset management services to a fund. The fund is not in a position to appoint different asset manager if the asset management services are not satisfactory.						

APPENDIX D

Conflict	Description	Risk?		Material?		Why *Not* Material?	Conflict …		Conflict … Avoid	0	Weighting
		Yes	1	Yes	2		Ongoing	1	Manage		Column 3x4x6x7
		No	0	No	1		May exist	2	Disclose	2	
	22. Fund manager simultaneously manages hedge funds and registered funds.										
Front- running	23. Client issues a large buy order for Company Y: firm buys shares in Company Y ahead of client to take advantage of price increase.										
	24. Firm trades ahead of client to take advantage of pending favourable report prepared by the firm's research department/analysts.										
	25. Proprietary trading desk buys shares in Client X based on information from Corporate Finance that Client X will be bought by Company Y.										
	26. Salesperson informs colleague in fund management about large client order in Company Y. Fund manager purchases shares in Company Y for placement in the fund.										
Inducements	27. Employee accepts a gift from a customer which could compromise or give the impression of compromising his/her independence.										
Laddering	28. Firm offers shares in an IPO that it underwrites to 'preferred clients' with the understanding that they will purchase more shares at a specified price after the company begins trading publicly.										
Management/ director interlocks	29. Firm's officers and/or directors have seats on boards/committees of client companies.										
	30. Cross directorships of subsidiaries.										
Market manipulation	31. Intra-company dealing to boost book or to create demand perceptions.										
	32. Creating fake bids to give the perception of a competitive market (bid rigging).										
Market timing/late trading	33. Practices which enable firm to shift wealth from other investors to preferred clients (e.g., hedge funds).										

Conflict	Description	Risk?		Material?		Why *Not* Material?	Conflict …		Conflict … Avoid	0	Weighting
		Yes	1	*Ye*	*2*		Ongoing	*1*	Manage		*Column 3x4x6x7*
		No	*0*	*No*	*1*		May	*2*	Disclose	*2*	
Material interests	34. Firms fails to act in the customer's best interests when firm holds a material interest in a given transaction.										
	35. Firm fails to disclose a material interest in another firm which influences a buying decision (e.g., research firm) or which executes transactions (broker).										
	36. Separate customers with material interests which conflict.										
	37. Firm agrees to buy business of financial advisor on a 'last resort' basis, with the purchase price based on a multiple of annual commission.										
Misuse of confidential information	38. Firm acts, or appears to act, based on non-published confidential information not known by, or regarding, the customer.										
	39. Underwriting department sells shares aggressively to customers of the bank in order to benefit										
	40. Bank with loans to customer whose credit risk deteriorates, sells corporate bonds to the public, thus paying off the loan and earning a fee.										
	41. Firm pushes affiliates products to the detriment of customers.										
	42. Corporate finance uses confidential information on Client X to provide advice to Firm Y, a competitor of X in which the firm has made a venture capital investment.										
	43. Loan and/or credit derivatives trader obtains information that borrower/credit position is deteriorating and uses information to sell position.										
	44. Credit officer uses information from workouts group to request that debt trader reduce his position in distressed client's debt.										

Conflict	Description	Risk? Yes 1 / No 0	Material? Yes 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May exist 2	Conflict … Avoid 0 / Manage / Disclose 2	Weighting Column 3x4x6x7
	45. Firm acts or appears to act based on relevant/confidential information not known to other parties in a merger or acquisition.						
	46. Trader has access to confidential information on Client X and uses it to sell short the company's stock in advance of notice of poor performance.						
	47. Trader buys shares in Client X based on information gleaned from Corporate Finance that Client X will be bought by Company Y.						
	48. Sell-side analyst includes confidential information obtained from Corporate Finance within research report.						
	49. Cross-selling opportunities compromise client privacy through misuse of personal information.						
Non- disclosure and poor disclosure	50. Asset manager does not report, or incorrectly/incompletely reports, investment performance to clients or potential clients.						
	51. Tied agents do not adequately and clearly disclose their relationship with investment firm to clients and the impact that this relationship has on the advice/product offerings to the client.						
	52. Disclosures made to clients are obfuscated by being too legalistic, long-winded or presented in such a way as to discourage the client from fully understanding them.						
Personal account dealing	53. Firm's employee acquires or sells shares on personal account based on non-public information held by the firm.						
	54. Employee uses personal account to deal ahead of large customer order.						
	55. Employee uses personal account to deal in advance of research publication.						

APPENDIX D

Conflict	Description	Risk? Yes 1 / No 0	Material? Ye 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May 2	Conflict … Avoid 0 / Manage / Disclose 2	Weighting *Column 3x4x6x7*
Preferential treatment	56. Research analyst undertakes a personal account transaction which is contrary to research recommendation or advice given to clients.						
	57. Firm's officers/directors receive company loans at preferential rates.						
	58. Certain customers' orders are given priority over other customers' orders.						
	59. Account executives favour one type of customer over another (e.g., discretionary and advisory client) in allocating an over-subscribed stock.						
	60. Research department issues (or is perceived to issue) 'buy' recommendations only for listed entities with which the firm has a commercial relationship.						
Private interests	61. Directors and executives invest in company-managed private funds.						
	62. Individual managers take part, in parallel with their firms, in syndicates through private partnerships/companies.						
Remuneration/ rewards	63. Managers focus on revenues of own business to the detriment of other businesses within the organization.						
	64. Managers focus more on short-term revenues to detriment of longer-term investment objectives of shareholders/policyholders.						
	65. Staff given incentives to sell complex third party or in- house products which may not be appropriate for their clients.						
	66. Sales staff generating commission revenue to boost bonus.						
	67. Individual traders over-expose the firm due to excessive risk appetite.						
	68. Uncontrolled dispensation is given to 'star trader' in terms of internal controls/trading restrictions.						

Conflict	Description	Risk?		Material?		Why *Not* Material?	Conflict …		Conflict … Avoid	0	Weighting
		Yes	1	Ye	2		Ongoing	1	Manage		*Column 3x4x6x7*
		No	0	No	1		May	2	Disclose	2	
	69. Traders book fictitious trades to an affiliate to boost bonus pool.										
	70. Sell-side analyst compensation linked to providing favourable client research.										
	71. Sell-side analyst compensation is linked to success of corporate finance deal (e.g., loan, underwriting).										
	72. Investment bank provides credit facilities to client without due regard to credit risk profile for organization as a whole.										
Side arrangements	73. Deals contingent on buying debt or equity in customers or third parties.										
Spinning	74. Firm involved in IPO allocates shares to officers and directors of client firms on understanding of obtaining future business.										
Stuffing	75. Allocating securities from an undersubscribed IPO to the firm's discretionary retail accounts.										
Suitability	76. Firm sells complex structured derivative to client's treasurer without explaining the risks or understanding the client's needs/ sophistication.										
	77. Firm recommends that a customer frequently buy/sell riskier securities (even when not in the customer's best interest) as such securities generate higher commissions.										
	78. Investor advisor (in-house/agent) has interest in persuading client to invest in a product which is unsuitable in terms of the client's investor objectives.										
	79. Firm raises money for one client through securitisation and sells residual tranche ('toxic waste') to retail clients.										
Trade aggregation/	80. Firm aggregation/allocation favours one customer over another.										

APPENDIX D

Conflict	Description	Risk? Yes 1 / No 0	Material? Ye 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May exist 2	Conflict … Avoid 0 / Manage / Disclose 2	Weighting *Column 3x4x6x7*
Allocation	81. Firm aggregates client trade to the disadvantage of the customer.						
	82. Firm allocates trade to itself, or a member of its group, ahead of clients.						
Trade execution	83. Non-sequential execution of customer trades (allowing one 'preferred' customer to trade first).						
	84. Firm executes trade with own affiliate prior to that of customer.						
	85. Firm fails to identify/correct trade errors and does not pay/reimburse customer						
	86. Firm fails to follow client instructions on a market transaction or delays in making payment in order to increase float.						
Tying	87. Firm uses its power to influence a client to also use other services (e.g., firm denies credit to customers who refuse to use securities, advisory, insurance services).						
	88. Firm makes below market loans to third-party investors on condition that proceeds are used to acquire securities underwritten by its corporate finance unit.						
Undue influence	89. Allowing a relationship with a third party (with a material interest) to compromise actions on behalf of a customer in a transaction.						
	90. Underwriters exert undue influence on (in-house) analysts to provide favourable research.						
	91. Corporate Finance (or similar) has ability to influence outcome of draft research prior to						
	92. Undue pressure exerted by senior editorial body (or other) to change research message in order to support the client's specific interests (for example, in order to protect a client facing a hostile takeover).						

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Conflict	Description	Risk? Yes 1 / No 0	Material? Ye 2 / No 1	Why *Not* Material?	Conflict … Ongoing 1 / May exist 2	Conflict … Avoid 0 / Manage / Disclose 2	Weighting *Column 3x4x6x7*
	93. Preference for 'buy' recommendations (note: all clients can buy, on existing shareholders can						
	94. Sell-side analyst is encouraged to make recommendations which support proprietary						
	95. Analysts face pressure from institutional investor clients to create profitable investments.						
	96. Client pressures the firm into not issuing a negative recommendation based on difficulties the client is currently facing.						
	97. Issuer's management retaliate against a bad report by cutting off analyst's access to management: issuer carries ill-will against the analyst and in turn against the broker-dealer for whom the analyst works.						
	98. Market 'herd' mentality leads to overly optimistic or pessimistic research expectations/requirements from management.						
	99. Asset management unit pressured by corporate banking client with shares in that company into voting for management's position in a contested corporate action (e.g., proxy battle).						
Unfair pricing	100. Under-pricing new issue to generate additional sales revenues.						
	101. Over-pricing new issue to generate additional corporate finance fees.						
Additional	102. Sharing accounts with a client						
	103. Refusing all first client complaints on the basis many may not take the matter further						
	104.						
	105.						

APPENDIX D

WORKSHEET FOR FIRMS WITH MORE COMPLEX ORGANIZATIONAL STRUCTURES, E.G., SUBSIDIARIES AND AFFILIATES

Note: Use examples above, inserting

[Please tick as appropriate]

##	Conflict		Potential risks	Potential causes	Risk within my organization	Potential risk within my organization	Not a risk in my organization	Laws/regulations prohibit this

Which business(es) does this impact?

[Please tick (✓) as appropriate]

Retail bank	Commercial banking/ corporate finance	Investment bank/Dealer	Broker/sales agent	Asset manager/ investment fund	Investment analyst	Insurance company	Insurance intermediary	Other

	Structural Arrangements							Policies and Procedures					
What arrangements do you have in place to manage this risk?	*Separate subsidiaries*	*Separate department*	*Physical separation of potentially conflicted activities*	*Reporting lines*	*Information flow restrictions (Chinese walls)*	*'Crossing the wall' policies*	*Temporary Chinese walls for specific transactions*	*Non-sequential and non-simultaneous involvement of conflicted individuals*	*Personal account dealing*	*Investment*	*Ethics and confidentiality*	*Remuneration/ reward*	*Escalation*	*Conflicts disclosures*
[Please tick as appropriate]														

Additional Arrangements								
Transaction monitoring/ restricted lists and watch lists	*Compliance monitoring*	*Independent price verification*	*Exception reporting/ reporting triggers/ complaints monitoring*	*New business approval mechanisms (including legal & compliance sign-off)*	*Legal contracts*	*Conflicts management/monitoring system(s) [Technology]*	*Employment contracts/staff confirmations*	*Training programmes*

Other (please specify)