

# INVESTOR ADVISORY PANEL

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The Secretary

Ontario Securities Commission

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## **Re: CSA Consultation Paper 25-402 *Consultation on the Self-Regulatory Organization Framework***

The Ontario Securities Commission's Investor Advisory Panel (IAP) welcomes this opportunity to comment on CSA Consultation Paper 25-402 *Consultation on the Self-Regulatory Organization Framework* (the "Consultation Paper"). The IAP is an initiative of the OSC to ensure investor concerns and voices are represented in the Commission's policy development and rulemaking process. Our mandate is to solicit and articulate the views of investors on regulatory initiatives that have investor protection implications.

A comprehensive review of Canada's SRO regulatory framework is timely and appropriate. Given the dramatic changes that have taken place in the financial services industry over the last 20 years, a re-examination of the policy rationale underlying the current SRO framework and a thoughtful reassessment of its costs, benefits and challenges is necessary.

We note that concepts for SRO reform recently presented by the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association of Canada (MFDA) and Ontario's Capital Markets Modernization Taskforce (CMMT) have all focused primarily on burden reduction and cost saving. Those are worthy goals, but they are not the only important things that need to be attained in this process of designing an optimal SRO of tomorrow. Improving investor outcomes should be a co-equal priority. Also, a new design must resolve concerns that SROs have typically put the interests of their industry stakeholders above those of the investing public, and concerns that SROs have exhibited persistent blind spots in their complaint handling and enforcement processes.

These matters need to be addressed – not merely because they are important to investors, but also because any analysis of how to improve Canada's regulatory framework will be distorted, and thereby weakened, if cost savings and burden reduction dominate centre stage in the discussion while other key issues are overshadowed or ignored.

Our following comments on the Consultation Paper are specifically designed to highlight some of these key issues from the retail investor perspective.

## **Issue 1 – Duplicative Operating Costs for Dual Platform Dealers**

The Consultation Paper leads off by noting that dual platform dealers often experience higher operating costs and difficulty achieving economies of scale that inhibit their ability to minimize costs. Also, dual platform dealers are faced with maintaining separate compliance functions and they incur both IIROC and MFDA fees. Consequently, the CSA is targeting a “regulatory framework that minimizes redundancies that do not provide corresponding regulatory value.”

An IIROC-commissioned report prepared by Deloitte in July 2020 appears to have played a key role in prioritizing this issue. Deloitte estimated that consolidation of IIROC and the MFDA will save between \$380 million and \$490 million over a 10-year time period. However, we were struck by the small sample size and data limitations in the report. This brought into question the accuracy of Deloitte’s estimate of achievable savings.

Also, according to the report, as of January 2020 there were only 25 dual-platform dealers active in Canada. The largest eight – a group that will ultimately enjoy the bulk of the estimated savings – are currently each generating annual revenue in excess of \$2.5 billion in their IIROC entity.

Using Deloitte’s numbers, the annual savings for the industry will amount to just 0.2% of revenue. We do not believe that achieving this relatively small annual saving for the principal benefit of a small industry sub-group should drive the whole process of identifying what constitutes an optimal regulatory framework. Cost savings and burden reduction are too industry-centric and they neither acknowledge nor account for the consequential, and potentially negative, impact they may have on non-industry stakeholders.

Bottom line: while we subscribe to the premise that regulation should be as cost effective and efficient as possible, we do not believe that saving costs, particularly when the estimated savings are marginal, should be the primary determinant of what constitutes an optimal regulatory framework. Instead, we think a more appropriate focus of this SRO review should be the identification of a regulatory framework designed to improve outcomes for both industry members and investors. Once identified, that framework should be configured to operate as cost effectively and efficiently as possible.

## **Issue 2 – Product-Based Regulation**

The Consultation Paper notes that different rules or different interpretations of similar rules between IIROC and the MFDA exist notwithstanding the growing convergence of similar products and services between registrants of each SRO.

To address this situation, the CSA recommends a “regulatory framework that minimizes opportunity for regulatory arbitrage, including the consistent development and application of rules.” In practical terms, this augers in favour of moving to a single regulator model.

From an investor perspective, it makes sense to place investment dealers and mutual fund dealers under a common regulatory regime. However, it is neither obvious nor necessary that this regime must be operationalized through an SRO rather than a consortium of statutory regulators.

But if a ‘super SRO’ is to be considered the preferred option, we believe it must provide no less neutrality than statutory regulators and an equal commitment to delivering outcomes aligned with the public interest. That effectively means a new, consolidated SRO cannot be industry-centric in its orientation, governance and operations. Indeed, as outlined below, it must abandon altogether the notion of investment *industry* self-regulation and instead embrace and internalize the concept of investment *community* self-regulation for the communal benefit of the industry and investors.

### **Issue 3 – Regulatory Inefficiencies**

The Consultation Paper acknowledges that inefficiencies exist in accessing certain products and services. Specifically, mutual fund dealers under the MFDA are unable to easily distribute exchange traded funds. Also, the current framework makes it difficult to effectively resolve issues that span multiple registration categories.

To address this issue, the CSA’s proposed outcome is a “regulatory framework that provides consistent access, where appropriate, to similar products and services for registrants and investors.”

We support a more efficient regulatory framework, but we do not believe that the examples cited in the Consultation Paper reflect regulatory inefficiencies. Instead, from an investor perspective, they constitute regulatory safeguards necessary for investors to transact securely with various categories of dealers, including those staffed by salespeople with the lowest levels of proficiency offering advice on a relatively limited product shelf.

And context should not be forgotten. Many of the regulations that the industry now characterizes as burdensome were put in place as speed bumps to address problems dealers themselves created through a multiplicity of sales channels, opaque fee structures and complicated products that they promoted aggressively to retail investors.

### **Issue 4 – Structural Inflexibility**

In some respects, this issue is a variant of the previous issue (Regulatory Inefficiencies), articulated in a slightly different manner. Both echo the long-standing industry refrain that blames regulatory inefficiencies and structural inflexibility for impeding business model evolution, limiting the range of products and services that a single registrant can offer, and placing barriers on professional advancement. The CSA’s acquiescent targeted outcome – not dissimilar to the outcome it proposed for regulatory inefficiencies – is a “flexible regulatory framework that accommodates innovation and adapts to change while protecting investors.”

Regulation certainly needs to be nimble and appropriately elastic. Yet, policymakers also need to push back against the industry trope that regulation is synonymous with burden. As noted above, it bears remembering that what industry players identify as inflexibility (and/or inefficiency) in the current system are safeguards that have been specifically designed or retrofitted to protect investors from problems associated with products created and practices initiated by industry.

So-called ‘inflexible’ category-specific regulation is the direct result of industry adopting different sales practices and proficiencies in different distribution channels. Therefore, in our view, before acceding to industry calls to eliminate or streamline regulation, it may be more appropriate to encourage industry to standardize their sales practices and bring their proficiency levels into alignment. Less regulatory burden will be easier to achieve if there is less unnecessary divergence to regulate.

## **Issue 5 – Investor Confusion**

Based on survey feedback, the CSA posits that investors generally are confused by the existing regulatory framework, including the role of SROs, the barriers to one-stop shopping for investment products, and the labyrinthian structure of complaint resolution. In the face of this confusion, the CSA’s targeted outcome is a “regulatory framework that is easily understood by investors and provides appropriate investor protection.”

We expect there will be universal support for an easily understood regulatory framework; but simplifying the framework is not an investor priority in and of itself – and certainly not if simplicity is to be achieved by jettisoning any critical underpinnings of ‘appropriate investor protection.’ These would include requirements that anyone providing investment advice of any kind:

- (a) must be proficient;
- (b) must be able to advise in the best interest of the investor (either by being free of conflicts of interest or by disclosing and resolving any conflict in the investor’s favour); and
- (c) will be subject to a consistent level of robust oversight and effective rule enforcement.

In addition, an appropriately protective regulatory framework must feature a complaint resolution process designed to ensure that harmed investors will get a fair and quick resolution of their complaint, with restitution where warranted.

These are not things that can or should be traded off to make the regulatory framework simpler and easier to understand. They are, in fact, essential for making the framework understandable and sensible to the general public.

## **Issue 6 – Public Confidence in the Regulatory Framework**

The Consultation Paper acknowledges “a possible lack of public confidence in the existing SRO framework” as well as “inadequacies in the SRO governance structure (industry-focused boards and a lack of formal investor feedback mechanisms) that fail to provide enough support for SRO’s public interest mandate.” It also concedes that “concern exists regarding ineffective SRO compliance and enforcement practices.” To address these deficiencies, the CSA’s targeted outcome is a “regulatory framework that promotes a clear, transparent public interest mandate with an effective governance structure and robust enforcement and compliance processes.”

We find it troubling that public confidence was not ranked higher as a priority in the Consultation Paper. From an investor perspective, it would rank far above reducing operating costs, eliminating confusion or

gaining access to more products. Investors, in our experience, are more focused on outcomes than processes. They want more effective regulation, stronger enforcement, a higher standard of conduct from financial advisors, and lower fees. Ultimately, they want a regulatory framework they can trust to protect their interests in a fair, transparent and consistent manner.

We believe a redesigned framework will achieve this only if it takes the SRO model beyond its current form of industry-centric governance.

On this topic, we find much to commend in the CMMT's proposals. We endorse their recommendation for increased and more robust CSA oversight; we share their view that the number of independent directors should exceed the number of industry directors; and in principle we agree that extended cooling-off periods should be required before former industry personnel can become independent directors. We would add, however, that independent directors ought to possess a deep understanding of investor perspectives and concerns, and therefore ordinarily those directors should not be drawn from the ranks of individuals whose worldview has been shaped by careers within the investment business.

But, also, we urge the CSA to understand that a meaningful, credible overhaul of SRO governance must encompass much more than changing the makeup of the SRO's board of directors. It will require a fundamental re-imagining of self-regulation's object and purpose – by recognizing that the mutual interdependence of investors and the investment industry gives rise to their sharing intertwined communal interests, and those joint interests legitimately should be governed through a partnership conducted for communal benefit. In effect, the “self” in self-regulation should be this investment community, not just the investment industry.

At the board level, we believe all directors – industry appointed ones and independents alike – must act as fiduciaries of the investment community as a whole and not as representatives of its separate constituencies. They must draw on their experience and work together collegially to provide a broader and more nuanced perspective to balance competing needs, set appropriate priorities and operate fairly.

In addition, for reform of the SRO framework to gain public trust, the communal self-regulation concept must filter down to every level of the new SRO, permeating its executive and operations branches as well as policy and rule development committees and any decentralized nodes of influence such as district councils.

Lastly, for consumers to have faith in a new SRO, it will need to evidence a more credible approach to enforcement and redress than the current framework exhibits. Too often, sanctions are imposed only on errant salespeople and not on senior management, compliance officials or the firm itself, even where the firm's policies or standards of supervision appear to have been deficient. Most fines levied against advisors who have left the industry go unpaid, while their former firms are rarely, if ever, ordered to disgorge revenue the firm derived from the advisor's wrongdoing. Meanwhile, investors must rely on a flawed and protracted complaints process or costly litigation (not financially accessible for most retail investors) to pursue compensation for losses caused by misconduct.

These industry-centric outcomes are inimical to building public trust. A much better interface is needed between compliance, enforcement and redress in the SRO framework, and that will require a deep and comprehensive re-think rather than just a quick, superficial or expedient refresh.

### **Issue 7 – The Separation of Market Surveillance from Statutory Regulators (CSA)**

As noted in the Consultation Paper, IIROC is responsible for conducting surveillance of trading activity in Canada’s debt and equity marketplaces. As a result, in order to perform its own regulation of market operations, the CSA must rely on IIROC to provide critically necessary data and information.

Interestingly, the Consultation Paper appears to be concerned mostly with the possible information gaps and lack of market transparency resulting from this reliance. Less concern is expressed about the optics/probity of IIROC overseeing markets where its members interact with all other market participants.

The CSA’s targeted outcome is an “integrated regulatory framework that fosters timely, efficient access to market data and effective market surveillance to ensure appropriate policy development, enforcement, and management of systemic risk.” We support this outcome and, in general, we see merit in the CSA taking over this market surveillance function, either directly or through a new single-purpose market surveillance entity, in order to eliminate concerns about information gaps and transparency.

### **Summary and Conclusion**

We encourage the CSA to maintain a good balance between process and outcomes in its quest for an appropriate regulatory framework. We believe this framework will require a substantive integration of both industry and investor perspectives, in the following manner:

**Investors as Stakeholders** – Investors must be viewed as key stakeholders whose input on SRO strategic and regulatory priorities is necessary to ensure SROs devote their resources to, and undertake regulatory programs aligned with, the public interest. Investors should be full partners with the investment industry in governance of their intertwined community of interests. And it is this *investment community* that should constitute the “self” in self-regulation of Canada’s investment business through a new, redesigned SRO.

**Include Investors at the Decision-Making Table** – It is essential that the design incorporate full representation of investors’ concerns and interests throughout the SRO’s governance structure and at the heart of its decision-making apparatus. At a minimum, SRO directors must include a cohort of individuals whose lived experience equips them with deep understanding of investor perspectives and concerns, as opposed to being people whose worldview has been shaped by careers within the industry. Both viewpoints are essential and need to be at the table.

**Working for Communal Benefit** – The partnership between investors and the investment industry must be conducted collaboratively for mutual benefit. All directors, including these new ones, must come to the table with a mindset that their role is to act in the best interest of the investment community as a whole. They should not consider themselves to be representatives

of one constituency or the other. Instead, they should view their purpose as one in which, collectively, they provide the SRO with a broadened and more nuanced understanding, allowing the organization to better “see” key issues, set priorities and balance competing needs. In particular, this governance structure can best ensure a more efficient and more flexible regulatory framework that provides “appropriate investor protection.”

**Transform the Whole Framework** – This communal orientation must permeate the entire organization, including its executive and operations branches, policy and rule development committees, and decentralized nodes of influence (e.g., district councils).

Absent this type of integrated perspective and governance structure, a redesigned SRO would lack both the legitimacy and credibility to fairly serve the communal interests of investors and the investment business, to advance the broader public interest, and to increase public trust and confidence in our regulatory system.

We thank you for this opportunity to comment on the CSA’s review of Canada’s SRO regulatory framework. We would be pleased to discuss these ideas further with you, at your convenience.

Sincerely,

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Neil Gross

Chair, Investor Advisory Panel