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Via email

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CSA Consultation Paper 25-402 *Consultation on the Self-Regulatory Organization Framework*
https://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20200625_25-402_consultation-self-regulatory-organization-framework.pdf

Most of the issues raised in the consultation paper relate to industry. The real issues with the SROs is not the framework, it is the foundation. I will provide comments on the consultation but first I would like to give a brief overview my personal experience in dealing with an SRO - a lot of lessons can be learned from this experience.

In order to be concise and hopefully helpful to the OSC, I will narrow down my comments that are objective revelations of the facts of experience when trying to get the SRO IIROC to likewise respond to the facts when their adjudicating decisions were questioned.

This following commentary relates to IIROC being asked to review allegations of wrong-doings by a Bank-controlled Investment Dealer Financial Advisor. This is when the said Advisor provided investing "advice" to 70-year old senior citizens man and wife who were required by the CRA regulation to convert many years of accumulated RRSPs savings into RRIFs.

It is not the extent of the allegations of the said Financial Advisor's wrong-doing conduct that is the subject of my submission but rather the way that the SRO IIROC chose to initially interpret the complaint information and then the unreasoning way they responded when their decisions explanations were questioned. This is in spite of the IIROC rejection letter riddled with some false and quite a few deceptive inferences to justify their decision.

In essence, when the original IIROC decision sent to the Complainant rejecting the case by IIROC claiming no securities regulations had been violated by the Bank-controlled Investment Dealer employee, the IIROC explanations raised legitimate questions about their lack of depth of investigation that had been applied to the complaint that the Complainant had submitted to IIROC.

Very important: On account of the IIROC decision to use non-factual claims and inferences in their original rejection of the Complainant's case, the Complainant then found it necessary to determinedly spend many hundreds of hours researching CSA, OSC and IIROC Regulations, Rules and Guidelines. A Complainant should not have to go to this extent when there is supposed to be an SRO doing that job of protecting investors.

As a result of the Complainant's research, when questions were asked of IIROC the unsatisfactory responses, or for the most part should I say negative excuses for IIROC inaction, then came progressively from five escalating IIROC management levels. The last response from the IIROC Vice-President earned a 26-page rebuttal response from the Complainant. **[Substantiating information supporting these allegations is available upon request.]**

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The financial services industry is characterized by a culture of greed, misconduct and investor exploitation. The idea of this industry regulating itself in light of all of the available evidence is wholly inappropriate.

According to a recent MFDA national investor poll *What Canadian investors want in a modern SRO*:

- 88% of Canadian investors believe that Canadian regulators should provide more oversight of the investment industry;
- 91% of Canadian investors believe that financial products and services that are alike should be regulated in the same way; and
- more than two-thirds (69%) of Canadians investors think that designing a new SRO through a comprehensive review that emphasizes accountability, government oversight and investor protection is preferable to a simple status quo SRO merger.

Source: https://mfda.ca/news-release/invsro/ These results show that Canadians want real regulatory change.
Given the inherent tension between operating in the Public interest and operating in the interest of a regulated industry, self-regulation creates a reasonable apprehension of bias. The status quo is therefore unacceptable if investor protection is to be enhanced.

The existing SROs however, do have one big advantage, they are national in scope while the statutory regulators are not. The best solution appears to be one where statutory regulators and industry come together under a new "SRO", one with investor focus, transparency and accountability. The Ontario Taskforce on securities modernization provided some excellent ideas on how this might be accomplished and I recommend that they be examined. I believe if they were followed, the end result would be a fresh, modern, forward-looking SRO. And one that would be trusted by the public.

In this day and age, a regulator based solely on product, mutual funds, doesn't seem to make much sense. A combination of the two existing self-regulating organizations

makes sense but only if it leads to a different kind of SRO. The existing SRO's exhibit issues with regard to industry - favoured rulemaking, poor investor outreach, weak compliance monitoring , wrist-slap enforcement and of course , abusive complaint handling. I'd like to see 1+1 = 3 for investors resulting from a combination.

Beyond that, I'm not sure about melding in portfolio managers. PM's work to a fiduciary standard which is much higher than the standard utilized by IIROC and MFDA sales persons. If they were combined with the new SRO, I worry that their standards would end up being watered down by coming into contact with lower standard advisors. According to OBSI statistics, there does not appear to be many complaints against PM's. On the surface at least, the direct regulation of PMs by statutory regulators appears to be effective. I can provide no comments on the exempt market dealers except to note that their reputation tends to be a little shady. They have the image of being promoters- not a good fit with MFDA/IIROC.

No discussion on an SRO framework would be complete without inclusion of the Ombudsman for banking services and investments OBSI. 0BSI is a critical component of investor protection .They provides feedback to investment dealers directly on how the regulatory control systems are working. Client Complaints are an indicator of client satisfaction with the "system". The feedback provided to participating firms is invaluable towards improving client service, product design, disclosure practises and of course complaint handling. However, without a binding decision mandate many of these potential benefits cannot be achieved. Perhaps most importantly, complainants that are short- changed (lowballed) create the perfect storm for creating distrust in the financial services industry and its regulation. I therefore urge the CSA to provide OBSI with a binding decision mandate including a mandate to investigate systemic issues. At the same time, the Joint Regulators Committee (JRC) should be more transparent and proactive in its oversight of the financial ombudsman service. I also recommend that the SROs be replaced on the JRC by a consumer representative. The reasons for this are(a) the primary person stakeholder of OBSI is the consumer and (b) The SROs are in a conflict- of-interest in the sense that OBSI is monitoring one of their deliverables - effective complaint handling.

I base my commentary on the assumption that the CSA (a) is unwilling to regulate directly the financial advice dealers and (b) there is a preference for joint regulation. As a sidebar, most jurisdictions in the rest of the world appear to be disavowing self-regulation by the investment industry.

Core considerations in the SRO decision process

The new SRO framework (if chosen as the way forward) must address certain concerns. Rather than just integrating the IIROC and MFDA as they currently exist and papering over any differences, I believe that a new and different SRO based on updated principles, enhanced Recognition Orders and increased oversight by the CSA. The review should ensure that SRO's are empowered to regulate advice as a

service which may very well include matters of financial planning , taxation and estate planning in addition to securities trading and portfolio construction.

The need for CSA leadership

Before any significant changes are implemented to the SRO framework, it is essential that the CSA have a vision for securities regulation as it relates to investor protection. Where does the CSA leadership want to see regulation in three years, five years and 10 years from now? Without a vision there can be no coherent strategy and without a strategy it is difficult to make informed decisions on the optimum SRO framework.

The lack of a CSA articulated vision for securities regulation in Canada limits the planning for a more modern, adaptable SRO framework. In particular, there must be a vision for the future of financial advice as the driving forces for change are powerful and growing.

The CSA should define basic policies and design principles so that the construction of the SRO can be effectively operationalized. The role of OBSI should be included in the CSA SRO framework formulation since fair complaint handling is a core element of investor protection.

The CSA itself is at the center of many issues, so any reform of the SRO framework must involve the CSA looking in the mirror. For example, investor advocates are dumbfounded as to why the CSA allowed the sale of DSC funds after the issuance of the classic Stromberg reports in the mid-nineties (even now ,the OSC is seeking to retain the DSC option). Poor SRO regulation of DSC mutual fund sales has also harmed small investors, especially seniors, for two decades. Early redemption penalty fees associated with DSC sold mutual funds have cost investors untold millions of dollars over the last two decades. These fees have impaired the retirement income security of Canadians. Why did the CSA allow this to happen?

In 2017, the CSA issued a *Joint CSA Staff Notice 31-351, IIROC Notice 17-0229, MFDA Bulletin 0736-M - Complying with requirements regarding the Ombudsman for Banking Services and Investments* highlighting the tricks dealers were using in complaint handling. It was a real eye opener. This Notice also addressed concerns that the CSA identified regarding the manner in which some firms are using an internal "ombudsman" as part of their complaint handling system. In some cases, it appears that clients are not being given the clear option of using OBSI's services in the timeframes contemplated by NI 31-103 and applicable SRO rules with the effect that they are being diverted to an internal "ombudsman" while the time limits for submitting the complaint to OBSI or commencing a civil action continue to run. There is no question in my mind that the use of internal "ombudsman" is intended to wear client's down while running down the statute of limitations time clock. Re http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20171207_31-351_ombudsman-banking-services-investments.htm As of the time of writing of this letter, I see little improvement and no action by the CSA.

CSA Responsiveness, low sense of urgency, sluggishness

I'd like to see the CSA more decisive, time sensitive and responsive when it comes to protecting investors. Providing SRO's with weak laws/regulations and oversight makes the job of SRO's harder. It just takes far too long to make important reforms.

SRO Oversight needs enhancement

I believe the Ontario Taskforce recommendations should be considered in revising CSA oversight of the MFDA and IIROC.

SRO Governance must be designed to counter self-interests

Proponents of self-regulation claim that it offers significant advantages over government regulation. They contend that self-regulation is more flexible, more nimble and more efficient. Critics of self-regulation are justly concerned that it is self-serving, self-interested and too lenient. In addition to the inherent conflict-of-interest, the opponents of self-regulation point to its inefficiencies, including widespread collective action problems, lack of effective enforcement, inability to gain or maintain legitimacy, and, ultimately, the failure of accountability. I urge the CSA to take steps that will include investor representation on the Board of Directors.

OSC IAP research report suggests little financial advice is actually provided

A July 2019 Report by the OSC's Investor Advisory Panel *A Measure of Advice: How much of it do investors with small and medium portfolios receive?* https://www.osc.gov.on.ca/documents/en/Investors/iap_20190729_survey-findings-on-how-much-advice-investors-receive.pdf points to some serious issues. This survey of 3,000 Canadians shed light on the nature, scope and extent of investment advice that small and mass-market investors currently receive from their investment advisors. The survey results indicate that, in many cases, basic financial planning concepts are not addressed in the advice provided. For example, nearly a third (31%) of those surveyed were unable to say their advisor ever talked to them about concepts such as planning for retirement, for education, or for buying a home. 49% of mass-market investors said their advisor spent less than an hour, in total, communicating with them during the past year or didn't communicate at all. For small investors, the figure is 68% (less than an hour p.a. or no contact at all).In other words, much of the industry hype about the value of advice is hype. This is a socio-economic issue the CSA and SRO's have to address when designing the SRO framework.

Investor Outreach needs work

For the vast majority of Canadians, the SRO's are invisible. I recommend that the SRO's increase publicity and profile, improve investor educational materials (using plain language), engage investors pro-actively and listen better to the public.

Improved compliance monitoring can improve investor outcomes

In September 2019 Morningstar published Global Investor Experience: Fees and Expenses Report https://www.morningstar.com/lp/global-fund-investor-experience that grades the mutual fund investor experience in 26 countries. Canada ranks "Below average" in terms of fees and expenses in the report, although this represents an improvement from past years. Canada's fund industry has crawled out

of the basement in Morningstar Inc.'s global rankings of fund investor costs, but remains "Below average" due to the impact of high ongoing fees.

Exhibit 1: Fees and Expenses Scorecard

Top	Above Average	Average	Below Average	Bottom
= Australia	↓ New Zealand	↑ China	↑ Belgium	↓ Italy
= Netherlands	↓ Sweden	= Denmark	↑ Canada	= Taiwan
= United States	↑ Switzerland	↑ Finland	= France	
	= Thailand	↑ India	= Germany	
	= United Kingdom	= Japan	= Hong Kong	
		= Korea	* Mexico	
		= Norway	= Singapore	
		↓ South Africa	= Spain	

Source: Morningstar, Inc. Grade change indicators: ↑ Improved since last study ↓ Declined since last study = No change since last study *New to study

I am of the firm conviction that stronger compliance/ enforcement and better investor education programs by the SRO's could have significantly reduced the fee scalping of Canadians. This feature should be addressed when formulating the new SRO.

Enforcement efficacy needs to be improved

A very small percentage of complaints are investigated and reach enforcement. The CSA should try to understand why this is the case. Associate Professor Mark Lokanan (Associate Professor, Accounting Faculty of Management) Royal Roads University has submitted a Comment letter to the Ontario Taskforce. Some of his findings have implications for designing a new SRO. These include:

- In regulating securities trading, regulatory agencies must take into account the professional and organizational culture of the firms and their compliance policies
- Since there is a greater chance of delays or defaults on assessed fines as the fine collection rate from the individual offenders (25%) is far less than Firms that are at 100%, according to the IIROC's 2018-19 annual report. Therefore, if the individual fines are tied to the Firms, there are better chances for SROs to recover fines. Doing so will certainly impel the dealer firms to revisit their policies and train their agents to ensure they always comply with the rules.
- The trust and confidence of investors in capital markets can be strengthened when fraud or other non-compliances are detected early in their initial stages and avoid huge losses to investors. Implementing machine learning algorithms in the securities markets to detect non-compliance trading activities could improve detection
- There is a clear need to better understand the efficacy of SROs vis-à-vis enforcement.
- Consistency in applying both mitigating and aggravating factors in penalty
- hearings will bring a unified SRO a step closer to regaining public trust

- Enhanced investor protection can be achieved by focussing effort on seniors (>65), retiree, females, limited investment knowledge, and net worth since they are at greater risk of being victimized from investment fraud
- A more detailed review of the IIROC's legal, mandate, governance, limitations, and accountability frameworks as the oversight institution for certain aspects of securities market operations based on self-regulation, and how these conditions may affect decisions on the imposition of penalties (with and without 'capture' by members) should be carried out.
- The Hearing panels need to follow a standardized format of reporting the 'Decision and Reasons' in each case so cases can be analyzed to assist future decision-making and policy.
- Remove Quasi-criminal offences from the jurisdiction of the SROs because the internal resolution of such cases provides an opportunity for the offenders to get away with relatively benign penalties.

Source:
https://viurrspace.ca/bitstream/handle/10613/23361/Comment_Letter_Taskforce.pdf?sequence=1&isAllowed=y

I also recommend that disgorgement cash from Settlements should be returned to victims, not retained by the SRO. Indeed, I'd support a greater emphasis on investor restitution in general. If a trade-off had to be made between fines and investor restitution, I'd support making people whole.

SRO Dealer Complaint handling unfair

Per OBSI's 2019 Annual Report, there were 200 investment complaint cases opened for IIROC dealers and 138 for MFDA dealers. Of closed cases, 45 % were in favour of IIROC clients and 51% were in favour of MFDA clients. So, about half of the cases reviewed by OBSI result in client compensation, an indication of weaknesses in dealer complaint handling. I personally view robust complaint handling as a cornerstone of effective investor protection. The MFDA has sanctioned a number of dealers for deficient complaint handling (See the recent Keybase case https://mfda.ca/settlement-agreement/sa2017100/).I could find no evidence of an IIROC Member Firm being sanctioned for deficient client complaint handling.

It has been said that you can learn a lot about the integrity of an industry by the way it treats those who file complaints. That is where the rubber hits the road. Based on my experience with MFDA and IIROC dealers, I conclude that dealer client complaint handling is abusive and unfair to complainants. In its 2016 report, the OBSI Independent reviewer stated that 18% of cases were low-balled. If this is what happens when OBSI is involved, one can only imagine the state of affairs when OBSI is not involved.

We don't have to imagine. I can report from direct experience that Firms:

- Are dismissive , blame the investor
- Ignore key facts , fail to address the actual complaint filed
- Knowingly use flawed KYC as the basis for denying compensation

- Blame the market for losses despite a portfolio filled with risky investments

- Use a loss compensation model (book loss) that does not make the complainant whole
- Use signed investor documents as a shield for denying compensation
- Falsely claim the complainant is an experienced investor and knew the risks involved with the recommendations
- Make low-ball settlement offers to close the case, knowing that investors have little recourse

In a nutshell, the complaint handling system is broken –the Consultation is providing an opportunity to fix it .I recommend an overhaul of SRO rules regarding Dealer complaint handling and enhanced compliance monitoring. More emphasis has to be put on securing investor restitution.

SRO's should have an investor advisory Panel

In order to bring the voice of the investor to the Board, the modern SRO should have an Investor Advisory Panel .This should be financed by the SRO and should include cash for contracting for independent research as required.

As a retired senior I now mange my own investments after learning the hard lessons of dealing with untrustworthy conflicted advice from SRO Firms. It is very important that the CSA not permit SRO's to stifle innovation among discount brokers or limit access in order to protect the interests of full service brokers. See APPENDIX I. I also do not recommend that robo-advisors be regulated by SRO's until they are totally transformed into a "new" SRO.

I hope these comments are useful to you.

Please feel free to publicly post this Comment letter.

Peter Whithouse

APPENDIX I Regulatory Overreach- IIROC Guidance on Discount brokers

SRO's may overreach in their zeal for control .For example, we have asked the CSA to recall IIROC Guidance on OEO 11-0076 http://www.iiroc.ca/Documents/2018/54df3aa0-06d8-48fd-8e93-ce469be1c650_en.pdf [It has not done so as of the date of this report]

A Kenmar Associate's comment letter took IIROC to task for the attempt to curtail access to the excellent tools offered by discount brokers. https://www.iiroc.ca/Documents/2016/9557bad7-f6f4-4d75-8a37-4dbed68fd788_en.pdf Respected blogger and CFA holder Andrew Teasdale critiqued the guidance in his blog *Comments on IIROC's proposed guidance on Order Execution Only guidance* http://blog.moneymanagedproperly.com/?p=5835 So did industry participants.

I quote from the IIAC Comment letter (https://www.iiroc.ca/Documents/2017/abd57f24-6c2f-4213-a87e-0534fc11d57a_en.pdf) on the IIROC proposed Guidance: "Industry's Key Concerns: The *industry has many major concerns with the proposed Guidance. The key concern of our member firms is that clients may use online "educational" tools, products and information containing inaccurate data and information from unreliable sources in order to make investment decisions if the Guidance is implemented. Investors request tools and information from OEO firms in order to make educated investment decisions. Providing a wide range of documentation and products is to the benefit of the client and this Guidance, if implemented, will not protect the investor and is therefore not in the best interest of the client."*

Questrade had this to say" OEO firms must be permitted to push information to clients so that clients can make informed investment decisions. To prohibit OEO dealers from providing this important information could be harmful to the investor." https://www.iiroc.ca/Documents/2017/d823c1d1-cf1b-4e8a-88fa-858b72136fb2_en.pdf

I also believe that there are two other major concerns with the introduction of the Guidance:
1) An overly broad definition of "recommendation" and its ensuing applicability to both OEO and Advice dealers; and
2) The introduction of an "appropriateness" test. "

Another industry participant, RBC Direct Investing, asked IIROC to withdraw the Guidance Re http://www.iiroc.ca/Documents/2017/b8e3e93c-f7b6-4aaa-8576-74b0a10b9e3d_en.pdf So, basically industry participants did not support the proposed Guidance and expressed concerns. Investor advocates including SIPA, FAIR, Kenmar, individual DIY investors and the OSC's own IAP vigorously opposed the guidance. Yet here we are today stuck with Guidance that could harm retail investors and is clearly not in the Public interest. Discount brokers provide a safe, low-cost method of investing and through various tools, simulators and calculators assist in developing financial capability. Implementing the guidance could limit innovation, unduly constrain access and add to client costs.

It is very clear - there is no serious problem, DIY investors are not being harmed, all investor commenters said "Hands Off", and satisfaction with Discount brokers was very high. In order to justify their inappropriate action, IIROC had to redefine recommendation and advice to fit their approach to constrain discount brokers. We very much doubt if statutory Securities regulators ever conceived of these convoluted definitions. The consultation process itself was flawed – the submission timeline had to be extended twice, underlying research was not disclosed and claims of extensive consultation with advocates were rebutted. Despite IIROC's unsubstantiated assertions, discount brokers do not provide personalized investment advice.

What is galling is that despite the lack of support from stakeholders, industry and investors, IIROC issued the Guidance anyways with minimal change.

An SRO should not have the power to redefine recommendation and advice for the entire financial services industry especially via Guidance that bypasses formal regulatory approval. Such power should be left to statutory regulators and then only after adequate research and consultation. In this case, the IIROC Board were passive observers during the proposition phase, consultation phase and on the comments received phase. This consultation should never have happened in my opinion. The Board of a modern SRO should be composed of individuals who will act when such overreaches of power and anti-investor initiatives appear.