FAIR | Canadian Foundation *for* Advancement *of* Investor Rights

February 7, 2014

Frank Allen
Assistant Deputy Minister
Ministry of Finance
Frost Building North, 4th Floor
95 Grosvenor Street
Toronto, Ontario
M7A 1Z1

Dear Mr. Allen:

RE: Investigating the Merits of Regulating Financial Planners in Ontario

In the 2013 Economic Outlook and Fiscal Review, the Government of Ontario made a commitment to investigate the merits of proceeding with more tailored regulation of financial planners and recognized that "[p]eople who seek the assistance of financial planners expect access to sound, professional advice to ensure that their investment decisions best serve their financial goals." FAIR Canada commends the Ontario government for making it a priority to address the need for sound professional financial advice that best serves Ontarians.

This letter provides FAIR Canada's recommendations as to how the Ontario government can:

- ensure that consumers are adequately protected;
- promote more informed decision-making;
- provide more (and better) choices for consumers; and
- encourage more effective price competition as well as a more professional financial services industry and foster a greater level of trust in the financial services market.

In addition, FAIR Canada provides its responses to the specific questions posed in the consultation document.

FAIR Canada is a national, non-profit organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. Executive Summary

1.1. Existing regulatory requirements and industry practices (including Phase 2 of the Client Relationship Model which will be implemented over the next few years) do not provide adequate protection for consumers of financial services in Canada. Consumers believe and expect that financial advisors, including financial planners, are required to provide advice that is in their best interest. FAIR Canada recommends that the Minister of Finance lend its support to a statutory best interest standard.

1.2. Professional financial services must be provided to consumers in the absence of conflicted remuneration structures, including embedded third party commissions.

1.3. A person (or his or her firm) should not be permitted to hold out as a professional who provides financial advice unless they provide advice that is unbiased and not in conflict with the client's best interest and meet the minimum uniform level of proficiency.

1.4. The current compensation structure centers on transactional compensation which incentivizes the sale of products. The current system does not serve well-intentioned financial planners or consumers well and does not encourage the emergence of a true financial planning profession.

1.5. When financial planners assist with "implementing" the financial plan through the purchase of investment products, purchase of life insurance, or referrals to lawyers for the execution of a will or power of attorney the potential for serious conflicts of interest arise. Remuneration arrangements resulting from these activities may call into question the objectivity or appropriateness of the financial plan itself.

1.6. While FAIR Canada unequivocally supports regulatory measures that will provide the best and highest-quality financial advice to consumers, we suspect that the impact of compensation structures on the quality of financial plans (and adherence to them) is much greater than proficiency, professionalism, and other factors. The broader problem is that consumers are not being provided with real financial planning advice by those who are also registrants or licensed and are instead often being sold products under its guise.

1.7. Only those financial service providers who offer financial planning on a fee-for-service basis or a fee-based basis and who meet the required proficiency (and who have been granted a certificate or license) should be permitted to hold out as providing financial planning. Clear disclosure and transparency regarding fees (including referral fees) and commissions would be required as would prohibitions on self-dealing.

1.8. FAIR Canada strongly believes that if financial planners wish to professionalize, a key characteristic is ethical standards and a commitment to serve the public interest. Professing to do this as required by an association's Code of Ethics whilst actively opposing that such a standard be introduced as a statutory requirement and opposing reforms to reduce conflicts of interest that prevent the discharge of objective advice undermines any claim to aspire to professionalism.

1.9. FAIR Canada does not support a model where financial service provider associations would be deemed self-regulatory organizations and given the authority to regulate financial planning or financial advice more broadly. Existing statutory regulators should regulate the provision of financial advice, including financial planning advice. To allow existing associations to regulate this activity would simply give further legitimacy to the status quo of low levels of proficiency and conflict ridden transaction-based sales recommendations which lead to poor consumer outcomes.

2. FAIR Canada's Recommendations to Improve the Provision of Financial Advice (including Financial Planning Advice) to Ontarians

<u>Statutory Best Interest Standard Essential</u>

2.1. FAIR Canada, in its submission to the Canadian Securities Administrators ("**CSA**") in response to Consultation Paper 33-403[1], has urged securities regulators to require dealers and their advisors to act in their client's best interest. As we noted in that submission to the CSA, a statutory best interest duty must be introduced in order to protect investors and is both desirable and feasible. **Existing regulatory requirements and industry practices (including Phase 2 of the Client Relationship Model which will be implemented over the next few years) do not provide adequate protection for consumers of financial services in Canada. FAIR Canada recommends that the Minister of Finance lend its support to a statutory best interest standard.**

2.2. Consumers believe and expect that financial advisors, including financial planners, are required to provide advice that is in their best interest. This is the representation made to consumers in marketing and advertising, but unfortunately this is not the current regulatory requirement. We note that reference to serving the best interest of clients was made by numerous organizations during the roundtables hosted by the Ontario Ministry of Finance, including by self-regulatory organizations, industry lobby groups, and registered firms, many of whom have publically opposed the implementation of such a duty. FAIR Canada has difficulty reconciling the positions of these parties regarding a statutory best interest duty with the representations they make to Ontarians every day.

2.3. **In order for consumers to obtain sound, professional financial advice, it is necessary to remove conflicted remuneration, including third party embedded commissions which result in conflict-ridden advice, in order to allow dealers and their advisors to provide advice to their client in a manner that aligns the interest of the consumer**

[1] See: <http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-Submission-re-CP33-403-Statutory-Best-Interest-Duty.pdf>.

and the dealer/advisor. Even in the absence of a statutory best interest standard, which FAIR Canada strongly recommends, the removal of these influential conflicts from the relationship between the dealer/advisor and consumers must be achieved in order for consumers to be adequately protected.

Reform Mutual Fund Fees

2.4. FAIR Canada has provided comments on the CSA's Discussion Paper and Request for Comment 81-407 urging the reform of the mutual fund fee structure in Canada so that serious conflicts of interest are reduced. These conflicts are systemic and structural in nature and lead to higher costs, poor product recommendations and a lack of effective price competition that results in a reduced ability of consumers to adequately save for their financial goals.

Professional Financial Services

2.5. FAIR Canada believes that if a dealer and its advisors want to hold out as offering professional financial services to consumers, which may encompass financial planning, investment advice and the implementation or execution of investment recommendations, an increased, objective standard of minimum proficiency must be introduced before one can hold out as a professional. Consumers should not be required to assess the various confusing credentials and inflated titles that currently exist in order to ensure they will receive professional advice.

2.6. Professional financial services must be provided to consumers in the absence of conflicted remuneration structures, including embedded third party commissions. A person (or his or her firm) should not be permitted to hold out as a professional who provides financial advice unless they provide advice that is unbiased and not in conflict with the client's best interest and meet the minimum uniform level of proficiency.

Tiered Approach to Best Interest

2.7. Should regulators be unwilling to impose a best interest standard on all business models as we recommend, an alternative would be to take a tiered approach so that those who elect not to adhere to a best interest standard would be permitted to provide "restricted advice" along the lines of the model in the U.K.

2.8. FAIR Canada recommends that those who are permitted to provide "restricted advice" be required to use the title "salesperson", be subject to suitability requirements, and be precluded from holding out that they offer independent advice, act in the best interest of the client, or are a professional (whether it be a professional financial planner, financial advisor or otherwise). They must disclose in writing and orally that they are providing restricted advice, which is not required to be in the best interest of the consumer.

2.9. Stringent requirements with respect to marketing and advertising materials and titles and credentials would need to be imposed and enforced in order to prevent consumers from being misled. As noted by the CSA, "…some advisers and dealers market their services on the explicit or implicit basis that the advice they are providing is in the client's best interests."[2] Such misleading advertising and marketing would no longer be permitted and would be strictly enforced in respect of dealers and advisors who offer restricted advice.

2.10. While this is not FAIR Canada's preferred approach, particularly given the confusion observed in the U.S. where many consumers do not appear aware of the different obligations of registered investment advisors and broker-dealers, we believe that a tiered approach would at least offer the option of advice in consumers' best interest to financial consumers in Canada.

2.11. We have also recommended that if a firm is restricted in its product list, such as with mutual fund dealers, consideration should be given to permit registrants of such dealers to become registered to sell other collective investment products such as exchange traded funds (ETFs) provided they meet the necessary level of proficiency. We believe that by expanding the list of products such registrants are permitted to sell would result in better product recommendations for financial consumers.

3. Consumers' Experience with Financial Planning

3.1. Empirical research has shown that building a financial plan is one of the services that consumers expect when they seek out advice from their "financial advisor"[3] and that they expect this advice to be provided in the consumer's best interest regardless of any conflicts that exist.[4] The industry itself stresses the need for professional advice and financial planning in its marketing and advertising, no doubt as a result of consumers' needs and expectations. **Unfortunately, it appears that many consumers do not receive independent, objective, financial planning advice or written financial plans, but instead end up dealing with financial salespersons that make their livelihood through the sale of investment products.** Financial plans are often used as a teaser or loss leader to sell investment products to consumers. "[F]inancial planning... became simply a tool to sell investments."[5]

3.2. Many individuals who have gone to the trouble to obtain a financial planning designation end up being frustrated by the inability to provide true financial planning and put into practice what they have learned given the way the financial industry is

[2] CSA Consultation Paper, (2012) 35 OSCB 9558 at page 9585.
[3] Investor Education Fund, "investor behavior and beliefs: Advisor relationships and investor decision-making study", written by The Brondesbury Group, 2012 at page 11.
[4] *Supra* note 3, at page 28.
[5] John Lawford and Janet Lo, "Holding the Purse Strings: Regulating Financial Planners" (December 2009), at page 13.

structured.[6] **The compensation structure centers on transactional compensation which incentivizes the sale of products. The current system does not serve well-intentioned planners or the consumer well and does not encourage the emergence of a true financial planning profession.** As noted by PIAC:

> "For most Canadians, their experience with the financial planning industry does not involve actual financial planning at all. What it does include is a meeting with an individual who has a title that leads consumers to believe they are receiving financial planning advice. However, in reality consumers are dealing with financial salesperson who is employed by organizations to solicit a specific product or series of products. While it was noted previously that anyone can call themselves a financial planner in Canada, the notion that most individuals in the financial planning industry are merely salespeople is so prevalent that even most financial planning students don't bother completing the Certified Financial Planner designation."[7]

3.3. Financial planning itself is poorly articulated by those who claim to be financial planners as well as by consumers.[8] The consultation document itself does not define financial planners or what it considers financial planning to encompass. Consumers are aware of the term "financial planning" but what they understand to be the exact content is not easily discernible.

3.4. Generally financial planning bodies and some provincial regulation define financial planning as advice from an independent financial expert on all the following six major financial determinants in life:

1. cash and debt planning
2. income tax planning
3. investment planning
4. retirement and financial independence planning
5. insurance and risk planning
6. estate planning.

[6] Jonathan Bishop and John Lawford, "Purse Strings Attached: Towards a Financial Planning Regulatory Framework" (December 2012), at pages 27 to 29. See also Tim Kiladze, "Canada's trouble with investment advisers" (November 23, 2013) The Globe and Mail, available online at: <http://www.theglobeandmail.com/report-on-business/canadas-trouble-with-investment-advisers/article15574647/#dashboard/follows/>.

[7] *Supra* note 6 at page 27. See also pages 28 to 29 for the discussion how the industry is structured so that those who may have a financial planning designation do not provide real financial planning to their clients but are rather product driven, transactional agents who are asset consolidators and may provide limited financial planning advice along with the way.

[8] *Supra* note 5 at page 4.

3.5. The financial planner is expected to review all of these areas with their client and provide a written financial plan, which is then reviewed periodically for accuracy given changes in the financial circumstances and life stages of the client over time.[9] Financial planning is described as a process that should result in a written financial plan that involves determining how an individual can best meet their life goals (send their children to university, buy a house, pay off debts, retire comfortably, etc.) through managing their financial affairs.[10]

3.6. **When financial planners assist with "implementing" the financial plan through the purchase of investment products, purchase of life insurance, or referrals to lawyers for the execution of a will or power of attorney the potential for serious conflicts of interest arise. Remuneration arrangements resulting from these activities may call into question the objectivity or appropriateness of the financial plan itself.**

3.7. Consumers find existing credentials and titles incomprehensible and are not able to distinguish, for example, a "certified financial planner" from a "financial advisor" or a personal financial planner.[11] According to a report by the Public Interest Advocacy Centre, financial planner groups and their designations are largely ignored in the decision to use a financial planner.[12] A recent IIROC survey found that investors were divided as to how important business titles and financial designations are to entering into and maintaining a relationship with an advisor.[13] FAIR Canada is not aware of any data on the extent to which the provision of financial plans has led to consumer harm or consumer complaints and recommends that the government make public this information or that such research be commissioned. Do written financial plans that are not sound or are in some way negligent or substandard through failing to properly take into account relevant information or the use of faulty assumptions (expected rate of return for example, leading the individual to allocate a large portion of their financial assets to equity investments rather than paying down a mortgage faster) cause real harm to investors? While FAIR Canada unequivocally supports regulatory measures that will provide the best and highest-quality financial advice to consumers, we suspect that the impact of compensation structures on the quality of financial plans (and adherence to them) is much greater than proficiency, professionalism, and other factors.

3.8. Practically speaking, poor consumer outcomes result from: unsuitable recommendations regarding investments; recommendations that whilst they may be suitable, are high cost; unsuitable recommendations to borrow to invest and other problems which arise as a result of the conflicts of interest and misaligned incentives that currently exist rather than from problems with the financial plan itself. However,

[9] *Supra* note 6, at page 6.
[10] See, for example, FPSC Website at http://www.fpsc.ca/financial-planning.
[11] *Supra* note 5, at pages 4 and 61.
[12] *Ibid.*, at page 5.
[13] IIROC Notice 13-0005,"Use of Business Titles and Financial Designations, (January 8, 2013) at page 6.

this is not to say that there are no problems with the financial plans that are being provided to consumers**. Is regulation of financial planners needed to prevent substandard written financial plans by those who are not properly proficient but are nonetheless holding out as a financial planner to the public? FAIR Canada suggests that this regulatory gap should be addressed in the interests of consumer protection.** However, further data would be helpful in determining the extent and cause of harm and identifying the best regulatory response.

3.9. **The broader problem, however, is that consumers are not being provided with real financial planning advice by those who are also registrants or licensed and are instead often being sold products under its guise.** Given the structure of the industry, the implementation of financial plans often involves serious conflicts of interest given the prevalence of compensation structures based on commissions or amount of assets under management. This can lead to high costs and poor asset allocation and/or product recommendations.

4. FAIR Canada Recommendations Regarding the Regulation of Financial Planners and Financial Planning

<u>FAIR Canada Supports Regulation of Financial Planners</u>

4.1. **We recommend that there be regulation as to who can hold out as a financial planner by setting objective proficiency requirements. A profession (whether lawyer, accountant or financial planner) involves a clearly defined and articulated body of knowledge, skills and abilities.**

4.2. **FAIR Canada recommends that the Ontario government examine Quebec's regulatory requirements that are quite rigorous. Ontario should require a person who wants to hold out as a financial planner to obtain a certificate or license from the regulator in order to practice.** If a rigorous standard was set in order to hold out as a financial planner, a consumer would not need to make inquiries or attempt to sort through the numerous titles and designations prior to seeking advice and would not have to wonder whether the person they have chosen has a designation that is up to the task or not.[14]

<u>Independent Advice vs. Salespeople</u>

4.3. Consumers should be given a clear choice between those who are able to provide independent, objective financial planning advice free of third party embedded commissions and other forms of conflicted remuneration and who act in the client's best interest and those who do not are salespeople. Regulations should only allow those who meet the required proficiency (described in the aforementioned

[14] Quebec's The Act Respecting the Distribution of Financial Products and Services" should be examined and used as a de minimus standard.

paragraph) and who offer independent advice to call themselves a financial planner. Those who do not meet this standard should be required to use the title "salesperson".

4.4. **Only those financial service providers who offer financial planning on a fee-for-service basis (where clients pay an hourly fee for advice or pay a flat rate for a written financial plan and smaller amount thereafter for monitoring costs and necessary adjustments to the plan) or a fee-based basis (where a percentage is charged directly to the client for advice, usually based on the amount of assets under management and who meet the required proficiency (and have been granted the certificate or license) should be permitted to hold out as providing financial planning. Clear disclosure and transparency regarding fees (including referral fees) and commissions would be required as would prohibitions on self-dealing.**

4.5. FAIR Canada recognizes that the fee-based model still can still present conflicts of interest (for example, advice to move financial assets to the financial planner by commuting the value of a pension[15]) which will need to be immediately addressed in order to adequately protect consumers.

Need Real Ethical Standards and Professionalism

4.6. FAIR Canada strongly believes that if financial planners wish to professionalize, a key characteristic is ethical standards and a commitment to serve the public interest. Professing to do this as required by an association's Code of Ethics whilst actively opposing that such a standard be introduced as a statutory requirement and opposing reforms to reduce conflicts of interest that prevent the discharge of objective advice undermines any claim to aspire to professionalism.

Single Registration/Licensing Check Desperately Needed

4.7. **FAIR Canada recommends a one-stop licensing and registration check system so that consumers can easily determine whether the person from whom they seek financial advice from is properly registered/licensed and whether they are a financial planner (independent advice) or whether they are a salesperson.**

Securities Commissions Must Regulate Financial Planners

4.8. FAIR Canada does not support a model where financial service provider associations would be deemed self-regulatory organizations and given the authority to regulate financial planning or financial advice more broadly. Existing statutory regulators should regulate the provision of financial advice, including financial planning advice, given that such a small percentage of financial planners do not already come within

[15] See comments by Mark Fuller of the Ontario Pension Board during the Ontario Ministry of Finance Roundtable Session II held January 14, 2014, available online at: http://www.fin.gov.on.ca/en/consultations/14-Jan-14-MOF-Rountable.pdf, particularly at pages 31-32 and 71-72.

the jurisdiction of a financial regulator. The vast majority (approximately 95%) of Ontario's financial planners are involved in implementation of the financial plan by making investment product recommendations.

4.9. To allow existing associations to regulate this activity would simply give further legitimacy to the status quo of low levels of proficiency, and conflict ridden transaction based sales recommendations (rather than objective advice) which leads to poor consumer outcomes. To transform existing associations into an adequate self-regulatory organization ("SRO") would require significant government and regulatory resources, consolidation of multiple associations into one self regulatory organization, lengthy delay in implementation, and regulatory oversight of the SRO and would, at the end of the day not result in effective regulation or adequate consumer protection. FAIR Canada believes that government and regulators' efforts would be better spent on other initiatives which would be of far greater benefit to consumers, such as removing conflicts from advice and implementing a statutory best interest standard.

5. Answers to the Ministry of Finance's Questions

Question 1: *Is Ontario's current regulatory approach in relation to financial planners appropriate?*

5.1. No it is not as most consumers are not provided with objective financial planning advice.

Question 2: *How would you improve Ontario's current regulatory approach?*

5.2. FAIR Canada recommends that the government implement a statutory best interest standard that would also require that third party embedded commissions be banned and other types of conflicted remuneration eliminated. FAIR Canada recognizes that an incremental approach may be necessary and therefore makes recommendations in Section 2 above.

Question 3: *Are there approaches to regulating financial planners which you would recommend?*

5.3. Yes, see sections 2 and 4 above.

We thank you for the opportunity to provide our comments and views in this submission. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Ermanno Pascutto at 416-214-3443 (ermanno.pascutto@faircanada.ca) or Marian Passmore at 416-214-3441 (marian.passmore@faircanada.ca).

Sincerely,

Ermanno Pascutto
Executive Director, FAIR Canada