

## **The Battle for Investors' Rights**

### **An interview with FAIR Canada founder Ermanno Pascutto**

*By Rossa O'Reilly, CFA*

The Foundation for the Advancement of Investors' Rights of Canada (FAIR Canada) can be described as the consumer protection agency for small investors. It stands apart from the industrial and professional associations within the investment industry which, though often acting in the interests of small investors, have mandates to serve their respective members' interests first. FAIR Canada shares objectives with industry and professional associations, but at times it finds itself at loggerheads with them or some of their members over issues involving the investment industry's treatment of small investors. The CFA Society Toronto has worked with FAIR Canada on investor events and on advocacy issues such as the recent call on regulators to require advisors to assume fiduciary-like duty by putting their clients' interests first when providing investment advice. FAIR Canada's founder and executive director Ermanno Pascutto was instrumental in the creation of the foundation in 2008 with funding from Market Regulation Services Inc. (RS) and the Investment Dealers Association of Canada (now merged to become the Investment Industry Regulatory Organization of Canada or IIROC). We had the opportunity recently to discuss with him the foundation's work on behalf of small investors.

#### **Q: What caused you to embark on the years of hard work that have brought FAIR Canada to where it is today?**

**A:** Prior to the launch of FAIR Canada, regulators and government policy-makers would receive input from the financial industry, listed issuers, financial institutions and their legal and other advisors, but would receive limited or no input from the investors they were mandated to protect. Retail investors did not have the resources necessary to advance their interests, while industry and their lobby groups were robustly funded. I proposed the start-up of an investors' rights organization to address this problem.

It took me almost two and a half years of speaking to dozens of different people and organizations and numerous submissions before FAIR Canada evolved into its final form. I agreed to be the initial Executive Director and gave up my Hong Kong securities law practice with the US law firm of Troutman Sanders and international consulting to devote my full time attention to the foundation..

In addition to the support of the board and staff of RS, I was fortunate to have the assistance of Stanley Beck and Ed Waitzer two friends and former chairs of the Ontario Securities Commission. Also I give a great deal of credit to the boards of directors of both RS and the IDA for being willing to fund an organization that invariably would not agree with many securities industry practices and would seek greater protection for consumers and investors.

#### **Q: What do you regard as FAIR Canada's greatest achievements to date?**

**A:** FAIR Canada has helped focus the public's and regulators' attention on issues of importance to retail investors. For example in our first year we issued two reports on the dangers posed by leveraged, inverse, and commodity exchange-traded funds (ETFs), the lack of industry understanding of these complex products, and the misleading way they were marketed and advertised. These reports received attention from regulators and the media in Canada and abroad. Not long afterward, IIROC issued a guidance note for its dealer members about their duties with respect to these complex products. Shortly thereafter some retail firms decided to prohibit their advisors from selling these products.

In our second year, FAIR Canada (with the support of the CFA and the Hennick Centre at York University) led the debate in Canada on whether registrants should have a fiduciary duty or, more simply, a duty for financial advisors to act in the best interests of their client. We organized the first Canadian conference on the topic in March 2010, and also hosted a follow-up roundtable in February 2011. This topic had been the subject of significant discussion by regulators in the U.K., U.S., and Australia but there had been no discussion in Canada. The OSC undertook in its 2011 to 2012 Statement of Priorities to issue a report on fiduciary duty. And as your readers are aware, the CSA issued a consultation paper on the best interest standard late in 2012. Of course, this is simply the beginning of the debate but is it an important milestone.

A third initiative was to advocate better representation of investors and consumers of financial products in policy development in securities regulation. FAIR Canada made a submission to the Ontario Standing Committee on Government Agencies and several representations to the OSC on the need for an investor advisory panel. The report of the Committee, which was unanimous, adopted our recommendations and the OSC announced the creation of its Investor Advisory Panel (IAP) when the report was released and it recently announced the creation of the office of the investor. We would like to see similar initiatives in the other provinces and more permanent arrangements for a consumer voice for investors as they have in the UK. But this is a good start.

The key to any success is a willingness to listen and act on investor protection issues on the part of leaders in government and among regulators. FAIR Canada has very limited resources and no power to affect change. All we can do is advocate for change. We have been fortunate that our submissions have found a receptive ear whether it is IIROC on leveraged ETFs or the OSC on the investor advisory panel.

**Q: In your view, what is the most important issue when it comes to improving fairness for the small investor?**

**A:** FAIR Canada believes that the interests of the financial industry and the interests of investors have to be better aligned. The introduction of a statutory best interest standard for dealers and advisers would better align the interests of the industry with their clients and will result in increased investor protection, better financial outcomes for consumers and more effective competition. Ultimately, it increases the level of trust in the financial services industry.

The second part of aligning these interests is eliminating the worst conflicts of interest. We believe that the best way to protect consumers from conflicts of interest arising in the advisor-client context is to ban the most egregious conflicts and in particular conflicted remuneration. We believe that third-party commissions should be prohibited and that investors in mutual funds and other products should be charged commissions or other fees in the same way as when they purchase shares of listed companies. In our view, third-party commissions contribute significantly to the opaqueness of cost information and do not provide any tangible investor benefits.

**Q: What are the greatest challenges facing FAIR Canada?**

**A:** The two major challenges are funding and staffing. At the startup of FAIR Canada I was not aware of the sad state of funding of consumer organizations in Canada. Most operate with extremely scant budgets. We came fairly close to the end of our financial resources last year but obtained last minute funding from the OSC and IIROC. There is no longer term sustainable funding arrangement so we will face the same challenge next year. We understand that in the telecom and energy sectors statutory provision has been made for funding for a consumer voice at regulatory hearings but there is nothing similar in the securities field.

Staffing and funding are linked in that we are unable to compete with the compensation paid by the financial industry or regulators and there is no certainty that positions will be there next year. We are fortunate to have two excellent professionals, Marian Passmore and Lindsay Speed who do much of

heavy lifting when it comes to preparing the many formal and informal submissions that we prepare every year.

**Q: I understand that your daughter, who is a member of CFA Society Toronto, has successfully completed all the CFA examinations and is currently working in the investment industry. What advice would you give to her and other investment professionals about their future careers?**

**A:** The CFA qualification is the gold standard in the investment industry both in terms of proficiency and ethics. When I was executive director of the OSC in the 1980s the Toronto CFA society impressed me as virtually the only voice for better corporate governance and regulation in general. I am proud that my daughter had the discipline, drive and intelligence to complete the challenging CFA process and hope to see more professionals taking this route. The CFA Institute and CFA societies are important institutions and I hope to see them (and all CFAs) play an even more active role in helping the financial industry evolve so that it better serves the long-term interests of both consumers and the industry.

***CFA Society Toronto members and all interested parties are invited by FAIR Canada to access its website at: [www.faircanada.ca](http://www.faircanada.ca) where copies of the foundation's numerous submissions and press releases are archived and where a free online subscription to its monthly newsletter is available.***

## **SIDEBAR**

### **FAIR Canada's Strategic Priorities**

**Providing the Investor's Perspective to Securities Regulators and Governments** - FAIR Canada submits comments on all relevant requests for comment issued by Canadian securities regulators (including SROs) and governments.

**Addressing Financial Fraud and Other Misconduct and Improving Consumer Redress** - FAIR Canada strives to:

- Improve the prevention, detection, investigation, prosecution, and punishment of financial fraud and other misconduct
- Educate investors, especially vulnerable groups, about the importance of dealing with registered individuals or firms and about the implications of SRO membership and compensation fund backing.
- Improve avenues of compensation and consumer redress for victims of financial fraud and other misconduct.  
Support a national, independent, consumer-friendly financial services dispute resolution service for clients of banks and securities firms.

**Curbing Complex and High-Fee Investment Products and Misleading Advertising** - FAIR Canada investigates and analyzes the impact of complex and high-fee investment products on investors, and advocates greater transparency surrounding fees as well as more substantive regulation of such products. FAIR Canada also pressures regulators to be more proactive in addressing misleading advertising.

**Improving Client-Advisor Relationships** - FAIR Canada works to stimulate reform of the client-financial advisor relationship to encourage a better alignment of the interests of retail investors and financial advisors, and advocates the adoption of a requirement that registrants have a fiduciary duty or duty to act in their clients' best interest

**Increasing Awareness** - FAIR Canada maintains and enhances relationships with securities regulators, including provincial commissions, SROs, government and other organizations.

**Monitoring Emerging Issues** - FAIR Canada monitors emerging trends and issues in securities regulation and takes action where warranted in the interest of investors.

**(INSERT PHOTO OF ERMANNIO PASCUTTO)**