September 30, 2016

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

Josee Turcotte, Secretary
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8
Sent via e-mail to: comments@osc.gov.on.ca

Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, QB H4Z 1G3
Sent via email to: consultation-en-cours@lautorite.qc.ca

RE: Request for Comment – Proposed Best Interest Standard and Proposed Targeted Reforms

FAIR Canada is pleased to offer comments on the set of regulatory amendments to National Instrument 31-103 to enhance various specific obligations that registrants owe to their clients (the " Proposed Targeted Reforms") as well as the proposal to implement a regulatory best interest standard that all members of the Canadian Securities Administrators (other than the British Columbia Securities Commission ("BCSC")) are consulting on as set out in the CSA Consultation Paper 33-404 "Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward their Clients" dated April 28, 2016 (the "Consultation Document").

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

1. <u>Overview</u>

1.1. FAIR Canada strongly believes that Canada urgently needs to implement reforms so that dealers and their individual registrants (individual registrants are also referred to herein as "financial advisors") have a statutory duty to act in their client's best interests and to ensure that they will be able to meet their obligations to do so. FAIR Canada strongly believes this requires enactment of a statutory best interest duty. The Proposed Targets Reforms will not suffice. They are inadequate because they do not effectively address conflicts of interest and other problems that can, and frequently do, exist at the heart of the relationship between dealers, financial advisors and their clients.

1.2. The need for a best interest duty arises from the fact that many Canadians today are forced to navigate complex financial markets in order to achieve retirement security and their other financial goals, yet at the same time, most investors are ill-equipped for this task. Lacking much financial literacy, they find the markets bewildering and, therefore, they turn to financial advisors for help. Many investors rely heavily on their financial advisors, who often exert tremendous influence over the decisions these clients make. (An explanation of the problems that exist currently is detailed in section 2 below).

1.3. To be beneficial for Canadians, however, the advice they receive from their financial advisors must be objective as well as proficient. But financial advice shaped or influenced by conflicts of interest can never be objective. Therefore, the only advice investors should receive from a truly professional financial advisor is advice that is free from conflicts and is, therefore, focused on what's best for the investor, not what's best for the advisor.

1.4. Although securities regulation in Canada does not require it, Canadians believe dealers and their financial advisors are required to provide advice based on their clients' best interests. This is a perfectly reasonable belief – one that's fostered by the financial services industry and also by securities regulators. Both encourage Canadians to regard individual registrants as knowledgeable, licensed professionals.

1.5. There is no justifiable reason why dealers and their financial advisors should not be required, like all other professionals, to act in their clients' best interests. In particular, there is no merit to the contention that a best interest duty would cause investors to rely excessively on their advisors and would amount to an abdication of responsibility. Relying on a professional's advice is a sensible thing to do given the professional's greater knowledge and expertise and given the professional's duty to do what's best for those who seek their help. Accordingly, it is appropriate, fair, essential and completely concordant with the public interest that financial advisors should be bound by a best interest duty.

1.6. FAIR Canada believes a meaningful best interest duty is necessary not merely as a prescriptive obligation, but also as a guiding principle for dealers and their financial advisors in all aspects of their conduct and their business operations.

1.7. Furthermore, FAIR Canada believes the best interest duty must be articulated clearly and unequivocally in legislation governing both dealers and their advisors so that it will be fully enforceable and so that it will be understood to govern firms and individual registrants in all aspects of their relationship with their clients.

1.8. Of key importance to the successful implementation of a best interest standard is the adoption of rules prohibiting embedded third party commissions and other advisor compensation arrangements that foster the misalignment of client and advisor interests ("conflicted remuneration"). Such rules should also apply to portfolio managers.

1.9. Such a step is necessary to ensure that all registrants provide their services in a manner that does not actively jeopardize or subvert the interests and wellbeing of their clients. Compensation drives behaviour, and conflicted remuneration in embedded third party commissions, affiliated dealer fund flows and deferred sales charges have been proven to harm investor outcomes and harm the market. These problems can no longer be ignored and must be addressed. FAIR Canada disagrees with the Consultation Document insofar as it gives credence to the notion that most conflicts of interest can be adequately addressed, or managed, through disclosure. In general, the objectivity of financial advice can be safeguarded only by avoiding conflicts of interest; and in rare circumstances where a conflict is truly unavoidable, financial advisors must be required to act in a manner that adequately protects the interests of the client and benefits the client, not the advisor.

1.10. Disclosure does not work to adequately protect investors from conflicts of interest. Individuals do not respond in a manner traditional economic theory would expect. Investors do not have the knowledge to appropriately factor the impact of a conflict of interest into their evaluation of the "advice" they receive. Also, disclosing conflicts of interest can have perverse effects that make matters worse, such as leading advisors to unconsciously give more biased advice once they have made the disclosure. And fundamentally, disclosure does not address the structural and systemic problems that the conflicts have created, hurting investors and the market itself.

1.11. FAIR Canada recognizes that some investment firms and their financial advisors are unable to operate on a conflict-free basis because of the very nature of the business models they utilize. For example, firms with intimate ties to issuers, approved shelves containing only proprietary products or programs designed to channel sales primarily toward particular products lack the objectivity required to formulate advice based on their clients' best interests. We would prefer to see these business models abolished. However, if registrants are going to be allowed to continue using them, FAIR Canada believes the activities of those registrants should be strictly confined to product sales (with associated reforms we discuss below regarding suitability, know-you-client and know-your-product requirements and rules prohibiting conflicted remuneration). These registrants should be prohibited from providing financial or investment "advice" and they should be prohibited from portraying themselves as advisors.

1.12. Business titles, therefore, should be limited to three categories:

- "Investment Advisor" or "Financial Advisor" for those operating within business models that allow them to comply with the statutory best interest duty;
- "Portfolio Manager" for those licensed to exercise discretionary authority (including robo-advisors) while operating within business models that allow them to comply with the fiduciary duty already required of such registrants; and
- "Salesperson" for those operating within business models that prevent them from complying with the statutory best interest standard.

1.13. FAIR Canada believes this straightforward nomenclature will allow consumers to distinguish between financial advice, which can be relied upon as being professional in nature, and sales pitches, which may be informative but which should be viewed guardedly and with some skepticism.

1.14. All three categories of registrant should remain fully bound by know-your-client, know-your-product and suitability obligations (except to the extent exempted in discount brokerage (also known as "order execution only") situations) and FAIR Canada believes certain targeted reforms that can strengthen those obligations should be adopted (for details see our comments on the Proposed Targeted Reforms below).

1.15. Additional specific reforms must, by necessity, accompany a shift to a best interest standard. Besides removing conflicted remuneration, these other reforms (described in more detail below)include (i) increasing education and initial proficiency requirements; (ii) changes to the rules regarding referral fees (iii) changes to the regime surrounding "outside business activities"; and (iv) reforms to consumer redress.

1.16. In summary, FAIR Canada, shares the CSA's view that the status quo is not acceptable, but we maintain the response required is not one of incremental steps. Such an approach would be woefully inadequate. Instead, the opportunity should be seized now to institute a profound shift to a statutory best interest standard that will ensure Canadians receive the objective, professional financial advice they need and expect.

1.17. Other leading jurisdictions have implemented reforms in this area - including best interests duties, banning conflicted remuneration, banning inducements (both monetary and non-monetary) and increasing proficiency requirements for advisors while also providing investors with summary disclosure about different types of investment products. We include a summary of the reforms in other leading jurisdictions at Appendix A. These reforms are yielding greater protection for investors in those jurisdictions. Canadians deserve no less. We also need comprehensive reforms that tackle in a meaningful way the problem of conflicts and poor quality financial sales that all too frequently are devoid of objective "advice".

2. <u>The Problems</u>

2.1. FAIR Canada commends the CSA for the research and outreach activities the various CSA jurisdictions have conducted and for the third party research that the CSA has commissioned and published and/or reviewed (as summarized in Part 3 of the Consultation Document). This extensive body of research and its findings are important in identifying the key problems and devising responses to address them.

2.2. Some industry groups nonetheless continue to deny that any problems exist, and continue to delay reforms in an effort to maintain the status quo. In addition, the Consultation Document does not adequately describe the key investor protection concerns in Part 5. FAIR Canada therefore summarizes below the evidence that demonstrates the many problems that exist for Canadians who seek financial advice or otherwise purchase investment products through dealers and their registrants. These problems do **<u>not</u>** mainly stem from bad apples in the system but are systemic issues that arise from those who are operating in accordance with the existing regulatory rules and industry practices that have been permitted.

2.3. FAIR Canada also takes issue with the BCSC's approach to address the problems that have been identified. The BCSC seems to acknowledge the problems but at the same time wants to maintain the existing business models and conflicts of interest that exist in the financial services marketplace. As a result, the BCSC places the onus on educating investors and getting them educated to the point they will be wary and distrustful as a means to protect themselves.

2.4. FAIR Canada believes it is inefficient and ineffective to attempt to put the onus on the investing public to educate themselves to the point that they have sufficient financial literacy and sufficient financial knowledge to effectively protect themselves in their relationship with someone who is supposed to be providing them with "advice" but is not actually meeting a best interest standard. FAIR Canada explains in further detail below why this approach will result in investors continuing to be inadequately protected, will result in an inefficient allocation of responsibilities, will prevent a competitive financial services marketplace from arising and will result in unnecessary and significant costs being incurred by the investing public.

2.5. There is a pressing need to implement a statutory best interest standard with the necessary accompanying fundamental reforms that are necessary to achieve such a standard.

2.6. Requiring dealers and their registrants to act in the best interest of their clients will ensure the more efficient allocation of responsibilities between the advisor and the consumer given the level of financial literacy of consumers, the degree of knowledge and specialized skills and abilities that the advisor should possess , and the complexity of financial products. We agree that "[T]his would place an appropriate obligation on the party to the relationship who is most often the most knowledgeable and financially literate, namely the adviser or dealer and their representative."[1]

2.7. ***Consumer Confusion (also referred to in the Consultation Document as the "Expectations Gap")*** Evidence demonstrates that "[s]ome 7 out of 10 investors believe their advisor has a legal duty to put the client's best interest ahead of his or her own. They rely on their advisor to select the best investment for them and most believe the advisor will recommend what is best for the client even at the expense of their own commission."[2] This is combined with the fact that "[i]nvestors have little or no idea about how advisors can get paid"[3]. It is clear that investors do not understand the nature of their relationships with their advisors, including the conflicts of interest that may be present in the relationship and their impact.

2.8. ***Heavy Reliance by Canadians on Registrants*** – The relationship between registrants and clients is a spectrum ranging from unconditional confidence and trust to dealing with the

1 (2016), 39 OSCB 3947 at 3967.

2 The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (prepared for the Investor Education Fund), at page 2, online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

3 The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (prepared for the Investor Education Fund), at page 3, online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

registrant as a mere order taker. Having said that, typically, advice is a recommendation upon which investors place a great deal of reliance. Securities are most often sold and not bought.

2.9. For example, a report prepared for the Investor Advisory Panel of the Ontario Securities Commission ("OSC") in 2011 found "the majority say they work with a financial advisor for investment. Only a handful are not using an advisor at the present time. Overwhelmingly, participants put unconditional confidence and trust in their advisor. Advisors are the main source of investment information and most blindingly trust the advice they are given."[4] Similar results were reported in a report to The Joint Standing Committee on Retail Investor Issues[5] wherein "[f]ully one-quarter (26%) report that they decided based solely on their advisor's verbal recommendation. Likewise one-fifth (19%) skimmed the documents their advisor provided and decided based on their advisor's verbal recommendation. Alternatively, only one-tenth (10%) decided based solely on their own research."[6] A further 21% "carefully reviewed their advisor's documents, decided based on those documents and the advisor's verbal recommendation." In total, this report found that 45% of investors made their decision to invest based almost solely on their advisor's verbal recommendation, and 66% made their decision based primarily on their advisor's verbal recommendation. Most investors follow the advice they receive as to what investments to buy.

2.10. A more recent study again found similar results: a 2015 BCSC survey of 2,407 Canadians aged 35 and over found that 40% of respondents (and 49% of BC respondents) responded positively that "[d]oing my own research on new investments that my advisor recommends" was "wholly or partially an investor's responsibility when working with an advisor".[7] Therefore, 60% of respondents thought that it was not their responsibility when working with an advisor. The level of trust placed in a Canadian's investment advisor was "strong" for 90% of those who responded in BC and 89% nationally.[8]

2.11. ***Marketing Materials and Investor Tools Induce Trust and Reliance*** – The trust and reliance that Canadians have in their financial advisor can be attributed, in part, to representations in marketing materials and advertisements that are intended to, and do, induce trust and reliance. In addition, brochures produced by regulators (to the extent these are referenced by consumers) do not spell out clearly that financial advisors do not have to act in the best interest of their clients or make clear the potential conflicts of interest and their impact on the consumer.[9]

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4 The Brondesbury Group, Focus Groups with Retail Investors on Investor Rights and Protection (2011) (prepared for The Investor Advisory Panel of the Ontario Securities Commission), at page 8, online: http://www.osc.gov.on.ca/documents/en/Securities-Category1-Comments/com_20110427_11-765_ananda.pdf (at appendix A).

5 The Strategic Counsel, A Report to the Joint Standing Committee on Retail Investor Issues – Retail Investor Information Survey (June 2009), online: http://www.osc.gov.on.ca/static/_/JSC/jsc_retail-investor-info-survey.pdf.

6 The Strategic Counsel, *A Report to the Joint Standing Committee on Retail Investor Issues – Retail Investor Information Survey* (June 2009), at page 21.

7 BCSC Investright, *National Smarter Investor Study Public Opinion Research* (November 2015), at page 33, online: https://www.investright.org/uploadedFiles/news/research/Smarter%20Investor%20Study%20FULL%20REPORT.pdf.

8 BCSC Investright, *National Smarter Investor Study Public Opinion Research* (November 2015), at page 45, online: https://www.investright.org/uploadedFiles/news/research/Smarter%20Investor%20Study%20FULL%20REPORT.pdf

9 See for example, the CSA investor brochure, Working with a Financial Advisor, available online at https://www.securities-administrators.ca/uploadedFiles/General/pdfs/Working%20with%20an%20adviser%20web_ENG_2012.pdf. Later in the

2.12. ***Asymmetry in Knowledge and Experience*** – There is significant asymmetry in knowledge and expertise between the advisor and the client. Financial literacy is low in Canada.[10] Both the 2012 and the 2016 CSA Investor Index found that 4 out of 10 failed the general investment knowledge test included in the survey, answering fewer than four out of seven questions correctly.[11] Further, evidence suggests that "...[e]ven when people understand a financial or economic principle in theory, applying the principle to a real situation is difficult for them."[12] Low financial literacy is a stubborn problem despite the many organizations and individuals who work diligently to improve it.

2.13. ***Inflated and Confusing Titles and Low Proficiency*** – Moreover, advisors use a bewildering array of unregulated and frequently misleading titles that falsely convey high levels of seniority, knowledge, experience or executive authority and that don't reflect the standard of advice being provided. The level of education and initial proficiency is also too low.

2.14. ***Increasing Product Complexity and Product Proliferation*** – In addition to low financial literacy, the increasing degree of product complexity[13] and product proliferation makes it difficult for the average Canadian to be adequately informed about the different investment product options that are available. Academic research has found that firms strategically use product complexity to make product returns more salient and to shroud risk, making more profit for them but at the expense of lower returns for those who invest in them.[14] Canada has not been immune to the proliferation of complex products including complex exchange traded funds and structured products[15]. In addition, recent changes to securities regulations have allowed a greater number of exemptions from prospectus requirements allowing ordinary retail investors to be sold exempt market products.[16] This increases the number of types of

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paper we will discuss conflicts of interest and how: (1) investors have a very low awareness of (i) the existence of conflicts of interest, and (ii) the potential impact of conflicts of interest. In addition, investors do not have the requisite knowledge to appropriately factor the impact of a conflict of interest into their evaluation of the advice they receive. See also the more recent OSC Investor Education "Service expectations of financial advisors" tool; online: http://www.getsmarteraboutmoney.ca/en/tools_and_calculators/infographics/Documents/infographic-Service-expectations-of-financial-advisors.pdf.

10 (2016), 39 OSCB 3947 at 3956; (2012) 35 OSCB 9558 at 9580.

11 Innovative Research Group, Inc., *2012 CSA Investor Index: Full Report* (October 16, 2012), at page 38, online: https://www.securities-administrators.ca/uploadedFiles/General/pdfs/2012%20CSA%20Investor%20Index%20-%20Public%20Report%20FINAL_EN.pdf; Innovative Research Group, Inc. Key Highlights CSA Investor Education Study 2016 (April 2016), at page 7, online: https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSA_2016_Survey_Key_Highlights_English.PDF (note: full report not made public).

12 The Brondesbury Group, Benchmarking Investor Knowledge (2011) prepared for the Investor Education Fund), at page 16 online: http://www.getsmarteraboutmoney.ca/en/research/Our-research/Documents/Rpt_InvKnowl_Abridged_final%202011.pdf.

13 (2016), 39 OSCB 3947 at 3956.

14 Claire Célérier, Boris Vallée, "Catering to Investors Through Product Complexity" (2015) at page 33-34, online: http://www.hbs.edu/faculty/Publication%20Files/16-050_5e5fd8d5-652e-4a13-abe7-ffd1466ef691.pdf.

15 OSC Statement of Priorities for Fiscal 2011-2012 at page 4, online: http://osc.gov.on.ca/documents/en/Publications/sop_fiscal-2011-2012.pdf;

16 For example, see the Summary of Key Capital Raising Prospectus Exemptions in Ontario (January 28, 2016), available online: http://www.osc.gov.on.ca/documents/en/Securities-Category4/ni_20160128_45-106_key-capital-prospectus-exemptions.pdf. As noted by the GetSmarterAboutMoney website, exempt market products offer investors more "choice of investments" but with this comes "there are many risks associated with investing in the exempt market." See "The Exempt Market Explained", online: http://www.getsmarteraboutmoney.ca/en/managing-your-money/investing/investor-protection/Pages/The-exempt-market.aspx#.V7d4VK2NCw4.

investment products that consumers may be sold and, therefore, need to understand, in order to make informed investment decisions.

2.15. ***Consumers Unaware of the Importance of Costs and Don't Know About the Costs they are Paying -*** Costs are an important determinant of long-term returns from collective investments such as mutual funds.[17] Indeed,"...[p]revious analysis by Morningstar and others has looked at this question and found that expenses can be a good predictor of future fund performance."[18] At the same time, a significant number of investors do not know the importance of costs,[19] nor do a significant number of investor know about their advisor's compensation.[20]

2.16. ***Increasing Self-Reliance for Retirement Savings and Inadequate Savings*** – Governments and employers are shifting the onus of making investment decisions for retirement savings onto individuals. The number of employees in Canada covered by a registered pension plan was 38.1% in 2014.[21] Between 1977 and 2011, the proportion of the overall employed population covered by registered pension plans declined from 52% to 37% for men, mainly due to a drop in defined benefit coverage. In the same time period, coverage for women increased from 36% to 40%.[22] The statistics show that registered pension plan coverage is declining overall, and that the shift is increasingly from defined benefit plans to defined contribution plans.[23]

2.17. A recent study indicates that individuals who are currently retired and seniors have starkly different (lower) incomes if they are without pension income.[24] The study also shows that

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17 See the Securities and Exchange Commission's Calculating Mutual Fund Fees and Expenses (October 8, 2010), online: http://www.sec.gov/investor/tools/mfcc/mfcc-int.htm.See also the OSC's Get Smart About Money Mutual Fund Fee Calculator at http://getsmarteraboutmoney.ca/en/tools_and_calculators/calculators/Pages/mutual-fund-fee-calculator.aspx#.V-KyGK2NDdA. See also John Bogle's comments in *Lower fees: Slice your way to a more fruitful portfolio* (June 15, 2012) Globe and Mail online: http://www.theglobeandmail.com/globe-investor/personal-finance/lower-fees-slice-your-way-to-a-more-fruitful-portfolio/article4280020/.

18 Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance Report (2016), at page 8, online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf, citing Morningstar, online: http://news.morningstar.com/articlenet/article.aspx?id=347327.

19 The Brondesbury Group, *Investor behavior and beliefs: Advisor relationships and investor decision-making study* (2012) (Prepared for the Investor Education Fund), at page 2 found that cost of buying a factor for 2 out of 10 investors, online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

20 The Brondesbury Group, *Investor behavior and beliefs: Advisor relationships and investor decision-making study* (2012) (Prepared for the Investor Education Fund), at page 2 found that investors have little or no idea about how advisors can get paid, online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf. The 2015 National Smarter Investor Study found that 1 in 4 report they have never discussed compensation with their advisor, BCSC Investright, *National Smarter Investor Study Public Opinion Research* (November 2015), at page 22, online: https://www.investright.org/uploadedFiles/news/research/Smarter%20Investor%20Study%20FULL%20REPORT.pdf.

21 Statistics Canada, *Pension plans in Canada, as of January 1, 2015* (July 21, 2016), available online: http://www.statcan.gc.ca/daily-quotidien/160721/dq160721d-eng.pdf.

22 Marie Drolet and René Morissette, *New facts on pension coverage in Canada;* Statistics Canada (December 18, 2014) at page 1, available online: http://www.statcan.gc.ca/pub/75-006-x/2014001/article/14120-eng.pdf.

23 Marie Drolet and René Morissette, *New facts on pension coverage in Canada;* Statistics Canada (December 18, 2014) at page 2, available online: http://www.statcan.gc.ca/pub/75-006-x/2014001/article/14120-eng.pdf.

24 Richard Shillington, Broadbent Institute, *An Analysis of the Economic Circumstances of Canadian Seniors* (February 2016) at page 12; available online:

those who are near retirement and without employer pension plans will have "totally inadequate retirement savings".[25] Roughly half (47%) of those aged 55-64 have no accrued employer pension benefits and the vast majority of these Canadians have inadequate retirement savings (with the average amount being $85,000 and the median value being just over $3,000).[26] When looking at the amount of savings for those without pension assets and who are near retirement (age 55 to 64), regardless of income, very few families have enough savings to so supplement any CPP/QPP and OAS/GIS they will be eligible for, and only 15 to 20% have enough for five or more years.[27] The vast majority of middle-income Canadians retiring without an employer pension plan "will be hard pressed to save enough in their remaining period (less than 10 years) to avoid a significant fall in income".[28]

2.18. Coupled with the above, those with registered pension plans have more wealth than non-registered pension plan families, even after excluding pension assets. They are more likely to hold other types of assets as compared to non-registered pension plan families, such as real estate equity (82% versus 56%), investments or RRSPs/LIRAs (79% versus 55%), or vehicles (91% versus 76%).[29] This holds true even after accounting for income and other socio-economic factors (by a margin of 8 instead of 24).[30] It has not been determined whether this is a result of the causal impact of workplace pensions on wealth accumulation or the intrinsically different savings behaviour between those with pension plans and those without.[31]

2.19. In summary, those nearing retirement (less than 10 years) without retirement pension plans are unlikely to have adequate savings and are more likely to have fewer assets and therefore, less wealth. In addition, we have an aging demographic that often is forced to retire earlier

https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659.

25 Richard Shillington, Broadbent Institute, *An Analysis of the Economic Circumstances of Canadian Seniors* (February 2016) at page 3 and 14 to 18; available online: https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659.

26 Richard Shillington, Broadbent Institute, *An Analysis of the Economic Circumstances of Canadian Seniors* (February 2016) at 14 to 15; available online: https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659.

27 Richard Shillington, Broadbent Institute, *An Analysis of the Economic Circumstances of Canadian Seniors* (February 2016) at page 20; available online: https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659.

28 Richard Shillington, Broadbent Institute, *An Analysis of the Economic Circumstances of Canadian Seniors* (February 2016) at page 3, see also page 18, and Chart 6; available online: https://d3n8a8pro7vhmx.cloudfront.net/broadbent/pages/4904/attachments/original/1455216659/An_Analysis_of_the_Economic_Circumstances_of_Canadian_Seniors.pdf?1455216659.

29 Derek Messacar and René Morissette, Employer Pensions and the Wealth of Canadian Families; Statistics Canada (January 15, 2015) at page 1; available online: http://www.statcan.gc.ca/pub/75-006-x/2015001/article/14134-eng.pdf.

30 Derek Messacar and René Morissette, Employer Pensions and the Wealth of Canadian Families; Statistics Canada (January 15, 2015) at page 1, and 4 to5; available online: http://www.statcan.gc.ca/pub/75-006-x/2015001/article/14134-eng.pdf.

31 Derek Messacar and René Morissette, Employer Pensions and the Wealth of Canadian Families; Statistics Canada (January 15, 2015) at page 8; available online: http://www.statcan.gc.ca/pub/75-006-x/2015001/article/14134-eng.pdf.

than planned as a result of circumstances outside their control.[32]

2.20. In FAIR Canada's view, it is critical that those Canadians who are without pension coverage and who are forced to rely on their own savings (through such vehicles as RRSPs and TFSAs) must be afforded greater protection than they have now for their investment decisions and must be accorded a similar standard of care - a fiduciary duty - as those who have retirement pension plans. Better protection for financial consumers who are saving for their retirement, along with more effective competition, will result in better outcomes for retirees and for the public as a whole.

2.21. ***Persistent Low Economic Growth and Low Interest Rates Lead to Increased Individual Risk Taking*** – Developed economies have persisted with low economic growth and low interest rates. Low interest rates push investors to seek opportunities to achieve adequate yield on their investments or capital appreciation. This includes, especially, older Canadians who need sufficient returns for their retirement income. This can expose investors to investment risk including risks associated with increased use of leverage that "can have life-changing outcomes."[33] Low interest rates for an extended period are said to "...distort investment decisions, leading to excessive risk taking and inefficient and ultimately unprofitable investments...Some of the symptoms of inefficient investment and asset price bubbles are already evident in Canada."[34] Low interest rates have provided Canadian consumers with an incentive to accumulate a record proportion of household debt compared with their income and, for older households (both working and retired) that have accumulated financial assets, low interest rates have led to a search for higher yield in order to maintain a similar flow of interest income and standard of living.[35] This leads to finding riskier investments that the household would have previously avoided. The result is consumers taking on more risk.[36]

2.22. ***Mystery Shopping Report Highlights Problems*** – The results of the mystery shop of registrants across Ontario found that many Canadians are receiving poor quality advice that does not comply with existing rules. Where a product or specific recommendation was made, consumers weren't told how much the investment product costs over a quarter of the time (29% did not discuss product fees)[37], did not have advisor compensation explained in most

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[32] Angus Reid Institute Public Interest Research, Retirement in Canada: Lots to enjoy about 'golden years,' but financial worries loom large – especially for those still working" (July 1, 2015), at page 1; online: http://angusreid.org/wp-content/uploads/2015/06/2015.05.15-Retirement.pdf. Less than half (46%) of retirees say they retired when and as planned. The rest retired earlier (48%) or later (6%) because of circumstances outside their control. 53% of private sector employees retired earlier than expected while 41% of public sector employees did.

[33] OSC Notice 11-775, Notice of Statement of Priorities for the Year Ended March 31, 2017 (June 9, 2016) (2016), 39 OSCB 5155 at page 5160.

[34] Paul R. Masson, "The Dangers of an Extended Period of Low Interest Rates: Why the Bank of Canada Should Start Raising Them Now", C.D. Howe Institute Commentary No. 381 (May 2013), at page 2; online: https://www.cdhowe.org/pdf/Commentary_381.pdf.

[35] Paul R. Masson, "The Dangers of an Extended Period of Low Interest Rates: Why the Bank of Canada Should Start Raising Them Now", C.D. Howe Institute Commentary No. 381 (May 2013), at page 10; online: https://www.cdhowe.org/pdf/Commentary_381.pdf.

[36] Paul R. Masson, "The Dangers of an Extended Period of Low Interest Rates: Why the Bank of Canada Should Start Raising Them Now", C.D. Howe Institute Commentary No. 381 (May 2013), at page 10; online: https://www.cdhowe.org/pdf/Commentary_381.pdf.

[37] OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 8 to 9; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

cases (67% did not discuss advisor compensation)[38] and were provided with unsuitable recommendations 14% of the time[39] while almost 30% of the recommendations were made without the advisor obtaining sufficient information about the prospective client's financial circumstances, investment objectives or risk tolerance (29% did not comply with KYC, KYP and suitability requirements[40]). The study also found that only 63% of advisors had met or exceeded compliance expectations,[41] meaning 37% failed that test[42]. For those shops where there was no product or specific recommendation, a discussion of the relationship between risk-return occurred in only 52% of the shops[43] and in only one third of the instances (33%) were shoppers provided with a general and balanced explanation of the risk-return relationship[44].

2.23. A more recent limited mystery shop revealed that investors who asked at various banks for a portfolio of index funds were told to invest in high fee actively managed funds instead.[45]

2.24. ***Mystery Shopping Report Shows Consumers Unable to Assess Quality of Advice*** – All of the above (and the pervasive conflicts of interest described below) occurs in a context where consumers are unable to really assess the quality of the advice they are getting but nonetheless often believe it is good. For example, the Mystery Shop found that in 88% of shops (where a product or specific recommendation was made), consumers were happy with the recommendations they received even though one-third of the cases did not meet compliance expectations.[46]

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38 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

39 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

40 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

41 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 8; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

42 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 9; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

43 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 22; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

44 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 22; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

45 Andrew Hallam in the Globe and Mail (September 11, 2016), "What would your bank say if you asked for index funds? We found out"; online: http://www.theglobeandmail.com/globe-investor/investment-ideas/strategy-lab/what-would-your-bank-say-if-you-asked-for-index-funds/article31820874/?1473955741968.

46 OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 22; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf. See also Janet McFarland, "Ontario financial advisers pass muster with undercover 'mystery shoppers'" (September 17, 2015), Globe and Mail, who quotes Leslie Byberg then director of strategy research and planning as saying "…even though 88 per cent of clients were happy with the recommendations they received, regulators concluded one-third of the cases did not meet compliance expectations, including 29 per cent that did not

2.25. ***Mystery Shopping Report Shows Advisors Do Not Disclose Conflicts of Interest*** – Verbal disclosure about conflicts of interest was provided in connection with the discussion of fees and charges in only 4% of cases (2 of 49 shops) and in connection with the discussion of advisor compensation in only 9% of cases (2 of 22 shops).[47] Even if this type of disclosure were to work (which it doesn't – see below), compliance with existing requirements is extremely low, and enforcement almost non-existent.

Conflicts of Interest Are Pervasive and Harm Investors and the Market and the Traditional Remedy of Disclosure Is not an Effective Remedy

2.26. The current Canadian securities regulatory regime:

- Does not require the appropriate avoidance and management of actual or potential conflicts of interest. It therefore presents agency costs – investors need to expend resources to ensure their advisor is acting in their best interest (or not acting contrary to their interests) but investors have been demonstrated not to do so.

- Does not align the interests of portfolio managers, dealers and their financial advisors' interests with those of their clients; and

- Does not require clear disclosure of the legal obligations of dealers, portfolio managers and their financial advisors towards their clients.

Yet, the current regulatory regime:

- Permits third-party commissions to be embedded (and thereby hidden) in the cost of the product and permits fee structures that are opaque, complex and difficult for consumers to understand;

- Permits compensation structures to contain monetary and non-monetary inducements (such as targets for selling certain products or bonuses for meeting a certain amount of sales) that are misaligned with the interests of clients including inducements for the recommendation to leverage (or borrow to invest); and

- Permits firms to create increasingly complex products that are very difficult to understand and that have high-fees which are then sold by an advisor who is employed by the firm that has a proprietary interest in those products.

2.27. A best interest standard requires securities regulators to address head-on the fundamental conflicts of interest that are present in the relationship between dealers and their financial advisors and their clients. Compensation arrangements that generate serious conflicts of

comply with know-you-client or suitability requirements. She said it demonstrates that clients cannot always tell if they have received good advice. "It's really quite stark that in 37 per cent of the cases, the adviser didn't follow the process, but the client thought it was great," she said."

[47] OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into Advisory Practices and the investor experience in Ontario*, at page 29; online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf.

interest (hereinafter referred to as "conflicted remuneration") and have a significant impact on consumer outcomes are not compatible with a best interest standard.

2.28. Regulators and governments need to ensure that financial advisors (including financial planners) who are relied upon to help further consumers' interests (for example, to help them to adequately save for retirement or save for their childrens' education) have the ability to provide objective, unbiased professional advice. There needs to be a shift from regulating the product recommendation to regulating advice. This necessitates a shift to a framework that considers whether the advice provided to the individual (and not just the product recommendation) is provided in the best interest of the client.

2.29. Financial firms and their advisors will need to have the expertise and processes to carry out their duties effectively. This will include having compensation structures that support the provision of objective, professional financial advice. Dealers, portfolio managers, and their financial advisors should not be permitted to receive conflicted forms of remuneration. Only fee structures that are aligned with consumer's interests should be permitted. **The approach that has been taken, to date, to deal with conflicts of interest is failing investors and needs to change.**

2.30. **Firstly, investors simply don't understand conflicts of interest and do not respond in manner that traditional economic theory would suggest.** Investors have been found to have a very low awareness of (i) the existence of conflicts of interest and (ii) the potential impact of conflicts of interest[48]**. In addition, investors do not have the requisite knowledge to appropriately factor the impact of a conflict of interest into their evaluation of the advice they receive.**[49] The research suggests that disclosure would be more effective when recipients of advice have expertise or experience to help them assess the potential effects of the disclosed conflicts of interest.[50] However, most retail investors do not have this level of sophistication and are in need of greater protection.

2.31. In particular, "[f]or disclosure to be effective, the recipient of the advice must understand how the conflict of interest has influenced the advisor and must be able to correct for that biasing influence. In many important situations, however, this understanding and ability may be woefully lacking."[51] Behavioral studies present a number of explanations as to why the

48 The Brondesbury Group, *Investor behavior and beliefs: Advisor relationships and investor decision-making study* (2012) (Prepared for the Investor Education Fund), at page 29: "Having been informed about these various commissions and fees...[H]alf of investors (51%) had no view as to whether there was a conflict of interest or not. ...Among the half of investors with an opinion on conflict of interest, three-quarters believed that their advisor would look out for their best interest regardless of how the advisor was paid and at page 31 wherein it is described that investors believe that the advisor "...will recommend the best product for me even if it means less money for them" and at page 33: "Issues of potential conflict of interest are particularly difficult to consider, since they are counter to the high level of trust that underpins their advisor relationship."; online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.

49 Robert A. Prentice, "Moral Equilibrium: Stock Brokers and the Limits of Disclosure" (2011) Wisconsin Law Review 1059 at 1068.

50 Daylian M. Cain, George Lowenstein, and Don A. Moore, "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest" (2005) 34 (1) J. Legal Stud. 1 at 20.

51 Daylian M. Cain, George Lowenstein, and Don A. Moore, "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest" (2005) 34 (1) J. Legal Stud. 1 at 3. See also Robert A, Prentice, "Moral Equilibrium: Stock Brokers and the Limits of Disclosure" (2011) Wisconsin Law Review 1059 at 1080-1084.

conflicted advice is not appropriately discounted by investors. In FAIR Canada's view, most investors do not have the requisite knowledge and experience to sufficiently adjust for the conflict of interest that is disclosed. Indeed, quite the contrary – Canadians demonstrate a very high level of trust in financial advisors and a near-complete absence of comprehension regarding any effect that a conflict of interest may have on the advice provided.

2.32. **Secondly, there are perverse effects of disclosure wherein disclosing the conflicts of interest has unintended effects that can make matters worse.** Behavioural studies both within the financial services context and more broadly have proven the perverse effects of disclosing conflicts of interest. As summed up in the abstract to "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest":

> "Conflicts of interest can lead experts to give biased and corrupt advice. Although disclosure is often proposed as a potential solution to these problems, we show that it can have perverse effects. Firstly, people generally do not discount advice from biased advisors as much as they should, even when advisors' conflicts of interest are disclosed. Second, disclosure can increase the bias in advice because it leads advisors to feel morally licensed and strategically encouraged to exaggerate their advice even further. As a result, disclosure may fail to solve the problems created by conflicts of interest and may sometimes even make matters worse."[52]

2.33. The unconscious increase in the bias of the advice provided from disclosing the conflict of interest is a serious concern. So too is the problem that disclosure can reduce legal liability and prevent more substantive changes being pursued as solutions (such as banning conflicted remuneration).

2.34. Another perverse effect of disclosure has been found – although it can decrease the investor's trust in the advice, it can also increase the pressure to comply with that advice if the investor feels obliged to satisfy the advisor's personal interests. This is known as the panhandler effect.[53] Disclosure leads to social pressures to comply with advice, even as it reduces trust in the quality of the advice.[54]

2.35. **Thirdly, conflicts of interest lead advisors to give biased advice without consciously and intentionally realizing that it is biased.**[55] While concerned about overt bias, "...considerable research suggests that bias is more frequently the result of motivational processes that are unintentional and unconscious."[56] For example, this can cause physicians to believe their judgments are not affected by the lavish gifts and wide-ranging benefits they wish to continue

[52] Daylian M. Cain, George Lowenstein, and Don A. Moore, "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest" (2005) 34 (1) J. Legal Stud. 1.
[53] Sunita Sah, Daylian Cain and George Loewenstein, "The Burden of Disclosure: Increased Compliance with Distrusted Advice" (2013) Journal of Personality and Social Psychology, Vol. 104, 289.
[54] Sunita Sah, Daylian Cain and George Loewenstein, "The Burden of Disclosure: Increased Compliance with Distrusted Advice" (2013) Journal of Personality and Social Psychology, Vol. 104, 289 at 300.
[55] Robert A. Prentice, Moral Equilibrium: Stock Brokers and the Limits of Disclosure" (2011) Wisconsin Law Review 1059 at 1086.
[56] Daylian M. Cain, George Lowenstein, and Don A. Moore, "The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest" (2005) 34 (1) J. Legal Stud. 1 at 5.

receiving from drug companies.[57] Similarly, advisors who are subject to conflicted and misaligned compensation structures will tend to believe that their judgement is not affected and that they are acting in the best interests of their client (while the empirical evidence[58] demonstrates otherwise) while selling an inferior product that generates higher fees for them. Therefore, the effects on consumers may be unintended by advisors - however, the problem remains that the advice is poor or harmful to the investor's financial outcomes.[59]

2.36. The bottom line is that, for conflicts of interest, disclosure as the "go to solution" does not work and hurts the financial outcomes of those it is meant to protect.[60]

2.37. FAIR Canada is strongly of the view, in light of the evidence, that disclosure is insufficient to address the problems caused by conflicts of interest in the financial sector. The best solution is to eliminate conflicts of interest to the greatest extent possible. As has been shown in the academic behavioural economics research, if the person making the disclosure can avoid the conflict and then can disclose that there is an absence of such conflicts, the disclosure can be beneficial.[61]

2.38. While disclosure may make regulators and even those who are regulated feel like they have taken action to remedy the situation, the reality is far from it. The solution is simple. Rather than having a rule that requires portfolio managers, dealers and their financial advisors to disclose they may get a commission for selling a certain type of product or they may receive a bonus or a referral fee, promotion or other incentive, there should be a rule that (a) prohibits portfolio managers, dealers and their financial advisors from acting other than in their clients best interests; and, as a result, (b)prohibits conflicted remuneration and (c) requires the avoidance of conflicts of interest. In this manner, they will be able to disclose the absence of any conflicts of interest and will provide more objective advice. .

2.39. ***Fourthly, Conflicts of Interest are Structural and Systemic, Harming the Market as well as Investors*** – This is a key investor protection concern in respect of conflicts of interest. It is surprising that it was not identified in Part 5 of the Consultation Document, under *Key Investor Concerns – Conflicts of Interest.*

2.40. Conflicts of interest in the financial sector are structural and systemic and arise as a result of the conflicts between the investment firms and/or the mutual fund manager and the fund's investors. These conflicts of interest harm not only investors but the market itself. Instead of providing unbiased professional advice in the best interest of investors, the investment firms compete for assets under management by incentivizing the sales force to direct investor monies into those funds that pay trailing commissions or by incentivizing the sale of proprietary products. Instead of competing through stronger performance and greater real

57 Prentice, Moral Equilibrium: Stock Brokers and the Limits of Disclosure" (2011) Wisconsin Law Review 1059 at 1081.

58 See the Cummings report: Douglas Cumming, Sofia Johan and Yelin Zhang, "A Dissection of Mutual Fund Fees, Flows, and Performance" (2016) (updated version), online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_dissection-mutual-fund-fees.pdf.

59 Paavan Gami, "Conflict of interest 'no panace'" (February 21, 2012), Yale Daily News, quoting Dr. Daylian Cain, online: http://yaledailynews.com/blog/2012/02/21/conflict-of-interest-disclosure-no-panacea/.

60 Robert A. Prentice, Moral Equilibrium: Stock Brokers and the Limits of Disclosure" (2011) Wisconsin Law Review 1059

61 Sunita Sah and George Loewenstein, "Nothing to Declare: Mandatory and Voluntary Disclosure Leads Advisors to Avoid Conflicts of Interest", (2103) Psychological Science, 575; online: https://www.cmu.edu/dietrich/sds/docs/loewenstein/NothingDelcare.pdf.

returns to investors, we have mutual funds competing for financial advisors' business through the trailing commission payments and affiliated firms providing incentives for their owned dealer to sell proprietary products. The result is that investors are not provided with unbiased recommendations and investment performance in these funds is negatively impacted. In other words, the existence of conflicts in how portfolio managers, dealers and their financial advisors make money impacts investment decisions, negatively impacts fund performance and thereby hurts investors and the market.[62] Trailing commissions, deferred sales charges and incentives to sell proprietary products create conflicts that result in an inefficient market.[63]

2.41. It is not simply, as set out in the Consultation Document, that "[t]he application in practice of the current conflicts of interest rules is, in many instances, less effective than intended" and that there are behavioural effects of disclosure that are unintended. There is also the critical problem that conflicts of interest are also structural and systemic, generated through trailing commissions and proprietary products (also known as "affiliated dealer flows"). The harm occurs not only to investors but also to the market itself.

2.42. A brief summary of the findings of Professor Cumming is provided in the Consultation Document in the summary of research in Part 3:

> "The paper found that conflicts of interest, specifically sales commissions and trailing commissions paid by fund companies (embedded registrant compensation), dealer affiliation and the use of deferred sales charge arrangements materially affect representative/dealer behaviour to the detriment of investor outcomes and market efficiency. While generally mutual fund flows should (and do) bear a relationship to the fund's past performance, the research found that:
>
> - the payment of embedded registrant compensation and the use of deferred sales charge **arrangements materially reduce the sensitivity of fund flows to past performance and** increase the level of fund flows that have no relationship to performance;
>
> - the converse is also true: fund flows for mutual fund series that do not pay embedded registrant compensation (fee-based series) are more sensitive to past performance;
>
> - as embedded registrant compensation increases there is an associated reduction in future outperformance before fees; and
>
> - fund flows from affiliated dealers of the investment fund manager show little to no sensitivity to past performance, and this lack of sensitivity is also associated with reduced future outperformance before fees."[64]

62 Douglas Cumming, Sofia Johan and Yelin Zhang, "A Dissection of Mutual Fund Fees, Flows, and Performance" (2016) (updated version), online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_dissection-mutual-fund-fees.pdf.

63 Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance Report (2016), at 8, online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf.

64 (2016), 39 OSCB 3947 at 3951.

2.43. In fact on the latter point, a frequently asked questions document released in February by the authors states:

> "We can confirm however that *affiliated dealer flows showed no flow-performance sensitivity at all* which was found to be relatively more detrimental to investors relative to all trailing commission paying purchase options for non-affiliated dealer flows.
>
> In terms of which is the bigger concern, our research has shown that **both** affiliated dealer flows and the payment of trailing commissions result in material conflicts of interest that are detrimental to mutual fund investors over the long term."[65] [emphasis added]

2.44. These material and harmful conflicts of interest must be addressed head on if we are to achieve a situation where clients are better off as a result of engaging with the financial services sector let alone achieving a situation where financial advice is provided to investors in their best interest. It is simply not possible to achieve a meaningful best interest standard (or indeed, any meaningful level of investor protection or fostering of fair and efficient markets) while ignoring the business models that give rise to significant conflicts of interest that harm investors and market efficiency. It is not possible to have effective competition for the benefit of the investing public while allowing these systemic and structural conflicts to persist.

2.45. The BCSC may be alluding to this when it comments in the Consultation Document that "[I]ntroducing an over-arching duty called a best interest standard while continuing to permit certain fundamental conflicts to exist between registrants and their clients is not in the public interest". However, the fact of the matter is that you cannot *achieve* a best interest standard while continuing to permit certain fundamental conflicts to exist between registrants and their clients. Conflicted advice is nonsensical. Moreover, the *solution* is not to ignore the fundamental conflicts created by conflicted remuneration. Rather, as has been recognized in many other jurisdictions (Australia, the United Kingdom, Europe), the solution is to address conflicted remuneration. This is a necessary step in moving to a framework where financial advice can be provided in the client's best interest. It is simply illogical to expect advice to be provided in the client's best interests when the individual registrant is in a business model where he is being asked to serve two masters.

2.46. Moreover, the BCSC is wrong when it states this "may exacerbate one of the investor protection issues identified, that being misplaced trust and overreliance by clients on registrants". Rather if a best interest standard is implemented then the "advisor" must discharge their professional obligations and the client's trust will not be misplaced and there will not be any overreliance. Any professional relationship must properly rely on trust in order to function. With the implementation of a statutory best interest standard as FAIR Canada sets out above, the trust placed in the advisor will be appropriate as will the degree of reliance.

2.47. Failure to address these fundamental conflicts that have been identified and empirically shown

[65] Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance Report (2016), at 7, online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20160209_81-407_faq-dissection-mutual-fund-fees.pdf.

to exist in Canadian capital markets[66] would be a failure to fulfill the mandate of provincial securities commissions: that of providing protection to investors and fostering fair and efficient capital markets.

2.48. FAIR Canada is strongly of the view that given the recognition by CSA members that the status quo is not acceptable, the response should not be one of incremental steps – awaiting CRM2 and Point of Sale implementation - then the Proposed Targeted Reforms and then a regulatory conduct standard that includes a duty to act in the best interests of the client, and perhaps, sometime in the distant future, a statutory best interest standard. Such a drawn out process would be woefully inadequate and one in which the investing public and the market as a whole will incur significant costs. Rather, what we need is a profound shift immediately to a statutory best interest standard similar to a fiduciary standard wherein the investing public can expect and receive advice from a true professional that is in their best interests. What is needed is an overarching principled standard of conduct through which rules are interpreted. Necessary accompanying rules to a best interest standard should be implemented simultaneously.

Canada's International Obligations

2.49. Canada should live up to its international obligations by implementing a statutory best interest duty. The preamble to the International Organization of Securities Commission's ("IOSCO") Principles Relating to Market Intermediaries[67], which is intended to provide IOSCO's interpretation of its Objectives and Principles[68], states, among other things,

> "Market intermediaries should conduct themselves in a way that protects the interest of their clients and helps to preserve the integrity of the market. Fundamental principles include:

- A firm should observe high standards of integrity and fair dealing.
- A firm should act with due care and diligence **in the best interests of its clients** and the integrity of the market.

...

[66] As noted by Professor Cumming, Sofia Johan and Yelin Zhang, "A Dissection of Mutual Fund Fees, Flows, and Performance". Previous research has been completed in this area by many others. See Frequently Asked Questions about the Dissection of Mutual Fund Fees, Flows and Performance, page 4 and footnote 1. See also The Brondesbury Group, *Mutual Fund Fee Research*, (2015) (prepared for the Ontario Securities Commission on behalf of the Canadian Securities Administrators) at 13 to 18, online: http://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20150611_81-407_mutual-fund-fee-research.pdf.

[67] International Organization of Securities Commissions, Methodology: For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, FR08/11 (Version Revised August 2013), online: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdfhttps://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

[68] International Organization of Securities Commissions Objectives and Principles of Securities Regulation (June 2010), online: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf. There are three Objectives of securities regulation: protecting investors; ensuring that markets are fair, efficient and transparent; and reducing systemic risk. There are 38 Principles. IOSCO's Methodology provides IOSCO's interpretation of the IOSCO Objectives and Principles.

- **A firm should not place its interests above those of its clients** and should give similarly situated treatment to similarly situated clients."[69] [emphasis added]

Under Principle 32, and "Protection of Clients", IOSCO's Methodology considers the following as important components of market intermediaries' conduct with clients:

> "(h) A market intermediary should act: with due care and diligence **in the best interests of its clients** and protect their assets; and in a way that helps preserve the integrity of the market."[70]

2.50. The IOSCO Principles are recognized as the international regulatory benchmarks for all securities markets. Given that the OSC and the Autorité des marchés financiers are ordinary members of IOSCO and that the Alberta Securities Commission and the BCSC are associate members, we would expect the CSA would regulate in accordance with IOSCO's Objectives and Principles and its Methodology.

2.51. In addition, Principle 6 of the G20 High Level Principles on Financial Consumer Protection states (Canada is a signatory):

> "Financial services providers and authorised agents should have as an objective, **to work in the best interest of their customers** and be responsible for upholding financial consumer protection....Where the potential for conflicts of interest arise, financial services providers and authorised agents should endeavour to avoid such conflicts. When such conflicts cannot be avoided, financial services providers and authorised agents should ensure proper disclosure, have in place internal mechanisms to manage such conflicts, or decline to provide the product, advice or service.
>
> **The remuneration structure** for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and **to avoid conflicts of interest**..." [emphasis added].

2.52. In 2013, an update report to support implementing the G20 Principles was issued[71] which sets out effective approaches[72] to achieving Principle 6 including how to work in the best interest

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69 International Organization of Securities Commissions, Methodology: For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, FR08/11 (Version Revised August 2013), online: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdfhttps://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

70 International Organization of Securities Commissions, Methodology: For Assessing Implementation of the IOSCO Objectives and Principles of Securities Regulation, FR08/11 (Version Revised August 2013), online: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD359.pdfhttps://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf

71 Update Report on the Work to Support the Implementation of the G20 High Level Principles on Financial Consumer Protection: G20/OECD Task Force on Financial Consumer Protection, Principles 4, 6 and 9 (September 2013), OECD: https://www.oecd.org/g20/topics/financial-sector-reform/G20EffectiveApproachesFCP.pdf.

72 These are regulatory, supervisory and self regulatory measures and practices which have been developed and are considered by the Task Force to effectively implement the key aspects of the G20 High-Level Principles and are consistent with approaches developed by a broader range of jurisdictions. See the Update Report on the Work to Support the Implementation of the G20 High Level Principles on Financial Consumer Protection: G20/OECD Task Force on Financial Consumer Protection, Principles 4, 6 and 9 (September 2013), OECD at page 4; online: https://www.oecd.org/g20/topics/financial-sector-reform/G20EffectiveApproachesFCP.pdf.

of investors and how to design remuneration structures. The Task Force makes it clear that disclosure is not an adequate solution to ensure effective financial consumer protection and a range of measures are needed to ensure responsible business conduct.[73]

2.53. Accordingly, FAIR Canada is of the view that the Proposed Targeted Reforms dealing with conflicts of interest (including the associated guidance) are flawed and, without an accompanying best interest standard, are inadequate. We provide our comments on the Proposed Targeted Reforms below in Section 4.

2.54. Regulators and governments need to take the further step of being clear as to what is acceptable and what is not so as to prevent misaligned incentives which are currently pervasive throughout the financial services sector. Compensation drives behaviour. Therefore, getting rid of conflicted remuneration would eliminate many sources of conflicts of interest in the advisory relationship and would allow advice to be more likely provided in the manner consistent with the interests of the client. It would also simplify compliance and its oversight. The incentives of dealers, portfolio managers and their registrants should be consistent with the objective of safeguarding and advancing the interests of their clients. It is impractical and unworkable to devise conflict of interest rules while continuing to permit conflicted remuneration to continue that we know harms investors and the market itself. It will only lead to continued poor outcomes for the investing public. It also places registrants in an untenable position as they cannot continue with many of their current business practices and place the interests of their client first.

2.55. We note that the issue of conflicts of interest when providing investment advice is a new one, having been raised repeatedly in reports, consultations and in the media. Glorianne Stromberg's 1995 investment fund regulation report raised the problem of conflicts of interest in investment fund regulation and noted then that is was not a new issue. Over twenty years later, regulators are still "consulting" on the issue. Action is long overdue and must be taken now in a timely fashion.

Pace of Reform too Slow and too much Research is Kept Hidden

2.56. Other jurisdictions such as Europe in MiFidII, the Netherlands, and the United Kingdom, have addressed this problem head on. We provide a summary of those jurisdictions' reforms at Appendix A and encourage CSA members to take a similar approach.

2.57. FAIR Canada would like to note that the pace at which issues are examined seems very slow. The amount of time it takes for CSA members to react to investor protection issues, and conduct and release research is inordinately slow. The pace at which proposals are forthcoming as a result of that research is also very slow.

2.58. For example, the OSC in its Report on Statement of Priorities for fiscal 2013-2014 stated under "Best Interest Duty" that "Research was completed on proficiency standards in Canada, the US, the UK and Australia to inform our thinking on potential changes to our standards".[74] This

73 Update Report, at page 4 and 12 to 17.

74 OSC Report on Statement of Priorities For fiscal 2013-2014 at page 5; online: http://osc.gov.on.ca/documents/en/Publications/rpt-on-sop_fiscal-2013-2014.pdf.

research was never made public. It was not included in the Consultation Document. Moreover, the Consultation Document simply proposes increasing proficiency regarding the knowledge requirements for compliance with the proposed targeted reforms rather than more broadly conceiving and assessing proficiency requirements and continuing education requirements. No benchmarking to international jurisdictions is contained in the Consultation Document. Insufficient regard has been given to this critical issue.

2.59. Also under “Best Interest Duty” in the Report on Statement of Priorities for fiscal 2013-2014 it was mentioned that “[A] CSA committee on which the OSC participates also launched a pilot research project focused on examining advisor compensation. Based on the results, we will determine whether a full-scale research project on this topic is warranted.” Despite not publicly releasing the results, the findings must have been cause for concern because, in June 2014, the OSC’s Notice of Statement of Priorities for Financial Year to End March 31, 2015 set out under its action plan for the Best Interest Duty to Investors that the OSC would “Conduct research on advisor compensation to study the alignment of compensation with client’s interests and inform our assessment of the need for a best interest duty.”[75] Again this research has yet to be released. The Consultation Document states in Part 2 under “Compensation Practices Impacting Representatives” that “CSA staff conducted a survey to identify the practices used by adviser and dealer firms to compensate their representatives. The CSA expects that a staff notice summarizing the results of this research will be published before the end of the year”.[76]

2.60. This information is likely highly relevant to the issues discussed in the Consultation Document as well as the upcoming consultation paper on the reform of mutual fund fees. In light of how important the issue is to investor outcomes and any analysis of a best interest standard, this information should have been prioritized to be released with the Consultation Document.

2.61. It would also have been helpful and efficient to have included in the Consultation Document, (or released, when completed) the OSC’s Investor Office “...key research study using focus groups and online polling to examine several topics, including investors’ understanding of certain investment industry and regulatory terminology being considered as part of a proposed best interest standard and target reforms...”.[77]

2.62. Similarly, IIROC’s Business Conduct and Compliance group has reviewed and/or conducted a study of conflict of interest management practices amongst its dealer members. It noted as early as 2012 a number of deficiencies regarding identifying and managing various types of conflicts of interests.[78] In 2013 it noted that almost one third of its examinations noted conflicts of interest issues.[79] In January 2015[80] it announced a study that would focus on

[75] OSC Notice 11-770 – Notice of Statement of Priorities for Financial Year to end March 31, 2015, (2014), 37 OSCB 5982 at page 5987; online: http://osc.gov.on.ca/documents/en/Securities-Category1/sn_20140626_11-770_sop-fiscal-2014-2015.pdf.

[76] (2016), 39 OSCB 3947 at page 3952.

[77] OSC’s Report on Statement of Priorities for Fiscal 2015-2016, (summer 2016) at page 6; online: http://osc.gov.on.ca/documents/en/Publications/rpt-on-sop_fiscal-2015-2016.pdf.

[78] IIROC Notice 12-0359, Annual Consolidated Compliance Report, at page 14; online: http://www.iiroc.ca/Documents/2012/d63a417f-54b2-4e1d-b2f6-b5c589ced2f9_en.pdf.

[79] IIROC Notice 13-0296, Annual Consolidated Compliance Report at page 10, 12, 22, ; online: http://www.iiroc.ca/Documents/2013/6851752d-a07e-4168-a936-0d938bab6e93_en.pdf

three aspects of conflict of interest management:

- The governance and oversight of conflicts management by senior management and the Board;
- Compensation-related conflicts; and
- Conflicts relating to the marketing and distribution of new products.

The study was to involve the completion of a questionnaire by each selected firm and a review of the firm's policies and procedures and other documentation pertaining to conflict of interest management. While we question the rigour of the study's design, we also believe that details regarding the study's findings should be released.

2.63. The February 2016 IIROC Compliance Priorities document simply noted:

> "The results of the study indicate that, with a few notable exceptions, generally Dealer Members have implemented robust governance and oversight processes and also have incorporated an effective analysis of potential conflicts as part of their new product review processes. When it comes to compensation-related conflicts, however, the effectiveness of supervisory monitoring was found to be lacking in many cases."[81]

2.64. IIROC's Notice on Managing Conflicts in the Best Interest of the Client was released in April of this year (and in advance of the Consultation Document) and said this about the study's finding:

> "...when it came to compensated-related conflicts, most firms sampled lacked a meaningful process to identify, deal with, monitor and supervise compensation-related conflicts. For example, most firms did not have mechanisms in place to identify advisors who recommend products that yield higher fees and bonuses, when there are other suitable but less expensive alternatives available. They also did not have a process in place for implementing additional monitoring of advisors approaching compensation thresholds based on the amount of revenue generated.
>
> Furthermore, we found that there was confusion among some firms regarding the best interest standard as set out in our conflicts of interest rule and guidance. Although most Dealer Members responded that they always put clients' best interests first, we found little supporting documentation as far as compensation-related conflicts were concerned."[82]

2.65. IIROC is now taking the next step of conducting a comprehensive sweep of oversight and monitoring of compensation-related conflicts by its dealer members. It also plans to enhance

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[80] IIROC Notice 15-0021, Annual Consolidated Compliance Report, January 27, 2015, at page 16-17; online: http://www.iiroc.ca/Documents/2015/a2470ccd-819b-4165-b82a-8004b6e1a8c9_en.pdf.

[81] IIROC Notice 16-0034, IIROC Compliance Priorities, February 18, 2016, at page 14; online: http://www.iiroc.ca/Documents/2016/09cf32f7-236c-4d13-a3ca-4c53a2a32fd0_en.pdf.

[82] IIROC Notice 16-0068, Managing Conflicts in the Best Interest of the Client, at page 4.

its test procedures to look more closely at compensation grids, supervisory oversight of registrants that focus on products with high commissions, and monitoring of registrants who are approaching compensation thresholds.[83] It has also stated that its response "...may include rule amendments and/or additional guidance on conflicts of interest that clearly and in plain language outline IIROC's best interest requirements."[84]

2.66. FAIR Canada is of the view that such an examination should have been conducted years ago in light of the fact that conflicts of interest, including compensation-related conflicts are obviously a root cause of poor outcomes for the investing public, and are a key factor in the types of complaints that investors have made to IIROC, the MFDA and OBSI.

2.67. Moreover, as an SRO, IIROC should be familiar with the business models of its dealer members and should be aware and alert to the significant conflicts of interest that can arise as a result of the business models and related compensation structures of its members. It should also be aware of the potential conflicts of interest related to the creation and marketing of opaque and complex investment products and the resulting impacts on consumer outcomes. The need to change what is permissible is long overdue.

2.68. IROC dealer members and their representatives have long been allowed to engage in practices that a best interest standard should prohibit – such as utilizing business models where conflicts of interest are endemic and recommending high-fee products when equally suitable, low-fee alternatives are available. IIROC, as a regulator, has allowed these business practices to continue under its current rules.

2.69. We therefore find puzzling recent statements from IIROC that, "...taken together, our Dealer Member Rules and guidance put the best interest of the client before the interests of IIROC-regulated dealers and their representatives. We acknowledge that further clarification of our rules and guidance may be necessary to make this point absolutely clear."

2.70. A recent speech by the President and CEO of IIROC provided an opportunity for clarification that, regardless of how IIROC may have interpreted and applied its rules in the past, henceforth firms not only must have policies and procedures regarding compensation related conflicts of interest but they must no longer structure compensation so that is harms investors' interests, and that structures non-compliant with these requirements will no longer be tolerated.[85] Dealer members must be required to do more than just "consider" the best interests of the client or clients[86]; dealer embers must actually put the client's interests first.

2.71. In light of the investor protection concerns that have been identified above and by the CSA in the Consultation Document, reforms should be undertaken expeditiously and a response it "...will take time"[87], especially in the absence of any clear indication that the root causes of the

83 IIROC Notice 16-0034 at page 14-15.
84 IIROC Notice 16-0068, Managing Conflicts in the Best Interest of the Client, at page 5.
85 Notes for Remarks by Andrew J. Kriegler, President and CEO, IIROC, 2016 Stakeholder Reception, Toronto Board of Trade, September 12, 2016, online: http://www.iiroc.ca/Documents/2016/35268479-cf6c-4e81-a52c-d34ab2712887_en.pdf.
86 IIROC Rule 42.3(2), online: http://www.iiroc.ca/Rulebook/MemberRules/Rule00042_en.pdf.
87 Notes for Remarks by Andrew J. Kriegler, President and CEO, IIROC, 2016 Stakeholder Reception, Toronto Board of Trade, September 12, 2016, at page 8, online: http://www.iiroc.ca/Documents/2016/35268479-cf6c-4e81-a52c-d34ab2712887_en.pdf.

problem will be addressed, is not reassuring or an adequate response. Canadians cannot afford for this issue to be kicked down the road any longer.

2.72. We think that specific rule making setting out the types of compensation that is permissible and is not permissible is needed. Other jurisdictions that have adopted a best interest standard have, not surprisingly, also introduced restrictions on certain compensation models that create conflicts between registrants and their clients.[88] This is desperately needed in Canada and should be part and parcel of the formulation of a statutory best interest standard in securities legislation.

3. The Best Interest Standard

Principles of a Best Interest Standard

3.1. FAIR Canada strongly believes that Canadians deserve to receive financial advice or financial planning services from investment firms and their individual registrants that have a statutory duty to act in the client's best interest. Canadians rightly expect that when they receive advice it is in their best interests. That is the essence of "advice".

3.2. We believe that a statutory best interest standard will significantly reduce, if not eliminate, any confusion (for consumers as well as investment firms and their individual registrants) as to whether such a duty applies in a given situation. Canadians deserve to know *ex ante* (that is, before they enter into a relationship or engagement with a firm or an individual) whether the relationship is one where the firm/individual is providing professional advice in their best interest or not. Having to pursue a legal action to have a court determine whether the relationship is one that meets the common law requirements of a fiduciary relationship (by meeting the five common law indicia of fiduciary relationship) or whether the relationship falls within the types of relationships where there is a best interest requirement under the Civil Code of Quebec[89] is costly, and creates uncertainty.

3.3. The Consultation Document sets out five principles that would guide registrants in compliance with their regulatory conduct requirement to "...deal fairly, honestly and in good faith with its clients and act in its clients' best interests." The conduct expected is that of a "prudent and unbiased firm or representative (as applicable), acting reasonably." The five principles are:

i. Act in the best interests of the client;

ii. Avoid or control conflicts of interest in a manner that prioritizes the client's best interests;

iii. Provide full, clear, meaningful and timely disclosure;

iv. Interpret law and agreements with clients in a manner favourable to the client's interest where reasonably conflicting interpretations arise; and

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[88] (2016), 39 OSCB 3947 at 3972; see also Appendix A.

[89] Sections 1309, 2100 and 2138 of the Civil Code of Quebec. See (2012) 35 OSCB 9558 at page 9564-9465; online:

v. Act with care.

3.4. FAIR Canada has some concern about relegating such an important requirement to a rule, regulations or instruments such as OSC Rule 31-505, Conditions of Registration or BC Reg. 194/97 under the Securities Act (British Columbia), R.S.B.C. 1996, c.418.[90] While OSC Rule 31-505 and similar provisions in other provinces and territories could have been interpreted by regulators and courts as being equivalent to amount to a duty to act in the client's best interests, it does not appear to have been so interpreted. Indeed, the words "fairly, honestly and in good faith" are more notable for their existence having been ignored, both by the financial services industry and by regulators' enforcement departments.

3.5. FAIR Canada believes that guiding principles and guidance is appropriate and helpful. The five guiding principles set out in Part 8, however, need some work:

- First principle – This is not helpful because of having the same phrase "best interest" to explain what is meant by "best interest".

- Second principle – This is not adequate as there has been too much reliance on the "control" or management of conflicts of interest, which has allowed firms and their registrants to continue to operate with serious conflicts of interest that undermine investor outcomes and the fairness and efficiency of our markets. The CSA should be clear that avoidance of conflicts of interest is what is required for the reasons outlined above in the previous section.

- Third principle – While clear, meaningful, and timely disclosure should be required for the services offered by the investment firm and its registrant, FAIR Canada questions whether disclosure is a "principle" of a best interest standard. Important information needs to be disclosed to investors but it may not be read or understood (the information or its implications). Disclosure has, to date, often been used to avoid responsibility rather than accept responsibility as a true professional and has not protected the interests of investors. Disclosure requirements should be separate specific rules, where appropriate, rather than a principle of a best interest standard. While "full, true and plain" disclosure has been a fundamental bedrock of securities laws, disclosure is not an adequate substitute for objectively. Nor is it sufficient to discharge one's duty to act in the client's best interest given the degree of reliance and trust that clients place in the investment firm and the individual registrant with whom they deal. Does the disclosure make sense to the client, does the client understand it and its implications and possible consequences? Often the answer is no. What other steps are required in the process in order to discharge one's best interest obligation as a professional? As we have set out above, disclosure, in and of itself, may have perverse effects or unintended consequences.

- Fourth Principle – It should be made clear that a duty to act in the best interests of the client cannot be avoided through contractual provisions.

- Fifth Principle – Acting with care is far too vague and open to differing interpretations.

[90] Footnote 23 of CSA Consultation Document 33-403 sets out where the duty to act "fairly, honestly and in good faith with his or her clients" is found in various Province's securities legislative frameworks.

FAIR Canada prefers the CSA Consultation Document 33-403 version of the standard of care: "the financial firm and its financial service providers must perform services and provide advice with the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances". Consistent with our comments on 33-403, we believe that the registrant should be required to perform the services at a level commensurate with their professed level of knowledge and expertise.

3.6. FAIR Canada believes the best interest standard that should govern the relationship should be similar to that of a fiduciary relationship. Portfolio managers (including robo-advisors) are subject to a fiduciary duty, in large part due to the amount of discretion that they have over the client's monies. Other advisor-client relationships are not that different – there is a great deal of trust and reliance that the individual places in the advisor, and the advisor has a large amount of influence over the client's investment decisions. Therefore, the standard should be similar.

3.7. FAIR Canada believes that dealers and their individual registrants should be required to:

- Act fairly, honestly and with a duty of loyalty or duty of utmost good faith to the client.
- Put the client's interests first (in other words, make the client's interests paramount).
- Avoid, ordinarily, conflicts of interest:
    - When, in exceptional circumstances, the conflict cannot be avoided, it should be addressed through management techniques such as informational barriers, or dealing restrictions so long as such mechanisms will actually protect the interests of the client.
    - Disclosure as a management technique to address conflicts of interest has been shown to be ineffective and should not be relied upon unless as a key mechanism (though it can properly be used to disclose the absence of conflicts).
    - Disclosure should be an absolutely last resort, to be used only when it is demonstrable that it will actually be effective in protecting the interests of the client, taking into account the findings of valid behavioural economics research.
- Require a standard of care where the financial firm and its individual registrants must perform their services and provide advice with the degree of care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.
    - The standard of care should have regard to the special knowledge or experience that the firm and the individual holds themselves out as possessing.
- FAIR Canada is of the view that the firm and its individual registrant should be required to take any step that at the time the advice is given, and throughout the continuation of the professional relationship, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

3.8. FAIR Canada is strongly of the view that in order to meet a best interest standard some business models must change their compensation structures. Regulators should not shy away from this necessity. Securities regulators do not have as their mandate the protection of business models or the support of a particular level of profitability for the financial industry, especially business models which do not serve consumers and lead to poor outcomes. The business model must support the provision of unbiased objective financial advice and, if investment products are recommended, the recommendation is to be made from a wide enough range of products that can be said to meet the best interests of the clients of the investment firm.

3.9. If a business model does not and cannot meet a best interest standard, then the firm and its registrants have the option of evolving their business model to one that can provide advice in the best interest of the client or they can cease pretending to provide advice. If the latter is chosen, they should be required to explicitly communicate to the investing public that they do not provide advice, that they are not advisors or professionals, and that they are selling investment products as a salesperson. Any advertising and marketing should make this clear and not be misleading. In addition, they should be required to communicate these essential points in writing and orally to any retail investor.

Other Reforms Need to Accompany a Best Interest Standard

3.10. Specific reforms will by necessity, accompany a shift to a best interest standard. Besides removing conflicted remuneration, as described above, the following reforms are necessary:

i. Increase the education and the initial proficiency requirements for all registrants:

- A critical assessment of existing designations and credentialing entities currently operating needs to be undertaken by regulators and an assessment needs to be arrived at as to what level of qualifications are required to act with the care, skill and judgment of a professional who can act in the best interests of the client.

- FAIR Canada believes that, at an absolute minimum, a high school diploma with completion of specific grade 12 maths courses should be required and recommend that further more substantial educational requirements be considered and determined;

- See Appendix A for a summary of the proficiency requirements in other leading jurisdictions.

ii. Immediately prohibit the receipt of commissions or fees in respect of amounts borrowed to invest based on a leveraging strategy. Firms and their registrants should not benefit from recommending that the client borrow to invest given the inherent conflict in doing so.

iii. Reform the rules surrounding referral fees so that such fees are transparent (the fact of the fee, the amount, and its impact should be disclosed in plain language) and those subject to a best interest standard should only refer clients to another person or firm that is also subject to a best interest standard (unless it is to execute product recommendations through a discount brokerage).

iv. Reform outside business activities – Investment related activities should not be considered "outside business activities" and should be approved and supervised by the registrant's firm. Firms should be liable for the harm resulting from the acts and omissions of their representatives with respect to all outside business activities, except where the firm:

(a) Has reasonably determined that the activity could not be expected to be viewed by clients or by the public as part of the firm's business, and

(b) Has made it explicitly clear to its clients, in an effective manner, that the outside business activity is not part of the firm's business and that the firm will not be responsible for those activities.

v. Implement a requirement for dealers, portfolio managers and their individual registrants to disclose on their web-site the exact nature of their services in plain language – the type of advice they will provide and the cost of that advice including any minimum amount of assets required- so that consumers have the ability to shop around before entering into a relationship with any one dealer, adviser or individual registrant. Today, this information is not advertised or readily available.

vi. Ensure that the new standard of conduct and accompanying rules are complied with and that there is effective enforcement action taken against those who do not comply.

vii. Reform the process of consumer redress through the Ombudsman for Banking Services and Investments ("OBSI") so that consumers obtain a resolution of their complaint through instituting binding decision-making authority. This reform will improve compliance by firms and their individual registrants with the standard of conduct and accompanying rules while allowing consumers to resolve their complaints effectively and efficiently.[91]

3.11. FAIR Canada therefore envisages that after the above-noted reforms are implemented (including removal of embedded third party commissions) there will be two main tiers: one where there is an "advice" relationship and one where there is a sales relationship. Portfolio managers (including robo-advisors), investment dealers that have a wide product shelf, MFDA firms that have a wide product of shelf of mutual funds and exchange-traded funds, and financial planners who have the necessary proficiency (and who do not sell products or who are in a business model where there is a sufficiently wide product shelf) will be in the business of providing "advice" and must meet all of the requirements set out above in order to act in the client's best interests. They can hold themselves out as "advisors". Exempt market dealers, MFDA firms that only sell mutual funds, firms that only sell proprietary products, bank branches that only sell proprietary products and group scholarship plan dealers will be in the business of sales. Individual registrants of the latter category will be restricted to the title "salesperson".

[91] See FAIR Canada's submission to Ms. Deborah Battel, Independent Reviewer of OBSI, Feb 26, 2016, online: http://faircanada.ca/wp-content/uploads/2016/02/160226-FAIR-Canada-submission-independent-evaluation-of-obsi_final-2.pdf.

Discount Brokerages and Do-it-Yourself Investors

3.12. Unfortunately, discount brokerages have received no attention in the Consultation Document. This is a segment of the market that deserves greater attention. According to the 2015 National Smarter Investor Survey, only 30% of Canadians age thirty five and above invest through an advisor, while 19% say they do not invest with an advisor, but do say they have investments.[92] This is a significant consumer segment that should not be overlooked.

3.13. FAIR Canada recommends that discount brokerages should be prohibited from retaining trailing commissions on investment funds so long as such embedded third party commissions are not prohibited entirelyas there is no valid justification for such commissions in the absence of any advice being provided to consumers. All such commissions paid to discount brokerages should be passed through to clients. Secondly, the "tools" on discount brokerage websites need to be reviewed to ensure they are not thinly disguised attempts to steer clients to certain financial products.. Finally, complex structured products that the overwhelming majority of retail investors cannot understand should not be sold through discount brokerages. While these products may make large profits for the manufacturer and the discount brokerage, they cannot be said to be in the interests of the clients who purchase them.

4. The Proposed Targeted Reforms

4.1. The Proposed Targeted Reforms appear to be designed to address the lack of explicit requirements or the "gaps" that exist in the current requirements of 31-103. FAIR Canada therefore provides a summary of the obligations of registrants toward their clients for those directly regulated by provincial securities commissions (as set out in Part 4 of the Consultation Document) as well as those who are regulated by IIROC and the Mutual Fund Dealers Association of Canada at Appendix C. Ideally, the Consultation Document would have discussed and analyzed all dealers, portfolio managers, and individual registrants' explicit requirements, including those who are regulated by the SROs. Many consumers have a relationship with a dealer and individual registrant that is regulated by an SRO. These consumers should have been provided with a summary of the key obligations and any areas without explicit requirements in order to provide a fulsome and comprehensive response to the Consultation Document.

4.2. In addition, a discussion of how the existing rules that the SROs have and how they have been interpreted by enforcement decisions would have been helpful.

4.3. FAIR Canada is strongly of the view that the Proposed Targeted Reforms are not adequate to ensure adequate and effective investor protection. A statutory best interest standard is required in order for investors to receive professional, objective, unbiased advice. As part of that standard, conflicts of interest must be appropriately addressed as described above. The Proposed Targeted Reform on conflicts of interest does not accomplish this (as detailed below) and is therefore deficient. Some of the other Proposed Targeted Reforms are helpful (KYC and suitability in particular) while others are too vague and tentative (proficiency) while others only work if the best interest standard is implemented with such a reform (titles, relationship

[92] BCSC Investright, *National Smarter Investor Study Public Opinion Research* (November 2015), at page 16, online: https://www.investright.org/uploadedFiles/news/research/Smarter%20Investor%20Study%20FULL%20REPORT.pdf.

disclosure).

4.4. Therefore, FAIR Canada would not be supportive of an approach in which the Proposed Targeted Reforms would be implemented first and a best interest standard left for a later date.

(i) Conflicts of Interest

4.5. FAIR Canada is of the view that the overwhelming body of evidence does not support the approach taken to conflicts of interest in the Consultation Document. Disclosure has proven to be an ineffective regulatory tool for protecting investors (as discussed above). Instead of regarding certain fundamental structural conflicts as “inevitable” or “normal” and blithely assuming them to be manageable (typically by disclosure), regulators need to require that these conflicts be avoided wherever possible. By addressing conflicts at a structural level, regulators will simplify compliance and will eliminate much of the need for conflicts disclosure - (which does not work anyway) and correspondingly much of the regulatory burden and cost associated with disclosure.

4.6. In FAIR Canada’s view, conflicted remuneration must be addressed in order to adequately protect investors. Ideally, this would be done in conjunction with implementing a statutory best interest standard. While FAIR Canada supports the provision of important information to investors (such as the type of services that the firm and its representatives will offer, the costs for those services and the nature of reporting regarding performance of their investments), this does not mean that such disclosure is effective as a mechanism to protect their interests. As a result, we are of the view that the Proposed Targeted Reform on conflicts of interests falls short of what is required to adequately protect investors.

4.7. The Proposed Targeted Reform as drafted requires that firms and representatives “must respond to each identified material conflict of interest in a manner that prioritizes the interests of the client ahead of the interests of the firm and/or representative”. However, it requires this while permitting the harmful conflicts to continue (including embedded third party commissions) rather than be clear as to what compensation structures and types of conflicts should no longer be tolerated.

4.8. The Proposed Targeted Reforms also continue to allow firms and their advisors to use disclosure to accomplish their response to the conflicts: “[A]ny disclosure given to a client about a conflict of interest must be prominent, specific and clear” so long as the disclosure is “meaningful” to the client so that the client “fully understands the conflict including the implications and consequences of the conflict for the client”.[93] While this tries to be helpful because much disclosure has obfuscated the nature of the conflicts rather than explain it in plain language, disclosure as a solution is still problematic for all the reasons explained earlier.

4.9. **Trailing Commissions** - Appendix A – Guidance sets out how firms are to address conflicted remuneration such as trailing commissions. The Guidance relies on firms to

[93] Description of Proposed Targeted Reform, (2016), 39 OSCB 3947 at 3954.

"manage" this fundamental conflict. It states:

> "Firms must assess whether any remuneration could reasonably be expected to inappropriately influence how representatives deal with their clients. Firms should ensure there are adequate controls and oversight in place to mitigate this conflict. If the conflict cannot be managed, it must be avoided. For greater certainty, if a firm or representative gives priority to maximizing or receiving the non-client source of remuneration over the interests of the client, the firm or representative will be in breach of section 13.4 of NI 31-103 and their general duties to their client."[94]

4.10. Despite the overwhelming body of research, including the report of Professor Cumming, that trailing commissions and affiliated dealer flows harm investors and the efficiency of the market, the CSA professes to place faith in individual firms managing such conflicts. If the firm or representative can demonstrate that it has given priority to the client over that of the payment, then, it is claimed, the problem has been "managed." But when such payments are part of the bread and butter of the firm, putting in place such a system of conflicts management is antithetical to common sense. Even if this approach didn't belie the empirical evidence about fund flows, it would be impossible to oversee and police.

4.11. **Proprietary Products** - Similarly, instead of providing clear rules about incentives in respect of the sale of proprietary products which result in biased recommendations that increase the compensation of the individual registrant and the profits of the firm, the Guidance states that this "may increase the likelihood that the firm or representative will recommend a product that is not suitable".[95] Therefore, firms must "ensure that the products they recommend are "suitable and firms and representatives "...must respond to this conflict with thorough controls that effectively mitigate the conflict, and not rely on disclosure alone to mitigate the conflict."[96] Rather than clearly state that the firm must avoid this conflict, it suggests the firm can "control" it. FAIR Canada recommends that firms and representatives be required to recommend the investment product that better meets the needs of the client and modify or change governance, and compensation grids to avoid the conflict. This would be more practical and effective.

4.12. **Sales Practices** – The Guidance states that sales practices may result in firm representatives making recommendations to their clients that prioritize their interest in receiving the incentive ahead of the client's interest in receiving unbiased advice. Registrants are to "*consider* their obligation to identify and respond to material conflicts of interest in a manner that prioritizes the interest of the client ahead of the interest of the registrant when deciding what sales practices they will engage in." (emphasis added)[97] This is far too permissive.[98] The experience of other jurisdictions makes it clear that clear

[94] (2016), 39 OSCB 3947 at page 3979.
[95] (2016), 39 OSCB 3947 at page 3977.
[96] (2016), 39 OSCB 3947 at page 3977.
[97] (2016), 39 OSCB 3947 at page 3981.
[98] For example, Rule 42.3(2) of IIROC's Rule 42 requires the Dealer Member to consider the best interests of the client or clients. This Rule has not been effective in changing dealer behaviour to avoid conflicts and has allowed practices harmful to investors and the market to occur.

rules about what sales practices will and will not be permitted is what is required in order to change how firms operate and ensure that the interests of firms are aligned with their clients.

4.13. For example, Article 24(1) of Europe's MiFID II states that an investment firm "which provides investment services to clients *shall ensure* that it does not remunerate or assess the performance of its staff in a way that conflicts with its *duty to act in the best interest of clients*. In particular, it *should not make any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive* to its staff to recommend a particular financial instrument to a retail client when the investment firm could offer a different financial instrument which would better meet that client's needs."[99] (emphasis added) The final technical guidance states that "*Remuneration policies and practices shall be designed* in such a way so as *not to create incentives* that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client".[100] (emphasis added) It also places the day-to-day implementation of the remuneration policy and monitoring of compliance related to the policy as the responsibility of senior management of the firm.

4.14. Additionally, the Proposed Targeted Reform relies to a great extent on the mechanism of disclosure even though we know this does not work. Regulators (and firms) have no reasonable basis to "....expect that clients will use disclosure about conflicts of interest to help inform their decision when selecting a registrant and/or evaluating the registrant's business practices, conflicts management and overall performance on an ongoing basis."[101] Investors do not choose their registrant by researching the investment firm's business practices and how they deal with conflicts. They are also unable to critically evaluate the detailed client relationship disclosure documents provided at account opening which set out the many conflicts in technical, legal language. Rather, two thirds of investors know little about their advisor when they enter into a relationship (with the most common way of getting an advisor is to have one assigned by a bank or financial institution, and the second most common way is through a referral).[102] Investors place great reliance and trust in the firm and their registrant and believe that their "advisor" will provide them with "advice" in their best interest, even if the presence of conflicts of interest over them being paid based on the products that they recommend.[103]

4.15. FAIR Canada also believes that disclosure should not be the primary tool for responding to conflicts of interest between firms and their institutional clients as institutional clients can be relatively non-sophisticated clients such as a small pension fund, a municipality or a

[99] Article 24(1) of MiFIDII, Directive on Markets in Financial Instruments repealing Directive 2004/39/EC and amending Directive 2011/61/EU and Directive 2002/92/EC.
[100] ESMA Guidelines: Remuneration Policies and Practices (MiFid) at page 6; online: https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-606_en.pdf
[101] Consultation Document, at page 3979.
[102] The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (2012) (prepared for the Investor Education Fund), at page 1, online: http://getsmarteraboutmoney.ca/en/research/Our-research/Documents/2012%20IEF%20Adviser%20relationships%20and%20investor%20decision-making%20study%20FINAL.pdf.
[103] Add reference to Brondesbury study.

school board.

(ii) Know Your Client ("KYC")

4.16. FAIR Canada supports the enhancements to the KYC process which would require greater information being gathered relating to the three key elements of the KYC obligation, namely the client's: (i) investment needs and objectives (ii) financial circumstances and (ii) risk profile. We believe that many "advisors" do not have the proficiency level required to discharge these obligations adequately and believe that proficiency must be addressed by the CSA. Otherwise, financial advice will continue to be provided at a substandard level. In addition, we strongly recommend that the CSA consider the research that has been conducted by the OSC's IAP on risk profiling[104] as part of their consideration of implementing reforms to the KYC process.

4.17. While it is useful to have both registrants and clients sign the KYC form, the obligation should remain on the registrant to provide recommendations that are "suitable" for the client (if that remains the standard) or provide advice in the best interest of the client (if that standard is adopted). Retail investors will not necessarily understand all the information that is on the form, even if it is written in plain language, nor will they necessarily pay close attention to the form, given that they will trust their advisor to make the right investments for them.

(iii) Know Your Product ("KYP")

4.18. **KYP – Representative** – The CSA should benchmark to other jurisdictions to determine best practices with respect to know your product requirements for individual registrants.

4.19. **KYP – Firm** – The CSA should benchmark to other jurisdictions to determine best practices with respect to know your product requirements including requirements regarding product design and distribution for those who sell proprietary products. It appears to us that there is far too great a risk in the Proposed Targeted Reforms for firms to continue to have products on their product shelf as a result of the benefits to the firm rather than to its clients.

4.20. FAIR Canada believes that the existence of other products which could be "better" or more suitable for its clients than the products on the firm's shelf should be reason to question whether the firm's product list development process is reasonable, unbiased and based on sound, professional judgment. Moreover, if the individual registrant determines that there is a product or product type that would better meet the client's needs but it is not on the firm's product list, then the individual registrant should be permitted to obtain that product for the client, subject to the appropriate supervision. If this is not practicable, then the individual registrant should be obligated to advise the client where she or he can obtain the product.

4.21. Firms should be required to identify not only whether they sell only proprietary products or a mix of proprietary and non-proprietary products but also what general types of products they sell – mutual funds, exchange traded funds, close-end funds, individual securities, GICs, corporate bonds, exempt market products, etc. They should also be required to identify the types of products that they do NOT sell. For example, if the firm only sells mutual funds and

[104] Current Practices for Risk Profiling in Canada and Review of Global Best Practices, Prepared by Shawn Brayman, PlanPlus Inc. et al., online: http://osc.gov.on.ca/documents/en/Investors/iap_20151112_risk-profiling-report.pdf

exempt market products they should be required to disclose they do not sell individual securities or stocks (e.g. BCE shares) or exchange traded funds.

4.22. Please note that financial literacy challenges mean that many Canadians have low knowledge about the types of investment products that there are to choose from and can simply equate putting money in an RRSP with mutual funds – not realizing that there are other alternatives such as exchange traded funds (for example). It is for this reason that mere disclosure about whether the firm sells a mixture of proprietary and non-proprietary products or the types of products sold will not be sufficient to ensure adequate investor protection.

4.23. FAIR Canada does not agree that a firm with a proprietary product list does not have to do a comparison to other products in the market in order to determine whether such products meet the needs of its clients. It seems to us that such a comparison would be very important to undertake in order to ensure that the proprietary products are in the interests of its clients.

Suitability

4.24. Our comments are as follows:

- We support the requirement to determine, in light of the client's financial situation, whether other financial strategies, such as paying down high interest debt or saving, would more likely achieve the client's *financial* needs and objectives (not "investment" needs). Additionally, the risks and benefits of a given financial strategy should be required to be portrayed in a fair and balanced (and non-misleading) manner.

- Research has shown that realistic rates of return are not commonly understood by retail investors - The 2012 CSA Investor Index also found that 58% of Canadians do not understand the fundamental principle of risk-reward trade-off and found that only 12% of Canadians have realistic expectations of market returns. Only 9% of low knowledge investors were found to have realistic market expectations.[105] Accordingly, any target rate of return will need to involve a discussion of the type of returns that can be expected and the corresponding risk that this may involve - this will likely require educating the client as the risk-return relationship is not well understood.

- It would be far more preferable to remove conflicted compensation structures than require firms and individual registrants to factor such payments into their analysis of suitability – those who are in a conflict situation are the least likely to recognize it and appropriately factor it into any analysis.

- We believe that anyone who is involved in providing advice as to whether to commute a pension or transfer monies from a pension to a RRSP or otherwise <u>must</u> be held to a statutory best interest standard as described above.
  - If the firm and/or the individual registrant is in a position of conflict of interest

[105] Innovative Research Group, "2012 CSA Investor Index" (October 16, 2012), available online: <https://www.securities-administrators.ca/uploadedFiles/General/pdfs/2012%20CSA%20Investor%20Index%20-%20Public%20Report%20FINAL_EN.pdf>.

with respect to the recommendation, and if this is permitted to continue to occur by CSA members, then the firm and its representatives should be required to recommend that the individual obtain independent advice from a non-conflicted source (for example, a fee for service financial planner) before proceeding with the transaction.

- We believe that anyone involved in recommending borrowing to invest must be held to a best interest standard. In the interim, the CSA should immediately amend the rules so that no commissions or fees for assets under management can be obtained for any amounts borrowed in order to invest.

- If a representative of a firm determines that a non-securities product is more aligned with the client's investment needs and objectives and they sell such products to the client, then the firm should be responsible for this recommendation. A recommendation not to buy a security in favour of another investment product should be associated with potential liability similar to that of a recommendation to purchase a security product. This will reduce the ability of advisors who are dual-licensed to engage in regulatory arbitrage. Failure to apply the same standard to a registrant selling non-securities products will create incentives to sell such products to avoid consumer protection. This is not in the interests of investor protection or fair and efficient markets.

- Firms whose product list are very restricted – for example, group scholarship dealers and exempt market dealers – are likely not to be able to meet all of the investment needs and objectives of the client and should explicitly so advise. For example, if it would be suitable for a client to invest up to 5% of its investment assets in an exempt market product, the client should be so advised.

- Group scholarship plan dealers offer poor investment products with little or no benefit to consumers and have been found to engage in poor sales practices, largely driven by the large upfront commissions that they have been permitted to charge. These dealers in no way should be able to hold out as providing "advice" nor acting in the client's best interests.

- Given the importance of costs in predicting investment returns, f*i*rms and their representatives should consider product costs when determining what products are on their product shelf and what products are suitable for a client.[106] If a best interest standard as described above is implemented, providing unbiased advice about product selection will be far more likely given the removal of the incentives to do otherwise. Without such changes, firms and their individual registrants are likely to take a check the box approach and say they have considered cost, but will likely choose the products that compensate themselves better regardless of client outcomes.

- *Is there an ongoing obligation to conduct a suitability review* – FAIR Canada is of the view that if the investor pays for ongoing advice, then there should be a requirement to conduct a suitability review upon certain events occurring (as described in the Proposed

[106] Russell Kimmel, Morningstar (May 2016), "How Fund Fees are the Best Predictor of Returns", online: http://www.morningstar.co.uk/uk/news/149421/how-fund-fees-are-the-best-predictor-of-returns.aspx.

Targeted Reform) or at least once every 12 months. On the other hand, if the investor has paid for one-time advice and it has been made clear by the firm and the individual registrant that the obligation is not ongoing, then there is no ongoing relationship and there is no corresponding need to conduct a suitability review. The overriding issue is whether the relationship is ongoing or not.

Relationship Disclosure

4.25. FAIR Canada reiterates that simply disclosing to investors that the firm only sells proprietary products and that the firm does not consider whether non-proprietary products are best for meeting the client's needs is not adequate investor protection. As discussed above, Professor Cumming's findings included that proprietary funds were not sensitive to performance at all. Proprietary fund flows were just as problematic as those of embedded third party commissions. As a result, the CSA needs to come up with a policy reform that is effective. The proposal in the relationship disclosure requirements – again relying on weak disclosure to the investing public- is wholly inadequate.

4.26. FAIR Canada believes that the disclosure that is proposed to be required for those firms that have a restricted registration category will be confusing to investors and not effective for a number of reasons:

- Investors will be confused as to how meaningful "suitability" is if the only reference point for what is suitable is the limited product shelf of the specific firm.

- Investors will not know what other products there are that may be better since the level of knowledge about various types of investment products and familiarity with them is low. This is one of the reasons individuals rightly seek out "advice".

- Individual firms and their individual registrants may technically comply with the proposed disclosure requirement while indicating or suggesting that consumers would not want to go somewhere else because the products they are offering are going to provide better outcomes. For example, a mutual fund dealer may suggest this by having the individual registrant indicate to a given client that they wouldn't want to invest in the stock market and buy individual stocks and would be much better off, therefore, not seeing an IIROC dealer but sticking to mutual funds. After all, that is where over a trillion dollars is currently placed. FAIR Canada sees this as highly problematic.

Proficiency

4.27. FAIR Canada has examined proficiency standards in other jurisdictions and provides a summary of the requirements in Canada, the United Kingdom, Australia (proposed), and the United States at Appendix B. FAIR Canada is disappointed that no such benchmarking information was included in the Consultation Document.

4.28. There is a pressing need for a thorough, public review of existing proficiency standards in Canada and those standards need to be raised. FAIR Canada is disappointed that more attention was not placed on this issue as part of the examination of a best interest standard especially in light of the work that has already been done by regulators on the issue.[107] FAIR Canada calls on Canadian regulators to make public the results of their research and their findings.

4.29. National Instrument 31-103 provides that "[a]n individual must not perform an activity that requires registration unless the individual has the education, training, and experience that a reasonable person would consider necessary to perform the activity competently". FAIR Canada seriously questions whether many registrants have such education, training and experience to perform their activities as expected of a professional.

4.30. FAIR Canada has consistently called for greater proficiency requirements in Canada. The current proficiency framework was designed, many decades ago, around the sales process, for salespeople. The existing standards are structured around the particular products representatives are permitted to sell, not the overall quality of advice provided to retail investors. The existing proficiency requirements will need to be raised regardless of whether the conduct standard is raised to one of best interests, or those set out in the Proposed Targeted Reforms, or even if the status quo is maintained.

4.31. FAIR Canada believes that Canada is lagging behind other leading jurisdictions in the area of education and proficiency and oversight of such standards. The summary we provide at Appendix B supports this belief. For example, under its Retail Distribution Review the U.K. not only banned embedded third party commissions but also increased proficiency standards.[108]

4.32. Most investors do not seek out an individual "advisor" for a simple sales recommendation that falls within the registrant's specific regulatory license; they seek out unbiased advice for their particular financial needs. The appropriate minimum level of proficiency must also take into account investors needs and expectations.

4.33. The Proposed Targeted Reform on proficiency is not adequate in that:

- While knowledge and understanding of products is needed, the level of education and level of proficiency must go beyond that of investment products and consider the knowledge required to address the needs and service expectations of the investing public when dealing with a professional providing sound, objective financial advice in response to their financial needs and objectives.

- Specific recommendations are needed as to what will be the applicable and relevant level of education and qualifications and how those who have the current minimum qualifications will meet the new standard in order to provide professional, objective advice.

    - In the United Kingdom, advisors must obtain a QCF Level 4 qualification, which is equivalent to the first year of a university degree. Australia is moving towards requiring a bachelor's degree along with the passing of an exam that is developed

[107] See above at section 2.58 above wherein it is noted that regulators completed research on proficiency standards in the UK, US, and Australia.

[108] See online: http://www.fca.org.uk/you-fca/documents/policy-statements/fsa-ps11-01.

by an industry standards body.[109] In Canada, not even a high school diploma is needed.

- The level of training (or job experience) required in order to meet the appropriate standard also needs to be reviewed.
    - In the EU, 6 months of training is required. In Australia, it is a minimum of one year's work experience. Canada currently requires 3 months of on-the-job training.
- We support the requirement for continuing education set out in the Proposed Targeted Reforms but no specifics are provided. The CSA should consider requiring that firms ensure their employees remain competent in their roles and are acting ethically, and address any shortcomings in that regard, along with a specific number of hours of continuing education that must be completed in a given year similar to the model in the UK. Training and education on new products must be provided as necessary on an ongoing basis.
- Regulators should consider the independence and rigour that will accompany proficiency standards and continuing education requirements and should consider the appropriate role of regulators, firms and third parties in developing and overseeing competencies, courses, and examinations.
- Specific requirements should be legislated as to the level of education and proficiency that must be obtained before a certificate or license will be provided to hold out and practice as a financial planner. We have asked the Expert Committee on Financial Planning to critically assess the plethora of designations and credentialing entities currently operating as well as study the legislative regime in place in Quebec and its educational and proficiency requirements with respect to financial planners.
- Regulators will need to coordinate and provide a harmonized level of professional standards to the provision of professional, objective financial advice. Consumers deserve to have a high standard of professionalism met, regardless of which regulator oversees the provision of that advice.

Titles

4.34. Currently, advisors use a bewildering array of unregulated and frequently misleading titles that falsely convey high levels of seniority, experience or executive authority and do not reflect the standard of advice being provided.

4.35. The mystery shopping exercise that was reported on in September 2015 confirmed that the advisors use a wide array of titles. In the 88 shops, 48 difference business titles were used: 8 in the exempt market dealer platform, thirteen in the IIROC platform, twenty in the MFDA platform and eleven in the portfolio manager platform. The most common titles among the IIROC shops were "investment advisor", "financial advisor" and "financial planner", while the most common titles among the MFDA shops were the titles "financial advisor" and "financial

[109] The standards body has not yet developed the exam.

services representative".[110]

4.36. Titles need to be greatly reduced in number and they need to signal whether the individual registrant is subject to a statutory best interest standard (as we describe above) or not. Only those who provide services free from conflicted remuneration structures (including embedded third party commissions or compensation structures that incent the sale of proprietary products) and who have business models that allow themselves to provide objective advice should be considered to have met such a standard (for the reasons described above). Therefore, only such individuals should be able to call themselves an "advisor".

4.37. The "financial planner" designation should be limited to (i) those who have met the required level of proficiency, as hopefully will be determined and recommended by Ontario's Expert Committee on Financial Advisory of Financial Planning Policy Alternatives, or as required in accordance with current requirements in the Province of Quebec; (ii) are registered with the appropriate regulatory authority (which should be required) and (iii) are subject to a statutory best interest standard.

4.38. For example, a financial planner with a CFP at a mutual fund dealer, who is paid through trailing commissions (or not) would not be allowed to hold out as a financial planner as they could only sell mutual funds and this narrow product shelf would not meet the best interest standard. However, the person could so hold out if they also sell ETFs and the firm does not provide incentives to favour one type of product (such as mutual funds) over the sale of other products (for example, ETFs). Similarly, an individual registrant at a bank whose pay is derived from a compensation grid that incents the sale of proprietary products and other related banking products would not be able to hold out as a financial planner even if she has met the level of proficiency of a CFP or other accepted designation.

4.39. Our preference with respect to the Proposed Targeted Reform is to require only those who are subject to a fiduciary duty or statutory best interest standard and who are in a business model that allows them to operate on a conflict-free basis to hold out as an advisor. All other individual registrants should be required to call themselves salesperson. The first alternative in the Consultation Document's Proposed Targeted Reforms is far too confusing for investors as is the third alternative. Registrant categories do not provide meaningful and accurate descriptions of the standard of care being provided to consumers.

4.40. In short, only those subject to a best interest standard and who provide objective, professional advice should be able to use the title of "advisor".

Designations

4.41. FAIR Canada is also aware of the plethora of designations that exist. IIROC has created a glossary which amounts to disclosure through access. We do not believe that such a glossary helps most investors when they walk into an investment dealer and speak to an individual registrant. Would they be aware of the glossary? (we doubt it) and would using it get them any

[110] OSC Staff Notice 31-715, *Mystery Shopping for Investment Advice: Insights into advisory practices and the investor experience in Ontario*, September 17, 2015 at page 26; online: online: http://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf

further ahead in assessing the quality of advice being provided?

4.42. The Proposed Targeted Reform is vague as to its recommendations. It states that NI 31-103 would be amended to include specific provisions about the designations that each category and specific types of representatives may use when dealing with clients. This suggests that regulators would regulate the use/disclosure of designations. However, the Proposed Guidance at Appendix G suggests that representatives would regulate their own use of designations and that firms would have policies and procedures to oversee the use of designations by its individual registrants, so firms would monitor their use.

4.43. What is needed is for regulators to critically assess the plethora of designations and credentialing entities currently operating. For example, which designations for financial planning meet the acceptable proficiency standards? What designations meet the standard required to give professional, objective investment advice? Do any existing designations regarding providing advice to seniors have real substance?

Role of UDP and CCO

4.44. We believe that senior management should be responsible for identifying and responding to conflicts of interest, especially with respect to compensation related conflicts and product creation and distribution. We have already indicated our view on conflicts of interest above.

5. Client's Will not Become Complacent

5.1. The Jurisdictions with concerns about a best interest standard, namely the BCSC, the AMF, the ASC, the MSC and the NSSC believe that "[t]he proposed standard may also lead to client complacency. Trust already plays a significant role in the problem of overreliance....While trust in a representative is of course important and desirable, the proposed best interest standard may cause investors to completely absolve themselves of any responsibility for their investment decisions, on the mistaken belief that registrants will be held to a higher standard of care that will prohibit conflicts that are permitted today. Research shows that engaged and informed investors lead to better investment decisions."[111]

5.2. FAIR Canada notes that there is no research cited to support the assertion that a best interest standard would lead to client complacency or absolving themselves of responsibility for their investment decisions. The argument is without foundation. Firstly, if investors believe there is a best interest standard, how does actually imposing one lead them to all of a sudden change their behaviour? Secondly, we strongly recommend that the best interest standard address conflicts of interest rather than allow them to continue as proposed in the Consultation Document. Thirdly, a professional relationship does not lead to client complacency but rather leads to a more engaged, knowledgeable client when objective advice is provided. The client will not be imprudent as a result of obtaining advice. In fact, the opposite may be more likely with the current misaligned incentives that exist – the advisor benefits from having a disengaged individual with low financial and investment knowledge. Finally, FAIR Canada fundamentally takes issue with the notion that it is irresponsible for clients to trust and rely upon someone who is supposed to be acting professionally. Such reliance is perfectly

[111] (2016), 39 OSCB 3947 at 3969.

reasonable and, in fact, a responsible thing to do when the professional has far greater knowledge and expertise.

Can't Ignore Nor Simply Accept Fundamental Conflicts

5.3. We encourage the jurisdictions with concerns about a best interest standard to not simply accept the fundamental conflicts between registrants and their clients that they have identified, namely:

- "sell a limited range or type of investment products (these registrants have the clear limitation that there may be nothing in the limited range of products they offer that is actually in the investor's best interest" to buy);
- be owned by, or affiliated with, businesses that create the investment products they sell; and
- be compensated by investment product manufacturers rather than the clients they are meant to serve."[112]

5.4. Other jurisdictions have shown that it is possible to implement reforms to address conflicted remuneration (including banning third party embedded commissions) and implement a best interest standard. As result, their markets have firms that meet a best interest standard and provide professional, objective advice to investors. In Canada, certain firms, after a best interest standard is implemented (with its accompanying reforms as FAIR Canada has outlined above including reforms to conflicted remuneration) may not be able to meet a best interest standard (for example, group scholarship plan dealers, mutual fund dealers that only sell mutual funds (and not ETFs), and those that sell only proprietary products). These firms can continue to operate and sell investment products so long as they clearly disclose that they are salespeople.

5.5. FAIR Canada does not think that it is appropriate to identify fundamental conflicts that exist in our financial marketplace that have been empirically proven to harm investors and the efficiency of the market and simply allow them to continue. The Proposed Targeted Reforms are not sufficient, nor is a promise to vigorously enforce the current conduct standard "to deal fairly, honestly and in good faith". This approach will not result in adequate investor protection in light of all of the problems that the fundamental conflicts and known problems engender. In addition, promises to vigorously enforce should be accompanied by concrete proposals in order to be taken seriously.

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 Neil Gross at 416-214-3408/neil.gross@faircanada.ca or Marian Passmore at 416-214-3441/ marian.passmore@faircanada.ca.

[112] (2016), 39 OSCB 3947 at 3969.

Sincerely,

Canadian Foundation for Advancement of Investor Rights

CC: British Columbia Securities Commission
Alberta Securities Commission
Saskatchewan Financial Services Commission
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Appendix A – Reforms in Other Jurisdictions

Recent Developments in Other Jurisdictions:

Set out below are a summary of what other jurisdictions have implemented.

United Kingdom RDR Reforms and Recent Major Pension Reforms

Since late 2007, all securities firms have been subject to a statutory requirement to "act honestly, fairly and professionally in accordance with the best interests of its clients". This is a "qualified" best interest standard- since registrants are subject to a spectrum of requirements which vary according to whether they are "independent" and give unbiased advice on a wide range of products or "restricted" wherein they provide advice on mainly proprietary or other specific products. As of January 1, 2013, reforms (i) prohibit embedded commissions and (ii) prescribed higher professional proficiency requirements.

Post Implementation Review:
In December 2014 the Financial Conduct Authority ("FCA") published the findings from its Post Implementation Review which concluded that the ban on embedded commissions reduced product bias on recommendations and increased the sale of products which paid lower or no commission pre-reform.

Financial Advice Market Review:
In 2015, UK's HM Treasury and the FCA launched the Financial Advice Market Review ("FAMR") and published a report in March 2016. The FAMR examined whether there was an "advice gap". "Advice gap" was defined as "situations in which consumers are unable to get advice and guidance on a need they have at a price they are willing to pay." Their goal is to develop a market "...which delivers affordable and accessible financial advice and guidance to everyone, at all stages of their lives". The report noted that as a result of the reforms standards and professionalism have increased as has transparency. In addition, the reforms have ended conflicts of interest caused by a mainly commission-driven model. However, it did note that steps needed to be taken to make advice and guidance to the mass market more cost-effective for consumers. Issues were identified regarding supply and demand. The FAMR did not advocate returning to embedded commissions structures: "Given the strong arguments against a commission-based system, such as the lack of transparency and distortion of incentives, FAMR does not believe there is a case to consider this, and is therefore not recommending a return to commission-based financial advice."[113]

Pension Reforms:
In April 2015, the UK government introduced far-reaching reforms to the UK's pension system which allows "pensions flexibility", so that individuals can access their defined contribution pension pots at age 55. Individuals can take the amount as a lump sum or can opt to draw it down through having it invested in the stock market or by buying an annuity. This has led to a heightened need for individuals, even those with smaller amounts, to have access to advice. According to one commentator, "Put another way, pension freedoms have utterly changed the risk landscape in the mass affluent market. Having created

[113] Page 46 (get cite for document)

this new framework, the Government now wants to mitigate the risks to the consumer. Thus the FAMR."[114]

Australia

Australia introduced a qualified best interest standard which includes prescribed reasonable steps "safe harbour" (only have to take reasonable steps to discharge the duty) and allows for "scaled advice" (advice that only considers a specific issue). There is a duty to act in the client's best interests; a duty to provide advice that is appropriate; and a duty to prioritize the client's interests in the event of a conflict. In order to prioritize the client's interests, in the event of a conflict, the recommendation of the product of a related party must be supported by extra benefits for the client, and if the approved product list contains only products of a related party, the advisor must not recommend one over a competitor's product unless a reasonable advisor would be satisfied it was in the client's interests to be recommended that product over a rival product with similar features and costs. The overall approach to the three new duties is that "a reasonable adviser should believe that the client is likely to be in a better position if the client follows the advice."

The reforms also provided for a prospective ban on conflicted remuneration structures including commissions and volume based payments, in relation to the distribution of and advice about a range of retail investment products. Conflicted remuneration is "any benefit given to a licensee or its representative that due to the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the choice of financial product that is recommended or the financial product advice given". A benefit is presumed to be conflicted if it is volume based – so that it is then up to the recipient to prove that it was not conflicted. There is no general prohibition on the receipt of volume or asset based fees being charged by advisors (except to the extent that the investment uses borrowed funds). There are a number of exceptions to the general prohibition. An opt-in obligation requires that advice providers renew their clients' agreement to ongoing fees every two years and there is also an annual fee disclosure statement requirement.

Certain provisions were attempted to be amended in 2014 but they were disallowed by the Australian Senate. The Government then remade – with bipartisan support – some of the previously disallowed regulations which changes were passed on March 1, 2016 and received Royal Assent on March 18, 2016. Some of the changes included an extension of the timeframe for advisors to send renewal opt-in notices and fee disclosure statements to retail clients from 30 to 60 days and added consumer credit insurance into the basic banking provisions, and changes to ensure that benefits provided by a retail client to their financial adviser are exempt from conflicted remuneration provisions.

The "FOFA" reforms are now considered completed. The Government launched a far reaching financial systems inquiry in 2010 whose final report (the Murray Financial System Inquiry Report) was issued in December 2014. Current proposals arising from the Murray Financial System Inquire Report relevant to financial services include a new framework for the professional, ethical and education standards of financial advisors and changes to make issuers and distributors of financial products accountable for their offerings through a consultation on the introduction of a product design and distribution obligation and a new product intervention power for the Australia Securities and Investments Commission.

[114] Gregg McClymont: Why are savers reluctant to pay for advice? (Feb 23 2016) Moneymarketing, Online: https://www.moneymarketing.co.uk/issues/18-february-2016/gregg-mcclymont-why-are-savers-reluctant-to-pay-for-advice/..

The United States

The Securities and Exchange Commission ("SEC") and Dodd-Frank:

The SEC was obliged to examine a fiduciary duty requirement under Dodd-Frank. Investment advisors are subject to a fiduciary standard whereas broker-dealers are subject to a suitability standard. An SEC Study (arising from Dodd-Frank) recommended that the SEC establish a fiduciary standard for all brokers, dealers and investment advisors when providing personalized investment advice about securities to retail customers. On March 1, 2013 the SEC issued a request for quantitative data and economic analysis relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations. A draft rule has been stalled as there is a division amongst commissioners on the issue. The current SEC timetable suggests it will be in April 2017 that a rule proposal will be released.

U.S. Department of Labor Finalizes Rule to Address Conflicts of Interest[115]*:*

The new rule was considerably softened. Under the final rule and related exemptions, certain kinds of communications constitute investment advice and certain types of relationships in which those communications occur give rise to fiduciary investment advice responsibilities. The recommendation must be provided in exchange for a "fee or other compensation, direct or indirect (including commissions, loads, finder's fees, and revenue sharing payments)".

The rule allows for advice to be provided to investors "in their best interest" while also allowing advisors to continue receiving commission-based compensation, through the issuance of the Best Interest Contract Exemption ("BICE"). The BICE permits firms to continue to rely on many current compensation and fee practices, as long as they meet specific conditions intended to ensure that financial institutions mitigate conflicts of interest and that they, and their individual advisors, provide investment advice that is in the best interests of their customers. As stated in the U.S. Department of Labor Fact Sheet,

> "Specifically, in order to align the advisor's interests with those of the plan or IRA customer, the exemption requires the financial institution to acknowledge fiduciary status for itself and its advisors. The financial institution and advisors must adhere to basic standards of impartial conduct, including giving prudent advice that is in the customer's bet interest, avoiding making misleading statements, and receiving no more than reasonable compensation. The financial institution also must have policies and procedures designed to mitigate harmful impacts of conflicts of interest and must disclose basic information about their conflicts of interest and the cost of their advice."[116]

Disclosure requirements on material conflicts of interest, fees and charges and type of compensation firms receive from third parties in connection with recommended investments will be required. Investors also have the right to obtain specific disclosure of costs, fees and other compensation upon request. Certain information must be maintained on the website of the financial institution.

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115 The actual rule is 208 pages long and is available online at https://s3.amazonaws.com/public-inspection.federalregister.gov/2016-07924.pdf.

116 U.S. Department of Labor Fact Sheet, at page 1. Available online at https://www.dol.gov/ProtectYourSavings/FactSheet.htm.

An earlier version of the proposed DOL Rule required that the BICE agreement needed to be signed by the investor before any advice or product recommendation was made. The final rule requires this at account opening or at the same time as the recommended transaction.
An earlier version of the proposed DOL Rule required "total costs" to be disclosed in a form that would be useful to investors. The final rule omits this and replaces it with general fee disclosure found on the website.

There is no distinction whatsoever between a fee-only advisor whose only material conflict is negotiating his own fee and an advisor or broker heavily dependent on third party commissions, fees and payments. It also grandfathers status quo arrangements into the future.

It is not clear how courts will define "best interest" as there is no single definition widely accepted by industry and advisors today. The definition of a fiduciary, as defined in common law, has been rejected. It is also not clear how courts will interpret "reasonable compensation".

Europe (MiFID II)

MifID was a European Union law adopted in 2004 that was designed to provide harmonized regulation for investment services. Its limitations became apparent during the financial crisis, leading to MiFID II. MiFID II is a very broad piece of EU legislation that is scheduled to come into force January 2018 in all E.U. member states. The measures include:

- Firms that provide independent financial advice or portfolio management for retail and professional clients will no longer be able to accept or retain payments (fees, commissions or any other monetary benefit) or non-monetary benefits that they receive from a third party for a service they carry out on your behalf. They must pass on to the client any payment from a third party in relation to the provision of investment advice or portfolio management. Minor monetary benefits can continue under certain conditions.

- If firms are not providing portfolio management or independent advice, then these type of payments and non-monetary benefits can continue so long as they:

    - Are designed to enhance the quality of the relevant service provided to the client[117];

    - Do not impair the firm's duty to act honestly, fairly and professionally towards the client in accordance with the client's best interests; and

    - Are disclosed to the client.

- There are specific provisions on the remuneration of sales staff. Firms are required to "take all appropriate steps to identify and to prevent or manage conflicts of interest...including those caused by....the firm's own remuneration and other incentive structures." (Article 23(1) of MiFID II. Article

[117] See Final Report: ESMA's Technical Advice to the Commission on MiFIDII and MiFIR at pages 138-143, and in particular, paragraphs 10 to 15, available online at https://www.esma.europa.eu/sites/default/files/library/2015/11/2014-1569_final_report_-_esmas_technical_advice_to_the_commission_on_mifid_ii_and_mifir.pdf.

24(1) of MiFID II provides that an investment firm "*which provides investment services to clients shall ensure that it does not remunerate or assess the performance of its staff in a way that conflicts with its duty to act in the best interests of clients. In particular, it should not make any arrangements by way of remuneration, sales targets or otherwise that could provide an incentive to its staff to recommend a particular financial instrument to a retail client when the investment firm could offer a different financial instrument which would better meet that client's needs*".[118] The final technical guidance states that *"Remuneration policies and practices shall be designed in such a way so as not to create incentives that may lead relevant persons to favour their own interests or the firm's interests to the potential detriment of any client.*" It also the day-to-day implementation of the remuneration policy and monitoring of compliance related to the policy as the responsibility of senior management of the investment firm.

- Disclosure as to whether or not the advice provided is done on an "independent basis" or whether it is more restricted. To be "independent" the advisor must have assessed a sufficiently diverse range of financial products available on the market and does not accept or retain payments or non-monetary benefits paid from a third party in relation to the provision of the service that is being provided to the client.

- Firms are to have stricter internal or organizational requirements regarding product design and distribution – to better understand the nature and risks of the products they manufacture and/or sell (Product governance requirements)

- Regulators have the power to ban certain products.

- Cost disclosure – costs relating to the investment and the cost of advice to be disclosed and how the individual pays made clear. The total figure (aggregated) of all costs and charges to be provided to the client and an itemized breakdown of costs, upon request.

- The regulation of structured deposits including conduct of business and conflicts of interest rules. Complex products including structured deposits not to be sold to clients on an execution-only basis.

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[118] Remuneration is defined in MiFID's Guidelines on remuneration policies and practices – final report (ESMA/2013/606), available online at https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-606_en.pdf.

Appendix B - RETAIL INVESTMENT ADVISOR PROFICIENCY & CONTINUING EDUCATION REQUIREMENTS IN LEADING JURISDICTIONS

<table>
<tr><th>CANADA</th><th></th></tr>
<tr><td>Regulators</td><td>Canadian Securities Administrator (“CSA”); Investment Industry Regulatory Organization of Canada (“IIROC”); Mutual Fund Dealers Association of Canada (“MFDA”)</td></tr>
<tr><td>Laws/Guidelines</td><td>National Instrument 31-103 – Registration Requirements and Exemptions (“NI 31-103”); IIROC Rule 2900 – Proficiency and Education (the “IIROC Rules”); MFDA Staff Notice MSN-0077 – Approved Person Proficiency Requirements (the “MFDA Rules”)</td></tr>
<tr><td>Terminology</td><td>A “registered individual” is an individual who is registered to act as a dealer or advisor on behalf of a registered firm.
A “registered representative” is an employee of an IIROC-regulated “dealer member” firm who has been approved by IIROC to trade and advise in securities with the public in Canada.
An “approved person” is a person who is registered with the MFDA to trade or deal in securities in respect of a MFDA-regulated “member firm.”</td></tr>
<tr><td>Proficiency Requirements</td><td>NI 31-103 prohibits individuals from performing any activity that requires registration until the person has the education, training and experience that a reasonable person would consider necessary to perform the activity competently.[119]

<u>IIROC</u>

To become a registered representative, a person must complete: [120]
The Canadian Securities Course;
The Conduct and Practices Handbook Course;
A 90-day training program during which the person is employed with a dealer member on a full-time basis; and
Within 30 months of being approved as a registered representative, the Wealth Management Essentials Course (unless the registered representative deals only in mutual funds).
<u>MFDA</u>

To become a registered representative who deals exclusively in mutual funds (and an approved person), a person must complete one of the following:[121]</td></tr>
</table>

[119] NI 31-103, s. 3.4(1).
[120] IIROC Rules, Part I, s. 3.
[121] *Ibid*, s. 3.5

CANADA	
	• The Canadian Investment Funds Exam; the Canadian Securities Course Exam; or the Investment Funds in Canada Course Exam;[122] • Obtain a CFA Charter and have 12 months of relevant investment management experience in the 36-month period before applying for registration; or • Receive the Canadian Investment Manager designation and have 48 months of relevant investment management experience, 12 months of which was in the 36-month period before applying for registration.
Continuing Education	<u>IIROC</u> Registered representatives must complete a 12-hour compliance course and a 30-hour professional development course each three-year cycle. Registered representatives may take their courses from an external course provider or from a program offered by their dealer member.[123] <u>MFDA</u> The MFDA is currently undertaking consultations on whether to introduce continuing education ("**CE**") requirements for approved persons.[124]
Regulator/Firm Oversight[125]	<u>CSI</u> The Canadian Securities Institute ("**CSI**") creates and administers all proficiency courses and exams that individuals must take to become registered individuals. CSI develops its course and exam content by working closely with regulators, self-regulatory organizations and members of the investment and banking industries. <u>IIROC</u> IIROC's Business Conduct Compliance staff monitor dealer members to ensure they implement policies, procedures and controls to ensure compliance with regulations and industry guidelines. IIROC staff regularly reviews registered representatives, focusing on issues such as suitability, client account supervision and due diligence, corporate finance and research, employee activities and internal controls. IIROC staff also examines the firm's supervision of and internal compliance testing on these activities.[126] <u>Dealer members</u>

122 *Ibid*, s. 3.1(1), a person is deemed to have not passed an exam unless the individual has done so within 36 months before the date that the individual applied for registration

123 *Ibid*, Part III.

124 The MFDA recently put out a discussion paper on the topic titled *Discussion Paper on the Development of Continuing Education Requirements*. The paper can be found at http://www.mfda.ca/regulation/bulletins15/Bulletin0644-P.pdf.

125 "Regulator/Firm Oversight" refers to the level of oversight exercised by regulator(s) and/or firms to verify the quality of proficiency and continuing education requirements and to ensure that retail investment advisers are meeting these requirements.

126 See IIROC's webpage: http://www.iiroc.ca/industry/industrycompliance/Pages/Business-Conduct.aspx.

CANADA	
	A dealer member may develop and deliver CE compliance and/or professional development courses within its firm, or may engage an external course provider to do so. CE courses must comply with IIROC guidelines, but dealer members determine their own methods of evaluating registered representatives' knowledge and course comprehension. Dealer members must certify that their registered representatives have successfully completed their CE requirements, and retain records to this effect.[127] MFDA MFDA's Enforcement Department investigates situations where member firms or approved persons may have breached the MFDA Rules. It instigates a review after receiving a complaint.[128]

AUSTRALIA	
Regulator	Australian Securities and Investments Commission ("**ASIC**")
Laws/Guidelines	*Corporations Act 2001* (the "**Act**"); Regulatory Guide 146: *Licencing – Training of Financial Product Advisors* (the "**Regulatory Guide**");[129] the *Corporations Amendment (Professional Standards of Financial Advisors) Bill 2015* (the "**Bill**")[130]
Terminology	A "**financial product advisor**"[131] or a "**relevant provider**" is a person authorized by ASIC to provide advice on financial products on behalf of a financial services licensee firm (a "**licensee**") to a retail client. Under the new requirements (defined below), only relevant providers can use the titles "financial advisor" and "financial planner," or terms of similar import or combinations of words that include these terms.[132]
Proficiency Requirements	Under the Act's existing requirements (the "**existing requirements**"), to become a financial product advisor, a person must complete:[133] • Tier 1 training standards, which are education courses that must be broadly equivalent to the 'Diploma' level under the Australian Qualifications Framework (the "**AQF**");[134] and

[127] IIROC Rules, Part III.
[128] See MFDA's webpage: http://www.mfda.ca/enforcement/enforcement.html.
[129] Chapter 7 of the Act governs financial product advisers, but the proficiency requirements are set out in the Regulatory Guide, which can be found at: http://download.asic.gov.au/media/1240766/rg146-published-26-september-2012.pdf.
[130] The Bill takes effect July 1, 2017, with the exception of the provisions relating to the Code of Ethics, which take effect July 1, 2019.
[131] The existing requirements refer to "financial product advisers." The new requirements refer to "relevant providers".
[132] Bill, s. 1.25.
[133] Regulatory Guide, 146.10.
[134] The AQF is a national government system that provides the criteria for qualifications issued by the vocational education and training sector and the school and higher education sectors. The AQF can be found at: http://www.aqf.edu.au/aqf/in-detail/aqf-levels/.

AUSTRALIA	
	• Skill requirements, but only if the person will provide "**personal advice**" (i.e. advice that is tailored to a client's objectives, financial needs and situation).[135] Financial product advisors that only provide general advice (i.e. advice that is not personal advice) are not required to complete any skill requirements.[136]
	After the Bill takes effect (the "**new requirements**"), to become a relevant provider, a person must complete:[137] • A bachelor degree or equivalent qualification that is approved by the "**standards body**" (which is a company nominated by the Minister of Finance to develop education, training and ethical standards); • A year of work, training or both that meets requirements set by the standards body; and • An examination approved by the standards body.
Transition to new requirements	Under the new requirements, the standards body is required to develop a Recognized Prior Learning framework to assess the value of existing financial product advisors' prior education, on-the-job training and experience. Financial product advisors will have five years to reach degree-equivalent status (which can be achieved through various pathways, such as approved bridging courses) and two years to pass the standards body's exam.[138]
Continuing Education	Under the existing requirements, licensees are required to implement policies and procedures to ensure that their financial product advisors receive ongoing training to maintain and update the knowledge and skills they require for their professional activities.[139]
	Under the new requirements, relevant providers have an ongoing obligation to meet the continuing professional development ("**CPD**") requirements set by the standards body and to comply with the Code of Ethics (the "**Code**").[140]

135 Regulatory Guide, 146.51 and Appendix B.
136 *Ibid*, s. 146.52.
137 Bill, ss. 1.14 – 1.16
138 *Ibid*, ss. 5.3 – 5.7.
139 Regulatory Guide, 146.14.
140 Bill, ss. 1.18 – 1.1.9, 2.5.

AUSTRALIA	
Regulator/Firm Oversight	<u>ASIC</u> Under the existing requirements, ASIC does not mandate any particular course or training provider, and it does not prescribe any particular duration for a training course or method of delivery. It is not involved in assessing education courses: education courses must be approved by an "**authorised assessor**" (i.e. a registered training organization or professional association), and can thereafter be listed on ASIC's Training Register.[141] <u>Licensees</u> Under the existing requirements, financial product advisors are not required to undertake a formal diploma course, such as the one listed in the AQF.[142] Licensees can develop their own education courses and have them approved by an authorised assessor. An authorised assessor must assess whether an individual has met the training standards.[143] Licensees are also expected to have adequate policies and monitoring procedures in place to ensure that persons not trained in accordance with the training standards do not provide financial product advice.[144]

[141] Regulatory Guide, 146.71-72.
[142] *Ibid*, 146.58.
[143] *Ibid*, 146.11-13.
[144] *Ibid*, 146.32.

AUSTRALIA	
	Standards body Under the new requirements, the standards body is responsible for developing education and training standards and the Code, which sets out the ethical obligations applicable to relevant providers.[145] These ethical obligations go above industry legal requirements and aim to encourage professionalism in the financial services industry.[146] Licensees and professional associations Under the new requirements, all relevant providers are subject to the Code and are covered by a monitoring and enforcement scheme (a "**scheme**").[147] Schemes are developed by licensees or professional associations, and must be approved by ASIC.[148] A professional association must directly monitor the relevant providers covered by its scheme for breaches of the Code, and take enforcement action where necessary. A licensee cannot be the monitoring body for its own scheme: it must engage a third-party to monitor on its behalf.[149] A monitoring body must notify a licensee of a relevant provider's breach, and the licensee must in turn notify ASIC of the breach and the sanctions imposed for it. ASIC maintains a record of all breaches.[150]
Sanctions	Under the new requirements, relevant providers can be sanctioned for breaching the Code. Soft sanctions include a warning, additional training requirements or additional supervision. Tougher sanctions include revocation of membership within a professional association or termination of one's employment with a licensee.[151]

UNITED KINGDOM	
Regulator	Financial Conduct Authority ("**FCA**") (formerly, the Financial Services Authority)
Laws/Guidelines	*Financial Services and Markets Act* (the "**Act**"); the FCA Handbook (the "**FCA Handbook**")
Terminology	• An "**approved person**" is a person approved by the FCA to perform a "**controlled function**" for an authorized firm. The controlled functions

145 Bill, s. 2.3.
146 *Ibid*, s. 2.8.
147 *Ibid*, s. 2.30.
148 *Ibid*, ss. 2.4 – 2.6.
149 *Ibid*, ss. 2.13 and 2.20.
150 *Ibid*, ss. 2.37 – 2.40.
151 *Ibid*, s. 2.35.

<table>
<tr><th>UNITED KINGDOM</th><th></th></tr>
<tr><td></td><td>include a "customer function, which involves advising retail customers on retail investment products.
The FCA Handbook refers to “retail investment advisors,” which fall into one of two categories: “independent advisors” or “restricted advisors.” Independent advisors can consider and recommend any type of retail investment product; restricted advisors can only provide advice on a limited set of products and providers. Independent and restricted advisors must pass the same qualifications and meet the same requirements.</td></tr>
<tr><td>Proficiency Requirements</td><td>To be an approved person, a person must:[152]
Pass the “fit and proper test,” which is a FCA-conducted evaluation of whether a person is suitable to perform a controlled function. The test is not an exam, but rather an assessment of a person’s honesty (based on factors such as the person’s openness with self-disclosures, integrity and reputation), competence and capabilities, and financial soundness; and
Perform the controlled function in line with the Statements of Principle and Code of Practice for Approved Persons (“APER”).
To work at a firm, a person must:
Obtain the “appropriate qualifications” required to conduct the controlled function. Retail investment advisors are required to obtain the QCF Level 4 qualification, which is equivalent to the first year of a university degree.[153] The appropriate qualifications are set out in the Appropriate Qualification tables;[154] and
Undergo the training that the authorized firm considers necessary based on its assessment of the person’s needs at the time of hiring. A person cannot work unsupervised until the firm has determined that the person’s training needs are satisfied.[155]
A person that has not been assessed as competent by his or her firm is permitted to provide advice so long as he or she is appropriately supervised at all times. Employees have 30 months from the date they start providing advice (under supervision) to acquire an appropriate qualification. If a person fails to do so within this period, he or she must cease to engage in that activity. [156] Firms may require their employees to attain an appropriate qualification within less time.[157]</td></tr>
</table>

[152] See the FCA’s *The Fit and Proper Test for Approved Persons*: https://www.handbook.fca.org.uk/handbook/FIT.pdf.
[153] The Financial Advice Market Review Final Report, p. 35 (the “**FAMR Report**”).
[154] FCA Handbook, TC 2.1.10.
[155] *Ibid*, TC 2.1.11.
[156] The FAMR Report, Recommendation 5, advises the FCA to consider modifying the time limits for employees to attain an appropriate qualification. Some firms would like for employees to be allowed to work for up to four years under supervision before having to obtain the appropriate qualification.
[157] FCA Handbook, TC 2.2A.1 – 2.2A.4.

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Transition Provisions	Following the Retail Distribution Review, retail investment advisors that held designated qualifications were not required to complete further examinations, but were required to address any knowledge gaps (based on an assessment against the Financial Services Skills Council's examination standards), and have their qualification "gap-fill" verified by an accredited body.
Continuing Education	Firms are required to continually assess their employees' competence and to take steps to ensure they remain competent in their roles (the "**competent employee rule**"). In this assessment, firms should consider their employees' technical knowledge; skills and expertise; and changes in the market, products and legislation.[158] In addition, firms must ensure that retail investment advisors complete at least 35 hours of CPD every year. Of these 35 hours, at least 21 hours must be spent on "**structured CPD activities**," such as courses, seminars, lectures, conferences, workshops, web-based seminars or e-learning. The time not spent on structured CPD activities may be spent conducting relevant research; reading industry or other relevant materials; or participating in professional development coaching or mentoring sessions.[159]
Regulator/Firm Oversight	<u>FCA</u> The FCA approves "**qualification providers**" (such as the Chartered Institute for Securities and Investment), which create their own exams, study materials and appropriate qualifications (such as certificates, courses, designations, degrees and diplomas). In assessing whether to approve a qualification provider, the FCA considers whether the applicant has robust and reliable procedures for assessing exams and preventing conflicts of interest, and adequate financial resources.[160]The FCA oversees the development of qualification providers' exam standards and reviews them periodically. Before finalizing education standards, it publishes them for comment. The FCA reviews firms' systems and procedures for complying with the competent employee rule. It uses a data and risk-based supervisory approach, which is based on gathering insights from firm reporting and other intelligence. The FCA's objective is to ensure that it has a "longer-term view of advisors as they move between firms during their career."[161] <u>Firms</u> Firms decide how to assess employee competence, both at their time of hire and

158 *Ibid*, TC 2.1.12.
159 *Ibid*, TC 2.1.15 – 2.1.16; 2.1.20 – 2.1.22.
160 The FCA has approved approximately 550 qualification providers and more than 300 qualifications.
161 Financial Services Authority, Policy Statement 11/1, chapter 4, p. 30.

UNITED KINGDOM	
	throughout their employment. Firms must have clear criteria in place so all individuals know when competence is reached and what conduct is required to sustain it.[162] Firms must ensure employees are always supervised, although the level and intensity of supervision depends on a person's experience and whether they have been assessed as competent. Firms are required to obtain independent verification of retail investment advisors' qualifications from an accredited body,[163] and to notify the FCA of each retail investment advisor's professional information. Firms must also notify the FCA if a retail investment advisor loses competence, fails to obtain the appropriate qualification or breaches the APER or Code of Conduct.[164] On an annual basis, firms must obtain written confirmation that each retail investment advisor has completed their CPD requirements and complied with the Code of Conduct or APER.[165] Firms must keep records on everything relating to training and conduct compliance.

UNITED STATES	
Regulator	The Securities and Exchange Commission ("**SEC**"); Financial Industry Regulatory Authority ("**FINRA**")
Laws/Guidelines	*Investment Advisers Act of 1940* (the "**Advisers Act**"); *Securities Exchange Act of 1934* (the "**Exchange Act**"); FINRA Manual (the "**FINRA Manual**")
Terminology	• An "**investment advisor**" is a person or firm that is registered in accordance with the requirements of the Advisers Act that provides securities advice to others for a fee.[166] • A "**registered representative**" or "**broker-dealer**" is a person registered in accordance with the requirements of the Exchange Act and licenced with FINRA as a securities professional, who does not receive "special compensation" for its advisory services.[167] The SEC has acknowledged that investment advisors and broker-dealers routinely

162 See the FCA website: https://www.the-fca.org.uk/firms/training-competence.
163 FCA Handbook, TC 2.1.27.
164 *Ibid*, TC 2.1.31.
165 *Ibid* TC 2.1.26.
166 Advisers Act, s. 203(a). Since 1996, the Advisers Act has allocated regulatory responsibility for investment advisers between the SEC and the states. Today, most small adviser firms (assets under management < $25 million), mid-sized adviser firms (AUM > $25 and < $100 million), and their employees are subject to state regulation and are prohibited from registering with the SEC (unless the state has not enacted legislation governing investment advisers). Most large adviser firms must register with the SEC, and state adviser laws are pre-empted for these advisers.
167 *Ibid*, s. 202(a)(11). Broker-dealers are excluded from the definition of "investment adviser" if they meet the following requirements: (1) the performance of investment advisory services is solely incidental to the conduct of its business as a broker-dealer; and (2) no "special compensation" is received for advisory services and the broker-dealer does not receive any additional compensation to provide such service to their customers. Thus, income earned by registered representatives is often through commissions from the products they sell.

UNITED STATES	
	provide many of the same services to retail customers, yet are subject to distinct regulatory schemes.[168] Many individuals are registered as both investment advisors and registered representatives.[169]
Proficiency Requirements	Investment advisors There are no educational or "fit and proper" requirements for investment advisors under federal law, although state law may require an investment advisor to pass securities exams in the state in which they have a principal place of business.[170] For example, in both New York State[171] and California,[172] to become a state-registered investment advisor, a person must complete: • The Uniform Investment Adviser Law Examination (Series 65 examination); or • The General Securities Representative Examination (Series 7 examination) and the Uniform Combined State Law Examination (Series 66 examination). These exams must be completed before a person provides investment advice to the public, and must be completed within no more than two years prior to applying for registration. Registered representatives To become a registered representative that provides retail advice, a person must pass: • the Series 7 Exam – General Securities Representative Examination. If the registered representative performs other functions, it must demonstrate proficiency in the relevant areas by passing other qualification exams, a list of which can be found here. FINRA does not offer courses, but provides content outlines of the subject matter covered on exams.[173] FINRA does not mandate training or prior work experience, but some firms provide in-housing training programs.

168 "Duties of Dealers, Brokers and Investment Advisers," The Securities and Exchange Commission, p. 3: https://www.sec.gov/rules/other/2013/34-69013.pdf ("**Duties of Dealers, Brokers and Investment Advisers**").
169 "Suitability versus Fiduciary Standard," *Journal of Financial Planning*, https://www.onefpa.org/journal/Pages/Suitability-Versus-Fiduciary-Standard.aspx.
170 *Regulation of Investment Advisers by the U.S. Securities and Exchange Commission* (March 2013), p. 20: https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.
171 NYCRR Title 13, Part 11, Investment Advisory Services, §11.6 or §11.7.
172 How to Register as a California Registered Investment Adviser, Step 5: http://www.dbo.ca.gov/Licensees/Broker-Dealer_and_SEC_Investment_Advisers/pdf/HOW%20TO%20REGISTER%20AS%20A%20CALIFORNIA%20REGISTERED%20INVESTMENT%20ADVISER.v3.pdf

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<tr><th>UNITED STATES</th><th></th></tr>
<tr><td>Continuing Education</td><td><u>Investment advisors</u>

Investment advisors are not subject to any CE requirements under federal law.[174] New York State and California also do not impose CE requirements on state-registered investment advisors.

<u>Registered representatives</u>

The CE requirements for registered representatives consist of two mandatory programs: the “regulatory element” and the “firm element.”[175]

(i) Regulatory element

The regulatory element consists of periodic computer-based training on regulatory, compliance, ethical, supervisory and sales practice standards. Registered representatives must complete the regulatory element within 120 days of the second anniversary of their initial registration, and every three years thereafter. The content for the regulatory element is derived from industry rules, regulations and widely accepted industry standards and practices. The regulatory element can be completed online. FINRA makes resources, such as content outlines, available to registrants to help them prepare for it.

(ii) Firm element

The firm element applies to all persons registered with a FINRA “member firm” who directly interact with customers in conducting securities sales, trading or investment activities (“covered registered persons”). Each member firm must maintain a CE program for covered registered persons to enhance their securities knowledge, skills and professionalism.

At least once a year, a member firm must evaluate and prioritize its training needs and develop a written training plan, taking into account the member’s size, structure, scope, regulatory developments, and its covered registered persons’ performance in the regulatory element. A member firm must administer its CE programs in accordance with its written plan and maintain records thereof.</td></tr>
<tr><td>Regulator/Firm Oversight</td><td><u>SEC</u>

The SEC’s Compliance Office conducts inspections of investment advisor firms that have higher-risk investment advisors, or if it has received a complaint or has other cause to investigate.[176]</td></tr>
</table>

[173] FINRA Registered Representatives Brochure, p. 4 (the “**FINRA Brochure**”).
[174] Duties of Dealers, Brokers and Investment Advisers, p. 63.
[175] FINRA Manual, s. 1250.
[176] See *Regulation of Investment Advisers by the U.S. Securities and Exchange Commission* (March 2013), p. 57-58: https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf.

UNITED STATES	
	Investment advisor firms Investment advisor firms must implement policies and procedures designed to prevent employees from violating the law.[177] They must review the adequacy and effectiveness of their policies at least annually.[178] FINRA FINRA develops and administers its exams, and engages and oversees industry committees that assist in developing and updating competency profiles, exam questions and content outlines. Independent training providers also create study materials and courses for candidates seeking to prepare for their exams. FINRA conducts thousands of on-site member firm reviews each year. These reviews are meant to determine whether member firms and their registered representatives are complying with laws and guidelines. It will also review member firms or registered representatives in response to a customer complaint.[179] Member firms Member firms are responsible for designing, implementing and overseeing the firm element of the CE program.

EUROPEAN UNION	
Regulators	European Securities and Market Authority ("**ESMA**"); the public authorities designated by each European Union Member State to carry out the duties provided for under law (the "**Competent Authorities**").
Laws/Guidelines[180]	Markets in Financial Instruments Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments ("**MiFD II**") and ESMA Final Report: Guidelines for the assessment of knowledge and competence (the "**Guidelines**").[181]

177 Advisers Act, s. 206(4)-7(a).
178 *Ibid*, s. 206-7(b).
179 FINRA Brochure, p. 16.
180 Since MiFID II was adopted into European law on April 5, 2014, the ESMA has been working to create so-called Level-2 legislation across key aspects of the MiFID investor protection provisions. This Level 2 work takes two forms: delegated acts that are drafted by the European Commission on the advice of ESMA; and technical standards that are drafted by ESMA and approved by the European Commission.
181 The investor protection provisions set out in the Guidelines, Annex VI, are set to take effect January 3, 2018.

EUROPEAN UNION	
Terminology	The Guidelines apply to Competent Authorities and to "**firms**" that provide investment services. Firms are responsible for ensuring their "**staff**" members fulfill the Guidelines' requirements.
Proficiency Requirements	For a person to provide investment advice[182] or give information about financial instruments, structured deposits, investment services or ancillary services to clients (the "**relevant services**"), a firm must ensure that the person has: • "**appropriate qualifications**," in the form of exams or courses that meet the Guidelines' criteria; and • "**appropriate experience**," which is a minimum of 6 months' prior work experience providing the relevant services. If a staff member does not have appropriate qualifications, appropriate experience or both, the staff member can only provide the relevant services under supervision, and this supervisory period cannot exceed 4 years. The Guidelines grant firms the flexibility to determine how trainees should be supervised within the firm (i.e. it is not necessary for them to be shadowed by a qualified advisor).[183]
Continuing Education	At least annually, firms should review staff members' development and needs; assess regulatory developments; and take action to comply with the Guidelines. Firms must ensure staff maintain and update their knowledge and competence by undertaking CPD or training as well as specific training in advance of the firm offering any new investment products.
Regulator/Firm Oversight	<u>Firms</u> Firms are responsible for ensuring that staff know, understand and apply the firm's MiFID II compliance policies and procedures, and posses the requisite knowledge and competence to fulfil their obligations. On request, firms must submit records to their Competent Authority establishing the knowledge and competence of their staff, which should enable the Competent Authority to verify compliance with the Guidelines.

[182] The Guidelines distinguish between staff that provide investment advice and staff that only provide information on investment products/services. The Guidelines hold investment advisers to a higher knowledge and competence standard. This chart does not outline firms' responsibilities in respect of staff that only provide information on products/services, but this information can be found in the Guidelines at Annex VI, s. V.II.

[183] Note: The ESMA qualification standards are similar to those in the U.K., although they afford firms greater flexibility to determine how trainees should be supervised within the firm. The FAMR Report notes that U.K. firms have been dissatisfied with the lack of clarity surrounding training supervisory standards. See FAMR Report, p. 36.

Appendix C – NI 31-103 SRO Rules Obligations of Registrants

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
Conflicts of Interest	No explicit requirement to prioritize the interests of the client when responding to conflicts. No explicit requirement that: (i) disclosure related to conflicts of interest is fully understood by the client, including the implications and consequences of the conflict; and (ii) registrants must have a reasonable basis for concluding that a client understands such disclosure. Only explicitly applies to firms, not representatives.	NI 31-103 would be amended to require that firms and representatives respond to conflicts of interest in a manner that prioritizes the interests of the client ahead of the interests of the firm and/or representative. The disclosure to a client about a conflict must be prominent, specific and clear. In addition, firms and representatives would be required to have a reasonable basis for concluding that a client fully understands the implications and consequences of a disclosed conflict.	Rule 42 42.1: Identify material conflicts of interest and report material conflicts of interest to Dealer Member 42.2: Approved person to consider the implications of material conflicts of interest; must address all existing and potential conflict of interest in a manner that is consistent with the vest interests of the client; conflicts of interest that cannot be addressed must be avoided 42.3: Dealer Member to consider the implications of material conflicts of interest; must address all existing and potential conflict of interest in a manner that considers the best interests of the client; conflicts of interest that cannot be addressed must be avoided; must adequately supervise how existing or potential material conflicts of interest between	Rule 2.1.4 A: Members and Approved Persons will be aware of conflicts and Approved Persons will disclose conflicts to the Member. B: Members and Approved Persons will address conflicts of interest in the best interests of the client. C: Conflicts will be disclosed in writing to the client. D: Members will develop and maintain policies and procedures to ensure compliance.

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
			the Approved Person and the client are addressed by its Approved Persons pursuant to s. 42.2 42.4: if not avoided, conflicts of interest must be disclosed to the client 42.5: Dealer Members will develop and maintain written conflicts of interests policies and procedures -	
Know Your Client	No explicit requirement to collect certain key elements of investment needs and objectives and financial circumstances (e.g., amount and nature of debts). No explicit requirement around developing risk profiles for clients. No explicit requirement that the original KYC	Additional "client-centred information" would be required as part of a KYC process that ensures a thorough understanding of the client. Such additional "client-centered information" relates to the three key elements of the KYC obligation, namely the client's: (i) investment needs and objectives, (ii) financial circumstances, and (iii) risk profile. Registrants would	Rule 1300.1, 1300.2 Dealer Members will use due diligence to learn and stay informed about the essential facts relative to every client and every order or account accepted so they understand the client's identity and creditworthiness. Dealer Members must designate a Supervisor to be responsible for opening new accounts and for establishing and maintaining appropriate	Rule 2.2.1 Each Member and Approved Person will use due diligence to learn essential facts relative to each client and each order or account. Rule 2.2.4: KYC information will be updated when there is a material change in client information. See also: Staff Notice MSN 0069, Section II of Policy 2

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	information, and any material change, is confirmed in writing with a signed copy provided to the client. No explicit requirement that registrant take reasonable steps to update KYC information at least once a year.	also be required to take reasonable steps to update their clients' KYC information and forms at a minimum annually and more frequently where there are material changes affecting the client or the client's portfolio.	procedures. IIROC Dealer Member Rule 2500 which sets out supervisory requirements including requirements specific to complying with the KYC obligation – eg establish procedures to maintain complete and accurate information on each client. See also IIROC Notice 12-0109, Notice 14-0044	Members must obtain and maintain complete, timely and accurate KYC information which includes essential facts relative to each client. Members must have policies and procedures in place relating to obtaining and updating KYC information. Members must have policies and procedures in place to review and approve KYC information.
Know Your Product	Although KYP is a key element of the suitability analysis, it is not an explicit, standalone requirement (currently embedded for representatives as an element of proficiency that applies only when a recommendation is made, but not explicitly when the client initiates the order). No explicit requirement for	Enhancements to the KYP obligations would include requirements for representatives to understand his or her firm's products (including structure, product strategy, features, costs and risks) in comparison to other products on the firm's product list. The representative would also have to understand and	No specific rule, but KYP is a key element of the suitability analysis. See also the following guidance: Guidance – IIROC Notice 09-0087 Best practices for product due diligence	No specific rule, but KYP is a key element of suitability analysis. See also the following guidance: Staff Notice MSN 0069 Staff Notice MSN 0048 Members and Approved Persons must understand the salient facts about the products they offer.

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	representatives to know about all the products on their firm's product list, how each product compares to the others, and all fees, costs and charges connected to the product, the client's account and the product and account investment strategy. No explicit role for the firm in meeting the KYP requirement. No explicit requirements for shelf development by the firm	consider the impact on the performance of the product of all fees, costs and charges connected to: the product, the client's account, and the product and account investment strategy. There would be requirements for the firm to ensure that there are adequate policies and procedures, training tools, guides etc. to enable representatives to comply with the KYP obligation. Firms would have to identify whether they have a proprietary or mixed/non-proprietary product list. Those with a "mixed/non-proprietary product list" would be required to select the products they offer based on policies and procedures that include a "fair and unbiased market investigation of a reasonable universe of products" and a product comparison and optimization process.		
Suitability	Requirement is primarily	- Prior to recommending or	Rule 1300	Rule 2.2.1

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	"trade"-based (i.e., based on a product order or recommendation to buy or sell only). No explicit requirement to consider product/account costs against the client's investment needs and objectives. No explicit requirement to conduct a suitability review for recommendations or decisions to hold or exchange securities. No explicit requirement to conduct a suitability review for recommendations not to purchase, sell, hold or exchange securities. No explicit requirement for representatives to recommend the product from their firm's shelf that is most likely to meet the investment needs and objectives of the client	accepting a client instruction regarding a securities transaction, or a decision not to purchase, sell, hold or exchange of a security, a registrant would be required to assess three forms of suitability: (a) basic financial suitability (should they pay doubt high interest debt first?); (b) investment strategy suitability (including identifying a target rate of return to meet client's investment needs and objectives and assessing this against the client's risk profile); and (c) product selection suitability (including the impact of registrant/third party compensation on performance). There are triggering events for a suitability review, but in any event at least once every 12 months.	1300.1(p)(q)(r)(s)(t)(u)(v): each Dealer Member will undertake a suitability determination, which includes using due diligence, when accepting orders, providing recommendations, for account positions held when certain events occur. Suitability of investments must be reviewed. See also: Guidance Note – IIROC Notice 12-0109	A suitability review must be performed for each order accepted or recommendation made for any account of a client. This includes trades recommended by the Approved Person, orders proposed by the client, transfers, material changes to KYC or when a client is transferred to a new Approved Person. Approved Persons must also assess the suitability of investments. See also: Staff Notice MSN 0069

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	compared to the other products on the firm's shelf. No explicit requirement to consider the investment strategy and other basic financial strategies as part of the product-focused suitability analysis. No explicit requirement that suitability be conducted upon certain key events, including at least once a year.			
Relationship Disclosure	No explicit requirement for firms to provide disclosure about the general nature of the client-registrant relationship in easy to understand term. No explicit requirement for firms to provide disclosure about the nature and impact on the client of the firm's approved	Firms would be required to disclose the actual nature of the client registrant relationship in "easy-to-understand" terms. Firms would also be required to disclose whether they offer proprietary products only or a mix of proprietary and non-proprietary products and the suitability analysis does not consider non-	Rule 3500 Requirements for the written communication between the Dealer Member to the Client describing the products and services offered, the nature of the account and how the account will operate, and the responsibilities of the Dealer Member to the client. The rule notes the format and	Rule 2.2.5 On account opening, Members provide all clients with core information about the nature of their relationship with the Member and its Approved Persons. See also MR 0075

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	product list or restricted category of registration, as applicable.	proprietary products and whether they are better, worse or equal in meeting the client's needs and objectives.	content of the relationship disclosure. See also: IIROC Notice 12-1070 and Notice 12-0039	
Proficiency	No explicit ongoing continuing education requirement. Less, or no, emphasis on the areas that lack certain explicit obligations set out in this table.	– NI 31-103 would be amended to impose increased proficiency requirements for representatives, including requirements that all representatives must generally understand the basic structure, features, product strategy, costs and risks of all types of securities and how product costs and investment strategies can impact outcomes, and a new continuing education requirement for representatives.	Rule 2900 Sets out the proficiency requirements for "Approved Persons", which include both entrance thresholds and on-going requirements.	Rule 1.2.2 Approved Persons must have satisfied any applicable proficiency requirements set out in securities legislation.
Titles and Designations	Limited regulation on client-facing titles has allowed proliferation of dozens of confusing and competing titles.	Titles - The CSA is proposing that 31-103 explicitly prescribe uniform client-facing business titles for representatives. CSA Consultation Paper 33-404 presents three alternatives for consideration:	No specific rule, but guidance. See IIROC Notice 14-0073.	Rule 1.2.5 Misleading business titles are prohibited.

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
		Alternative 1: securities advisor – portfolio management, securities advisor, restricted securities advisor or securities salesperson. Alternative 2: advisor or salesperson. Alternative 3: only use CSA registration categories. The AMF stated in a meeting it prefers this option. Designations – NI 31-103 would be amended to prescribe the designation that representatives may use when dealing with clients. In addition, firms would be required to have policies and procedures that provide guidance and restrictions on the designations representatives may use. No specificity is provided and the rule and guidance is meaningless.		
Role of UDP and CCO	No explicit requirement for ultimate designated persons (UDPs) and chief compliance officers (CCOs)	Amendments to NI 31-103 would clarify UDP and CCO roles. UDPs and CCOs would reinforce compliance	Rule 38.5 Sets out the requirements for who can act as UDP and role of the UPD.	Rule 2.5.2 Sets out the requirements for who can act as UDP and the responsibilities of UDP.

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
	in the context of key compliance and oversight obligations, such as the compliance obligations relating to conflicts of interest and suitability.	responsibilities and obligations specifically related to managing conflicts of interest (including ensuring that material conflicts are avoided if they cannot be managed by disclosure and controls) and compliance with the suitability obligation. Comment: Senior management should have the responsibility to determine how compensation practices may impact potential conflicts.	Rule 38.7 Sets out the requirements for who can act as CCO and role of the CCO. IIROC Dealer Members subject to s. 5.1, 5.2 and 11.1. IIROC Notice 12-0379 which discusses the role of the UDP and the CCO	Rule 2.5.3 Sets out the requirements for who can act as CCO and the responsibilities of CCO.
Statutory Standard of Conduct	Limited guidance that explains what regulators' expectations are and how this standard is used separately from, and together with, more targeted obligations.	Securities legislation in British Columbia, Saskatchewan, Ontario, Québec, Nova Scotia, Prince Edward Island, Nunavut, Yukon and the Northwest Territories would be amended to introduce a statutory fiduciary duty for registrants when managing an investment portfolio for which a client has granted discretionary authority.	Rule 42 42.2. Approved Person responsibility to address conflicts of interest (2) The Approved Person must address all existing or potential material conflicts of interest between the Approved Person and the client in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients.	Rule 2.1.4 In the event that a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only by the best interests of the client and in compliance with rule 2.1.4(c) and (d).

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
			42.3. Dealer Member responsibility to address conflicts of interest (2) The Dealer Member must address the existing or potential material conflict of interest in a fair, equitable and transparent manner, and considering the best interests of the client or clients. Dealer Member Rule 42 is a principle-based rule that is supplemented by guidance. Under the rule and guidance, Dealer Members must address conflicts of interest that do, or could, arise with different business models. For example, the rule requires that all existing or potential material conflicts of interest between a Dealer Member and a client must be addressed 1 IIROC Guidance Notice 12-0108, "Client Relationship Model – Guidance". IIROC Notice 16-0068 – Rules Notice – Guidance Note – Managing	

Obligation	CSA (summary of areas without explicit requirements)	CSA Targeted Reform	IIROC (current corresponding rule or guidance)	MFDA (current corresponding rule or guidance)
			Conflicts in the Best Interest of the Client 3 "in a fair, equitable and transparent manner and considering the best interests of the client or clients", and that those between an Approved Person and a client must be addressed "in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients". See IIROC Notice 16-0068. See IIROC Notice 12-0108	