

FAIR

Canadian Foundation *for*
Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement
des droits *des* investisseurs

WHAT ABOUT THE INVESTORS?

WHITE PAPER ON THE PROPOSED COOPERATIVE CAPITAL MARKETS REGULATOR

ANITA ANAND*

Special Advisor to the Board of FAIR Canada

July 1, 2017

* Email: anita.anand@utoronto.ca. Special Advisor to the FAIR Canada board. Professor and J.R. Kimber Chair in Investor Protection and Corporate Governance, University of Toronto. Thanks to Alexander Buckley, Krupa Kotecha, Chris Puskas and Tegan Valentine for valuable research assistance.

Abstract

This white paper highlights investor-related concerns with the proposed Cooperative Capital Markets Regulatory System (“CCMR”). In both its governance structure and substance, the CCMR is not in the interests of investors. It does not contemplate the creation of an investor office or investor advisory panel, and no investor representative sits on the board of directors. In terms of substantive law, the contemplated legal regime does not contain a statutory best interest duty, an ombudservice for investor redress, a regime with financial incentives for whistleblowers or a prohibition on embedded commissions. From the perspective of Ontario investors, it makes little sense to exchange an investor-focused securities regulator for one that institutionalizes a governance structure in which investor representation is effectively nil.

Table of Contents

Table of Contents

1. LIST OF RECOMMENDATIONS1

2. INTRODUCTION2

3. CCMR STRUCTURE.....3

a) No Investor Advisory Panel4

b) No Investor Representation on Board of Directors5

c) No Investor Representative on Regulatory Policy Forum6

d) No Investor Office7

4. SUBSTANTIVE CMA7

a) No Statutory Best Interests Duty7

b) Consumer Redress.....9

c) No Whistleblowing Incentives 10

d) No Proposal regarding Embedded Commissions 11

5. TRANSITION.....12

6. CONCLUSION13

7. DEFINED TERMS.....15

1. List of Recommendations

This white paper makes the following recommendations that address structural, substantive and transitional concerns with the CCMR. At present, the CCMR exhibits weak governance especially in terms of the composition of its board which contains no investor representation. Prior to implementation of the proposed model, the following reforms should be implemented.

- i. Investor protection initiatives must be implemented in the legislation underpinning the CCMR.
- ii. A statutory Investor Advisory Panel should be created under the CMA and should form part of the structure of the CCMR.
- iii. The CCMR Board of Directors should include at least three retail investor representatives.
- iv. Investor representatives, preferably members of an Investor Advisory Panel or investor representatives who are placed on the Board, should have at least two seats in the Regulatory Policy Forum.
- v. An Investor Office should be carried forward under the CCMR.
- vi. The CCMR should not throw away the efforts to establish a statutory best interest duty and should seek to implement this duty in the CMA for the benefit of investors in the capital markets.
- vii. The CCMR should have a single statutory independent dispute resolution ombudservice for consumer disputes with the power to make binding decisions.
- viii. The CCMR should implement an explicit whistleblower program that contains monetary rewards to incentivize whistleblowers to come forward.
- ix. The CMRA should carry forward the content and proposals in the recent CSA consultation paper on embedded commissions and should disallow embedded commissions.
- x. The CCMR must not only implement the aforementioned investor-focused initiatives prior to its launch but also ensure a short and more certain route to transition for the benefit of retail investors.

2. Introduction

The current proposal for reform of Canada's securities regulatory structure is referred to as the "Cooperative Capital Markets Regulator" (CCMR). The CCMR involves the federal government and British Columbia, Ontario, Saskatchewan, New Brunswick, the Yukon and Prince Edward Island. Under a Memorandum of Agreement,¹ these governments have agreed that a new securities regulator will come into existence before July 1, 2018 and individual securities regulatory authorities in each of the participating jurisdictions will cease to exist. The provinces that are not participating in the CCMR -- including Alberta, Quebec and Manitoba -- will continue to operate under the CSA and the passport system of regulation.²

The CCMR was borne after the *Securities Reference* case in which the Supreme Court of Canada rejected the federal government's proposed statute³ on the basis that it falls outside the general trade and commerce power in the Constitution.⁴ The Court also issued a challenge to the federal government to cooperate with the provinces to address the issues raised in the case.⁵ The CCMR is a direct result of such cooperative efforts. The CCMR began with the federal government, Ontario and British Columbia signing an initial agreement in principle⁶ after the *Securities Reference* with the additional provinces named above joining the effort to create a cooperative regulator thereafter.

In both its governance structure and substance, the CCMR is not in investors' interests though this may be unintentional on the part of the participating provinces. The CCMR board of directors represents stakeholders in the financial industry but has no investor representation. The CCMR does not contemplate the creation of a statutory investor advisory panel (unlike the previous version of the proposed national regulator). Major investor-focused initiatives like the best interest duty are absent from the proposed legislation and may not be adopted at all since some participating provinces in the CCMR, such as British Columbia, do not support it. In addition, given that the Ontario Securities Commission (OSC) has been focused on investor protection and is leading important reforms for investors, it makes little sense for investors in Ontario to exchange an investor-focused securities regulator for one that institutionalizes a structure in which investor representation is effectively nil.

¹ Cooperative Capital Markets Regulatory System, *Memorandum of Agreement Regarding the Cooperative Capital Markets Regulatory System* (25 July 2016), online: <ccmr-ocrmc.ca/wp-content/uploads/moa-23092016-en.pdf> [MOA]. See also Cooperative Capital Markets Regulatory System, *The Cooperative Capital Markets Regulatory System Governance and Legislative Framework* (2013), online: <ccmr-ocrmc.ca/wp-content/uploads/Commentary-English1.pdf> [Framework].

² Note that even these provinces would be subject to the regulator that is part of the CCMR given that the federal government has jurisdiction over systemic risk and the criminal law.

³ Canada, Minister of Finance, proposed Canadian *Securities Act* (Ottawa: Department of Finance, May 2010) [proposed Act].

⁴ *Reference re Securities*, 2011 SCC 66, [2011] 3 SCR 837 [*Securities Reference*]; *Constitution Act, 1867* (UK), 30 & 31 Vict, c 3, s 91(2), reprinted in RSC 1985, App II, No 5.

⁵ See *Securities Reference*, *ibid* para 130, "While the proposed Act must be found *ultra vires* Parliament's general trade and commerce power, a cooperative approach that permits a scheme that recognizes the essentially provincial nature of securities regulation while allowing Parliament to deal with genuinely national concerns remains available."

⁶ Cooperative Capital Markets Regulatory System, *Agreement in Principle to Move Towards a Cooperative Capital Markets Regulatory System* (19 September 2013).

This white paper is written from the perspective of investors in the CCMR's participating provinces. Its focus is on comparing the CCMR with the current model of securities regulation in Ontario. If the OSC's investor-focused initiatives, along with recent proposals by the CSA towards enhanced investor protection, are not carried forward into the CCMR, investors in the capital markets will lose.

This argument is of crucial importance because securities regulation is founded on the need to protect investors in the capital markets.⁷ Under statute, securities regulation also seeks to maintain the efficiency of, and confidence in, the capital markets.⁸ The goals are complementary: investors will not place their capital in markets in which they are unprotected. In other words, there is no market – no efficient market and no market in which to have confidence - unless investors come forward with their capital. Thus, the protection of investors is, and should be considered to be, the primary goal of securities markets regulation including the structure and substantive content of the CCMR.

Specific investor protection initiatives are discussed below. But the main point made here is that there is no assurance that they will be carried forward under the CCMR or in its substantive legislation consisting of two statutes.⁹ Investors may not be as well protected in the new regime.

In making its argument, this white paper is divided into three broad areas of concern: the contemplated governance structure of the CCMR; the substantive proposed law; and the transition to the CCMR.

Recommendation: Investor protection initiatives must be implemented in the legislation underpinning the CCMR.

3. CCMR Structure

The proposed Capital Markets Regulatory Authority (CMRA) has a regulatory division run by a "Chief Regulator,"¹⁰ as well as a division independent of the Authority called the "Tribunal".¹¹ Thus, a bifurcated structure has been created, responding to previous calls for separation among the functions (e.g. adjudicatory and policy making) of securities regulators. In this way, the new regulatory body differs from most provincial securities commissions apart from the Autorité des marchés financiers (AMF) which has a bifurcated structure.

The CCMR's contemplated bifurcated structure does not represent a complete separation between the policy (i.e. regulatory) and the adjudicative arm of the Authority. Both divisions

⁷ *Securities Act*, RSO 1990, c S5, [Securities Act] at s 1.1. and *Pezim v. BC (Superintendent of Brokers)* [1994] 2 SCR 557, 48 ACWS (3d) 1279.

⁸ *Securities Act*, *ibid* at s 1.1.

⁹ Cooperative Capital Markets Regulatory System, *Capital Markets Act: A Revised Consultation Draft August, 2015* (20 October 2015), online: <ccmr-ocrmc.ca/wp-content/uploads/CMA-Consultation-Draft-English-August-2015.pdf> [CMA]. See also Cooperative Capital Markets Regulatory System, *Capital Markets Stability Act – Draft for Consultation* (5 May 2016), online: <ccmr-ocrmc.ca/wp-content/uploads/cmsa-consultation-draft-revised-en.pdf> [CMSA].

¹⁰ MOA, *supra* note 1 at ss 9.1(a) and 9.2(a). See also *Framework*, *supra* note 1.

¹¹ MOA, *ibid* at ss. 9.1(b) and 9.4.

report to the Board of Directors,¹² and the respective heads, in turn, report to a Council of Ministers. The Board has oversight over the non-adjudicative functions of the Tribunal,¹³ though it is not entirely clear what this oversight will entail, given that its primary role is to adjudicate matters (e.g. administrative proceedings, reviews of regulatory decisions).¹⁴

Components of this governance structure, including what is *not* in it, remain of considerable concern to investors as discussed below. The structure, especially the composition of a board with no investor representatives, does not exhibit “good governance” in the context of securities regulatory oversight.

a) No Investor Advisory Panel

In 2009, a standing committee of the Ontario legislature recommended that the OSC create an investor panel following on from a FAIR Canada submission to the committee.¹⁵ In addition, the pre-Securities Reference proposed Canadian *Securities Act* contemplated the establishment of a statutory investor advisory panel (IAP)¹⁶ following on from a report of the Expert Panel that contained a recommendation for an investor advisory panel.¹⁷ In 2010 the OSC created an investor advisory panel as a means to be responsive to investor concerns. These investor panels were modeled on the United Kingdom’s well-functioning statutory Financial Services Consumer Panel and Australia’s Consumer Advisory Panel.¹⁸

The IAP contemplated in the proposed Canadian *Securities Act* was mandated to “represent the interests of investors by advising the Chief Regulator with respect to the Authority’s regulations, policies and practices.”¹⁹ In addition, the Chief Regulator was obliged to provide a written response to any recommendations of the Panel. The IAP was intended to report to the Board of Directors and one member of the Panel was to participate in the Forum. The idea was that an

¹² *Ibid* at s. 7.

¹³ *Ibid* at s 7.2(a).

¹⁴ See Securities Policy Division (Finance Canada), *Backgrounder: A New Canadian Securities Regulatory Authority* (Ottawa: Department of Finance Canada, 2010) at 8, online: <https://www.fin.gc.ca/n10/data/10-051_1-eng.asp> [*Backgrounder*].

¹⁵ See Canadian Foundation for Advancement of Investor Rights, “Standing Committee on Government Agencies – Review of the Ontario Securities Commission: A Matter of Investor Confidence” (23 February 2009), *FAIR Canada*, online: <<https://faircanada.ca/submissions/standing-committee-on-government-agencies-review-of-the-ontario-securities-commission-a-matter-of-investor-confidence/>> and Canadian Foundation for Advancement of Investor Rights, “Re: Request for Comments regarding Statement of Priorities for Fiscal Year Ending March 31, 2011” (11 February 2010), *FAIR Canada*, online: <faircanada.ca/wp-content/uploads/2010/02/OSC-S-of-P_Feb-11_Final-_3_.pdf>.

¹⁶ Proposed *Act*, *supra* note 3 at s 51(1).

¹⁷ Expert Panel on Securities Regulation, *Creating an Advantage in Global Capital Markets: Final Report and Recommendations* (Ottawa: Department of Finance, 2009), online: <www.expertpanel.ca/eng/documents>.

¹⁸ See Ontario Securities Commission, “Investor Advisory Panel”, online: <www.osc.gov.on.ca/en/Investors_advisory-panel_index.htm>. Although supported by the OSC, the IAP is designed as a platform to solicit and represent the view of investors on the OSC’s policy and rule making initiatives. Information regarding Australia’s Consumer Advisory Panel can be found at Australian Securities & Investments Commission, “Consumer Advisory Panel”, online: <asic.gov.au/about-asic/what-we-do/how-we-operate/external-committees-and-panels/consumer-advisory-panel/>.

¹⁹ Proposed *Act*, *supra* note 3 at s 51.

independent committee, specifically tasked with advocating for retail investors in the development of regulatory policy, would help to promote public confidence in the regulatory process.²⁰

Yet the draft CMA does not contain a proposal for an IAP or similar entity. Commentary on the consultation draft explained that participating jurisdictions would “continue to discuss the possibility” of establishing an IAP and will “seek advice from the CMRA Board” on the matter once the Board was established.²¹ The Board was established in July 2016 and is largely representative of industry though not the retail investor community.

Because the CMA does not contain a provision for an advisory panel, and the creation of one is not explicitly on the table in terms of potential amendments to the current proposed structure, the CCMR as a model represents investor interests less than under the Ontario regime or the previous federal proposal. While other provinces do not have an investor advisory panel, it is nevertheless disconcerting that there is no formal mechanism enshrined in the proposed legislation ensuring that investors’ interests will be heard either through the IAP, the Board of Directors, or the Regulatory Policy Forum discussed below.

An IAP is fundamental to the development of policy that represents investors’ interests. As the Ontario and UK models have demonstrated, such panels provide a two-way channel for the transmission of investors’ concerns and, likewise, for the regulator’s consultation with investors. An IAP should not be formed by a policy statement or decision of the board that can easily be reversed. Rather, as with the U.K. Financial Services Advisory Panel, it should be a creature of statute with both the funding and a mandate to represent the interests of retail investors in Canadian capital markets.

Recommendation: A statutory IAP should be created under the CMA and should form part of the CCMR structure. The Chair of the IAP should have a seat on the Regulatory Policy Forum.

b) No Investor Representation on the Board of Directors

The CMRA has a Board of Directors (Board) which was appointed in July 2016.²² The Board is comprised of 14 individuals from various regions across the country with representation from industry, listed companies, exchanges and banks. It is diverse in terms of gender and geography. Yet there appears to be no individual on the Board who explicitly represents retail investors’ interests. This is a striking omission, given that the purpose of the cooperative model is to “provide increased protection for investors.”²³ Of course, it is still possible to appoint investor

²⁰ See *Backgrounder*, *supra* note 14 at 9.

²¹ Cooperative Capital Markets Regulatory System, *The Capital Markets Act – A Revised Consultation Draft* (25 August 2015), online: <ccmr-ocrmc.ca/wp-content/uploads/cma-commentary-en.pdf> at 19.

²² See Cooperative Capital Markets Regulatory System, “Capital Markets Regulatory Authority Initial Board of Directors and New Implementation Timelines Announced” (22 July 2016), online: <ccmr-ocrmc.ca/capital-markets-regulatory-authority-initial-board-directors-new-implementation-timelines-announced/>.

²³ *MOA*, *supra* note 1 at s 1(a)(ii).

representatives to the Board. As provided in the MOA, the appointment of directors is a democratic process as between the ministers of finance of the participating regions.²⁴

In a securities regulatory regime in which investor protection is a paramount objective, investor representation on the Board is a necessity and a glaring omission in terms of the current board's composition.²⁵ Such representation in the decision-making process is not only beneficial for investors, but also fundamental to the achievement of better regulatory outcomes on a broader basis. Management of the CMRA will report ultimately to the Board and it is absolutely crucial for the Board to have investor representation. Investor representatives warrant a *minimum* of three seats at the boardroom table (which on a board of 14 people is just over 20 percent of board seats).

Some may argue that to the extent that existing Board members invest in the capital markets, they are also investors. This is an unsatisfactory response given that many of these individuals, while highly knowledgeable and very well-qualified, also represent other constituencies. People who have spent their careers as executives of major financial institutions like banks or insurance companies or as professional advocates for these institutions are not representative of ordinary Canadian investors.²⁶ Representation from groups that explicitly speak on behalf of retail investor interests is crucial.

Recommendation: The CCMR Board of Directors should include at least three retail investor representatives.

c) No Investor Representative on Regulatory Policy Forum

The CMRA creates a Regulatory Policy Forum "...for consultation on policy issues, which will include all members of the Executive Committee, all members of the Tribunal and such other participants as may be appropriate, and which forum will serve to facilitate discussion among the regulators and adjudicators of the CMRA on significant policy issues...."²⁷ The Forum will participate in the consideration and development of the Authority's regulation and is meant to "ensure that the Tribunal is connected to the policy environment" of the Authority to ensure

²⁴ *Ibid* at s 5.1. An appointment of a member of the Board of Directors or of the Tribunal or a vote regarding an interface mechanism with non-Participating Jurisdictions must be approved by: (a) at least 50 per cent of all members of the Council of Ministers; (b) the member of the Council of Ministers from each Major Capital Markets Jurisdiction; and (c) the Minister of Finance of Canada.

²⁵ See Standing Committee on Government Agencies, 2nd Session 39 Parliament 59 Elizabeth II which states at 26 that there should be an "investor representative on the Commission's board of directors."

²⁶ To list a few examples: William Black, the chair of the board, has previously served as the President and CEO of Maritime Life, a major insurance firm, for almost a decade. Andrea Bolger currently sits on the Board of Directors for Equitable Life of Canada, Canada's largest mutual insurance company. Harold MacKay is Counsel and former chair of MacPherson Leslie & Tyerman LLP and has held numerous board positions, including with the Toronto-Dominion Bank. Nancy Hopkins is a partner with MacDougall Gauley LLP and has served as a director on many corporate boards. Jill Leversage was the managing Director of Investment Banking at TD Securities Inc. Eric Tripp is a former president of BMO Capital Markets and has served on the board of the Canadian Derivatives Clearing Corporation.

²⁷ *MOA*, *supra* note 1 at s 9.1(c). See also *Framework*, *supra* note 1.

more informed adjudication.²⁸ In other words, the Forum ensures that an understanding of securities regulatory policy will help to inform enforcement.

The Regulatory Policy Forum is presumably a benefit to investors given that the mandate of securities regulation is to protect investors and the initial iteration of the Forum contemplated investor representation. Yet, importantly, there is no assured investor perspective brought into the discussions in the Forum since no investor representative sits on the Forum and, as discussed above, the CCMR does not contemplate the creation of an investor advisory panel.

Recommendation: Investor representatives, preferably members of an Investor Advisory Panel, should have at least two seats in the Regulatory Policy Forum.

d) No Investor Office

The creation of the OSC's Investor Office is another initiative taken to further its mandate to protect investors and enhance investor protection. The Investor Office has led the formation of a Seniors Expert Advisory Committee; represents the OSC on the IOSCO Committee on Retail Investments; and oversees the IAP.²⁹ Like other provinces outside Ontario, the CCMR does not contemplate an investor office. Without an investor office, it may well be the case that investors' voices are not heard when the decisions about the transition are being made. This lack of investor representation is highly unsatisfactory in a regulatory regime that is ostensibly aimed at protecting investors' interests.

Recommendation: An Investor Office should be carried forward under the CCMR.

4. Substantive CMA

A number of substantive differences between the CMA and current securities regulation highlight that the CMA is not as advantageous to investors as the current model of securities regulation. These differences are described below.

a) No Statutory Best Interest Duty

At present, the Canadian Securities Administrators (CSA) are considering the merits of a statutory best interest duty applicable to investment advisers.³⁰ The U.K., the European Union and Australia already have a best interest duty for advisers. In Canada, British Columbia, Manitoba, Nova Scotia, Alberta and Quebec have all expressed serious reservations about a best

²⁸ See *Backgrounder*, *supra* note 14 at 9.

²⁹ *Investor Office Activity Report 2015-16*, OSC Staff Notice 11-776 [*Investor Office Activity Report*].

³⁰ *Proposals to Enhance the Obligations of Advisors, Dealers, and Representatives Toward Their Clients*, CSA Consultation Paper 33-404 (28 April 2016), online: <www.osc.gov.on.ca/en/SecuritiesLaw_csa_20160428_33-404_proposals-enhance-obligations-advisers-dealers-representatives.ht> [CSA Consultation Paper 33-404].

interest duty,³¹ due to concerns about legal uncertainty³² and a preference for targeted reforms.³³ On the other hand, Ontario and New Brunswick strongly support a statutory best interest duty and are rightfully moving towards implementation.³⁴ In addition to consultation on a CSA concept paper, the Province of Ontario's expert panel has issued a final report supporting the implementation of a statutory best interest duty applicable to both investment advisors and financial planners.³⁵ Nova Scotia and Saskatchewan have reservations but are willing to consider implementation in the future based off the work done by Ontario and New Brunswick.³⁶ Likewise, Prince Edward Island and the Yukon have left the door open for possible consultation in the future.³⁷

Despite this progress, the CMA contains no statutory best interest duty.³⁸ The 2014 Consultation Draft Summary states that the "adoption of a best interest standard is outside the scope of this project, but within the CMRA's regulation-making authority."³⁹ Omitting the best interest duty from the CMA would mean that the process of implementing one would be delayed for several years if not prevented altogether. Since the CSA has determined that the status quo is unacceptable and reform is needed to improve outcomes for investors, the adoption of a best interest standard should not be "out of scope."⁴⁰

Given that British Columbia, a founding participating province in the CCMR, strongly opposes this duty, the progress made in provinces like Ontario towards a best interest duty will be lost under the CCMR. In addition, opposition from provinces like Alberta, Manitoba, and Nova Scotia

³¹ *Ibid.*

³² David Hodges, "Provincial regulators raise concerns about best interest standard for advisors", *Toronto Metro* (11 May 2017), online: <www.metronews.ca/life/money/2017/05/11/provincial-regulators-raise-concerns-about-best-interest-standard-for-advisors.html>.

³³ Cristian Blidariu et al, "Targeted Reforms Update – Most regulators abandon the 'Best Interest Standard' but propose to proceed with refined 'Targeted Reforms' (19 May 2017) *McCarthy Tetrault Canadian Securities Regulatory Monitor* (blog), online: <www.securitiesregulationcanada.com/2017/05/targeted-reforms-update-most-regulators-abandon-the-best-interest-standard-but-propose-to-proceed-with-refined-targeted-reforms/> [Targeted Reforms Update].

³⁴ *Ibid.*

³⁵ Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives, *Final Report of the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives Report* (Ontario: Ministry of Finance, 2016), online: <www.fin.gov.on.ca/en/consultations/fpfa/fpfa-final-report.html> [Final Expert Report].

³⁶ Targeted Reforms Update, *supra* note 33.

³⁷ Erica Johnson, "'A very disheartening day': Most of Canada's regulators abandon plan to put your financial interests first", *CBC News* (11 May 2017), online: www.cbc.ca/news/business/financial-best-interest-standard-financial-regulators-1.4110767.

³⁸ Under the CMA, investment advisers are registrants as per section 22(1). According to section 55, "[a] registrant must deal fairly, honestly and in good faith with its clients and meet such other standards as may be prescribed." Section 56 uses similar language to create a duty of good faith and reasonable care owed by investment managers to their investment funds, and section 57 requires registrants to disclose and manage conflicts of interest. These provisions do not constitute a best interest duty.

³⁹ Cooperative Capital Markets Regulatory System, *Provincial-Territorial Capital Markets Act September 2014 Consultation Draft: Summary of Comments Received and Ministerial/Regulatory Responses*, online:<ccmr-ocrmc.ca/wp-content/uploads/2015-10-13-CMA-Comments-Chart.pdf> at 29.

⁴⁰ CSA Consultation Paper 33-404, *supra* note 30.

who may in the future become participating provinces makes implementation of this duty under the CCMR even less likely.

This is problematic, as a statutory best interest duty is necessary to meet clients' expectations and specifically to compel representatives [or advisors] to provide objective advice that always puts their client's interests first. Without this duty, retail investors' savings will continue to be managed by salespeople who are not legally bound to act in the best interest of their clients.⁴¹ As the recent CSA consultation paper notes, "[m]ost investors incorrectly assume that their registrants must always provide advice [...] in their best interest [...] clients have misplaced [...] trust on their registrants, resulting in opportunities for [...] registrants to take advantage of [...] clients and creating an expectations gap between clients and registrants.⁴² Unless the CMRA takes leadership on this issue, the move towards a best interest duty will likely falter with investors' interests falling through the cracks. This is worrying, as a recent CBC Go Public investigation has highlighted that financial institutions like banks are using high pressure sales tactics to sell products that consumers do not need.⁴³

We are left asking: will the debate about a statutory best interest duty need to begin anew within the CMRA? Will a new compromise among participating jurisdictions be required before any duty is implemented? Investors (at least those in Ontario and New Brunswick, the two provinces that have endorsed a statutory best interest duty) may well be better off under the current regime where at least the move towards a statutory best interest duty has gathered steam and may come to fruition.

Recommendation: The CCMR should not throw away the efforts to establish a statutory best interest duty and should seek to implement this duty in the CMA for the benefit of investors in the capital markets.

b) Consumer Redress

Canadian investors should have access to one independent not-for-profit ombudservice that resolves complaints including the power to issue binding decisions. The Canadian financial services landscape is complex and the current maze of avenues for redress that confronts investors is unacceptable in a developed market economy such as ours. As noted in a January 2009 report by an expert panel on securities regulation, "the numerous organizations, the multi-step processes, and the lack of uniformity across Canada pose challenges for investors to properly understand and achieve a proper conclusion in an expeditious manner."⁴⁴ A single independent dispute resolution provider that meets international standards is essential in the

⁴¹ Final Expert Report, *supra* note 35. FAIR Canada, FAIR Canada Response to Proposed Best Interest Standard and Proposed Targeted Reforms (30 September 2016), online: <faircanada.ca/wp-content/uploads/2016/10/160930-Final-FAIR-Canada-Submission-33-404-Best-Interest.pdf>.

⁴² CSA Consultation Paper 33-404, *supra* note 30.

⁴³ Erica Johnson, "We are all doing it: Employees at Canada's 5 big banks speak out about pressure to dupe customers" *CBC News* (15 March 2017), online: <www.cbc.ca/news/business/banks-upselling-go-public-1.4023575>.

⁴⁴ Expert Panel on Securities Regulation, "Final Report and Recommendations," (12 January 2009), online: <www.expertpanel.ca/eng/documents/Expert_Panel_Final_Report_And_Recommendations.pdf> at 34.

Canadian context and is needed on an urgent basis to ensure adequate protection of Canadian consumers.

As FAIR Canada has previously suggested, our G-20 obligations require giving Canadian consumers access to a dispute resolution process that will actually deliver a resolution of each dispute, as is the case in other leading jurisdictions.⁴⁵ In the United Kingdom, Australia, New Zealand and Malaysia, for example, decisions are binding if the consumer accepts the recommendation. Canadian consumers deserve no less. Moreover, the consumer redress system in Canada (and for OBSI in particular) requires binding dispute resolution in order to work fairly and effectively for the benefit of investors, financial consumers and businesses and to improve confidence in, and soundness of, our financial marketplace and regulatory system. If the status quo is maintained, the opposite will be true.

Thus the CCMR should embody a single, national, statutory ombudservice in Canada with the power to make binding decisions. This is vital to the integrity of the Canadian financial services market and the protection of Canadian consumers.

Recommendation: In order for Canada to meet international standards, steps should be taken to implement a single, national, statutory ombudservice in Canada with the power to make binding decisions.

c) No Whistleblowing Incentives

In 2016, the OSC established an Office of the Whistleblower⁴⁶ and published a policy that contains details of its whistleblower program.⁴⁷ Under the program, individuals who meet certain eligibility criteria and who voluntarily submit information to OSC staff regarding a breach of Ontario securities law may be eligible for a whistleblower award if it is determined that: the information submitted was of meaningful assistance to OSC staff in investigating the matter; and, an OSC decision results in a final order imposing monetary sanctions or the making of a voluntary payment of one million dollars or more.⁴⁸

The OSC is the only regulator in the country to have a comprehensive whistleblower program containing incentives. Its policy recognizes that monetary awards are an integral component of an effective whistleblowing regime.⁴⁹ Indeed, such awards have been proven to be effective in

⁴⁵ See FAIR Canada, media release “Request for comment on the Independent Evaluation of the Ombudsman for banking services and investments with respect to investment related complaints” (26 February 2016), online: <faircanada.ca/wp-content/uploads/2016/02/160226-FAIR-Canada-submission-independent-evaluation-of-obsi_final-2.pdf> citing the G-20 obligation to ensure consumers have access to adequate complaint handling and redress mechanisms that are “accessible, affordable, independent, fair, accountable, timely and efficient...”

⁴⁶ See Ontario Securities Commission, “Ontario Launches Office of the Whistleblower” (14 July 2016), online: <www.osc.gov.on.ca/en/NewsEvents_nr_20160714_osc-launches-whistleblower.htm>.

⁴⁷ *Ibid.*

⁴⁸ See Ontario Securities Commission, OSC Policy 15-601 - *Whistleblower Program* (14 July 2016), online: <www.osc.gov.on.ca/documents/en/Securities-Category1/20160714_15-601_policy-whistleblower-program.pdf>.

⁴⁹ Alexander Dyck et al., “Who Blows the Whistle on Corporate Fraud?” (2010) 65 J. FIN. 2213.

incentivizing whistleblowing in other jurisdictions such as the United States.⁵⁰ One of the main benefits of monetary incentives is the potential for a broad set of whistleblowers to be captured by such a program. Even those who fear retaliatory action may nonetheless come forward if the award is substantial enough to outweigh such risks. The amount under the OSC's whistleblowing program is 15 percent of any recovery amount, up to a ceiling of an award of \$1.5 million, with no awards being given for recoveries below \$1 million. No rewards are provided if the enforcement proceeds criminally.

The CMA contains a “no reprisal by employer” provision which potentially prohibits an employer from trying to silence whistleblowers or punish them after the fact. This appears to be an anti-retaliation device⁵¹ which renders void any confidentiality agreement that would preclude an employee from cooperating with an investigation.⁵² However, the CMA contains no provision for financial compensation for whistleblowers and, apart from the “no reprisal” provisions, no overarching regime that would incentivize them to come forward in terms of the protection that would be provided to them and the provision of a financial reward.

The CMA regime is less friendly to potential and actual whistleblowers than the current OSC regime. A whistleblowing regime with financial incentives for those who report is necessary.⁵³

Recommendation: The CCMR should implement an explicit whistleblower program that contains monetary rewards to incentivize whistleblowers to come forward.

d) No proposal on embedded commissions

On January 10, 2017, the CSA published Consultation Paper 81-408 in which it stated that embedded commissions encourage the suboptimal behavior of fund market participants, including that of investment fund managers, dealers, representatives and fund investors, reducing market efficiency and impairing investor outcomes.⁵⁴ In particular, the CSA raised three specific problems with embedded commissions, stating that they: raise conflicts of interest that misalign the interests of investment fund managers, dealers and representatives with those of investors; limit investor awareness, understanding and control of dealer compensation costs;

⁵⁰ *Dodd-Frank Act*, Pub. L. No. 111-203, § 922, 124 Stat. 1376, 1844 (2010).

⁵¹ *CMA*, *supra* note 9 at s 77.

⁵² *Ibid* at s 77(2).

⁵³ See FAIR Canada, “FAIR Canada 2015 Response to OSC Staff Consultation Paper 15-401: Proposed Framework for an OSC Whistleblower Program” (4 May 2015), online: <faircanada.ca/wp-content/uploads/2011/01/150501-Final-Whistleblower-Program-Submission-May-1-signed.pdf> and FAIR Canada, “FAIR Canada 2016 Re: OSC Notice and Request for Comment on Proposed OSC Policy 15-601 – Whistleblower Program” (12 Jan 2016), online: <faircanada.ca/wp-content/uploads/2016/01/160112-Whistleblower-Policy-15-601-final_signed.pdf>. These two submissions by FAIR Canada, in response to the OSC's proposed whistleblower program, provide a thorough explanation for why financial incentives are needed and confidentiality provisions are required, etc.

⁵⁴ *Consultation on the Option of Discontinuing Embedded Commissions*, CSA Consultation Paper 81-408 (10 January 2017), online: <www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf> [CSA Consultation Paper 81-408].

and, generally do not align with the services provided to investors.⁵⁵ The CSA presents in-depth research findings regarding the harms caused by embedded commissions to investor protection and market efficiency. The research demonstrates, for example, that funds that pay commissions tend to underperform those that do not and that the level of ongoing service provided by fund managers receiving commissions is not commensurate with the amount of commissions they are receiving.

Thus, a significant body of research supports a prohibition on embedded commissions. Accordingly, the CSA has proposed a discontinuation of the embedded commission model and a transition to “direct pay arrangements.”⁵⁶ The discontinuation would affect investment funds as well as structured notes.⁵⁷ The CSA states that if they were to move forward with a proposed rule, they anticipate that they would seek to discontinue payments to dealers in connection with an investor’s purchase or continued ownership of a security above that made by any person or company other than the investor. If implemented, the initiative would preclude compensation to dealers who are “paid or funded by the investment fund or the investment fund manager or structured note issuer out of fund assets or revenue.”⁵⁸ We are concerned that if the CMRA does not carry forward the content and proposals of the CSA consultation, the useful steps that have been taken from a policy standpoint will be in vain.

Recommendation: the CMRA should carry forward the content and proposals in the CSA consultation paper and disallow embedded commissions.

5. Transition

The CMRA has published a summary of its proposed transition approach.⁵⁹ But the transition under which the CCMR will be formed will be difficult and complex. What is the likelihood that all issuers, self-regulatory organizations, investment advisers and investors will have a consistent view of their respective places in the new structure? What is the likelihood that the CMRA will have identified all of the issues that give rise to uncertainty? What will be the overall effect of this uncertainty on the capital markets, especially given that certain major jurisdictions are not participating?

In addition to these questions is the issue of the non-participating jurisdictions. What happens to CSA initiatives that had the support of non-participating jurisdictions prior to the formation of the CCMR (such as gender diversity)? Are they carried forward into the new regime? What happens to CSA initiatives that have the support of some participating provinces but not others (such as a best interest duty)? What happens to CSA initiatives in which there is unanimity on some aspects of the regulation but not others?

⁵⁵ *Ibid* at 3. This is a follow-up to Discussion Paper and Request for Comment 81-407 (published on December 13, 2012), which discussed mutual fund fees generally and first raised concerns over embedded commissions.

⁵⁶ *Ibid* at 4.

⁵⁷ *Ibid* at 19.

⁵⁸ *Ibid* at 21.

⁵⁹ Cooperative Capital Markets Regulatory System, *Provincial-Territorial Capital Markets Act: Summary of Proposed Transition Approach* (2015), online: <ccmr-ocrmc.ca/wp-content/uploads/summary-of-proposed-transition-approach-en.pdf>.

For example, consider exemptions from the prospectus requirement. The transition document states that “[m]arket participants must comply with the CMA on launch. Where the legislative exemption or blanket order is not carried forward or is different under the CMA, absent the granting of exemptive relief, the distribution would not be permitted under the terms of the existing exemption. Where the exemption is carried forward, the distribution could continue under the CMA.”⁶⁰ But there is little indication of how the exempt market is going to work under the CCMR apart from the carry forward of already-harmonized exemptions.⁶¹

One might argue that the transition to the CCMR may increase the cohesiveness of regulation, particularly with regard to enforcement since the criminal offences will be contained in the *Capital Markets Stability Act*. The introduction of additional market conduct provisions in the CMA will allow regulators additional tools to combat fraud and other wrongdoing such as the benchmark manipulation provision (s. 65), while the new evidence gathering tools (Part 11) are also positive reforms.

But one must question whether there will be some difficulty in practice of having centralized enforcement when non-participating provinces will still enforce administratively while the CMRA will pursue criminal matters? For example, it may be the case that Alberta seeks to pursue an administrative proceeding but the CMRA seeks criminal proceedings in the same matter. Will the two bodies cooperate? With major provinces not participating in the CCMR, it is not clear that centralized enforcement will be an improvement especially given that the federal government has had charge over criminal enforcement of financial markets crimes, while prosecution of these crimes has historically been weak.⁶²

In short, there is considerable uncertainty in terms of the applicable law and the way it will be applied and enforced in transitioning to the CCMR.

Recommendation: The CCMR must implement the aforementioned investor-focused initiatives prior to its launch and ensure a short and more certain route to transition for the benefit of retail investors.

6. Conclusion

There are many good reasons to support centralized decision making in securities regulation.⁶³ However, in light of the above considerations relating to the structural and substantive aspects of the CCMR, retail investors should be concerned about the proposed model. No statutory investor advisory panel is contemplated in the CCMR. No investor representatives sit on the

⁶⁰ *Ibid* at 7.

⁶¹ See 4-5 of Cooperative Capital Markets Regulatory System, “Draft Initial Regulations for The Cooperative Capital Markets Regulatory System” (25 August 2016), online: <ccmr-ocrmc.ca/wp-content/uploads/commentary-draft-initial-regulations-en.pdf>.

⁶² IMF Financial Action Task Force Group, *Report on Observance of Standards and Codes FATF Recommendations for Anti-Money Laundering and Combating the Financing of Terrorism* (IMF 2008) and Peter de C Cory and Marilyn L Pilkington, “Critical Issues in Enforcement” in *Canada Steps Up: The Report of the Task Force to Modernize Securities Legislation in Canada* (Government of Ontario, Toronto, 2006).

⁶³ Anita Anand and Andrew Green, “Why is this Taking So Long? The Move Towards a National Securities Regulator” (2010) 60:2 UTLJ at 663.

board of directors. In terms of substantive law, there is no statutory best interest duty, no independent statutory dispute resolution service with binding authority to deal with consumer redress, no whistleblowing regime with incentives, and no prohibition on embedded commissions. In addition, investors should be concerned about the adverse impact of a transition. Some participating provinces, such as British Columbia, do not support the statutory best interest duty, a key investor-friendly initiative. In short, the CCMR as currently structured is relatively disadvantageous to investor interests and warrants considerable reform before it is acceptable from an investor protection standpoint.

7. Defined Terms

AMF – Autorité des marchés financiers

CCMR – Cooperative Capital Markets Regulator

CMA – Capital Markets Act

CMRA – Capital Markets Regulatory Authority

CMSA – Capital Markets Stability Act

CRM2 – Phase 2 of the Client Relationship Model

CSA – Canadian Securities Administrators

Final Expert Report - Final Report of the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives Report

IAP – Investor Advisory Panel

MOA – Memorandum of Agreement

OSC – Ontario Securities Commission

POS – Point of Sale

Proposed Act – Proposed Canadian Securities Act

Securities Act - Securities Act (Ontario)