

OPEN LETTER

August 3, 2018

Louis Morisset
Chair, Canadian Securities Administrators
President and Chief Executive Officer, Autorité des marchés financiers
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Sent via e-mail to: Louis.Morisset@lautorite.qc.ca

Dear M. Morisset:

RE: CSA Notice and Request for Comment on Reforms to Enhance the Client-Registrant Relationship

We are writing in connection with the CSA's publication on June 21, 2018 of the Proposed Amendments to National Instrument 31-103 and its Companion Policy (Reforms to Enhance the Client-Registrant Relationship) and CSA Staff Notice 81-330 (Status Report on Consultation on Embedded Commissions and Next Steps).

FAIR Canada has long advocated for a statutory best interest standard so that Canadians receive objective, professional financial advice. Of key importance to successful implementation of a best interest standard is the adoption of rules that *prohibit* embedded commissions and other advisor compensation arrangements that foster the misalignment of client and advisor interests ("conflicted remuneration"). This is necessary to ensure that registrants provide their services in a manner that does not actively jeopardize or subvert the interests and well-being of their clients since an abundance of evidence has clearly demonstrated that compensation drives behaviour.

Having reviewed the proposed Reforms to Enhance the Client-Registrant Relationship, FAIR Canada would like to better understand how, in accordance with Proposed Section 13.4.2, "[a] registered firm must address, in the best interest of a client, all conflicts of interest between itself, including each individual acting on its behalf, and the client" while the firm continues to either utilize embedded commissions or employs incentive programs or sales targets or only sells product(s) from a related issuer. The Companion Policy provides that these (harmful) compensation arrangements can be addressed through the use of various controls, with some examples set out. The CSA has listed various controls which place an onus on individual firms and their individual registrants to address the conflicts of interest even though such firms profit from these conflicts.

In order to better understand and be able to assess how effective such controls will likely be in practice, we would appreciate the CSA's views about how firms will be able to address conflicts of interest in an effective manner so that advice will be in the client's best interests in the following types of scenarios:

1. *Embedded Commission Only MFDA Dealer*

Client works with a MFDA dealer who recommends only proprietary mutual funds with embedded commissions and recommends the client invest in a fund-of-fund mutual fund product with a 1% trailing commission and a MER of 2.04%. Client is provided with disclosure at time of account opening and before the trade but the suitability analysis does not consider the larger market of non-proprietary products or whether those non-proprietary products would be better, worse, or equal in meeting the client's investment needs and objectives. The mutual fund cannot be transferred in kind to any other firm.

2. *Commute the Value of a Pension*

An individual has recently retired and is deciding whether to keep her money with her employer's pension provider or move it. She is approached by an advisor at an IROC dealer owned by a major financial institution who recommends that the person move their funds out of her workplace pension to be invested by the advisor on the basis that the firm offers a wider selection of products even though the investment costs at the pension firm are lower.

3. *Leveraged Investing*

Advisor recommends that a 50 year old client borrow \$100,000 to invest in equity mutual funds in order to meet their financial goals as current rate of savings and investment is not on target absent a leveraging strategy and that the loan be taken out against the equity of her jointly owned home. The client has two children in high school, a \$325,000 mortgage on her Toronto home which is currently valued at \$1.1 million, a \$100,000 available line of credit (balance paid off on periodic basis as a result of bonus income received) and \$200,000 in RRSP assets. The Advisor will receive a 5% referral fee from the lender and will have more assets under management from which to earn commissions from the embedded commissions. Both conflicts are disclosed.

4. *Exempt Market Dealer*

This dealer offers prospectus exempt products of only related or connected issuers to its clients. It recommends, pursuant to the OM exemption, that John Adams, who meets the test of an eligible investor, invest \$100,000 in a mortgage investment corporation. Mr. Singh, who also meets the test of an eligible investor, is advised to invest in promissory notes in the amount of \$100,000. The conflict of interest in investing in a related party was disclosed.

We also wish to know how CSA members will be able to ensure from a compliance and enforcement perspective that firms are complying with requirements to address conflicts in the best interest of the client.

We look forward to your response.

Sincerely,



Frank Allen

cc: **Stan Magidson**, Chair and Chief Executive Officer, Alberta Securities Commission
(sent via email to: stan.magidson@asc.ca)

Brenda Leong, Chair and Chief Executive Officer, British Columbia Securities Commission
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Roger Sobotkiewicz, Chair and CEO, Financial and Consumer Affairs Authority of Saskatchewan
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