Comment Letter in Response to:

CSA Notice and Request For Comment Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*
and to
Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations*

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Superintendent of Securities, Nunavut

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Introduction

A best interests standard for advice is critical but it does not look like Canadians will have it any time soon. While deeply disappointed at the proposals, I will present my comments to make the best of a sub-optimal situation.

The CSA is trying to turn salespersons into trusted advisors. Dealing Reps are registered as salespersons, so if the CSA wants more from them, they will need to modify registration requirements in harmony with modifying conduct rules. Consider this characterization of a Representative courtesy of the ASC."…In that sense, it's not unlike purchasing a car from a dealership. If you walk into a Volvo dealership, and explain your needs (four-door, certain horsepower) the person working there will suggest the most suitable Volvo for your needs."
http://www.albertasecurities.com/investor/investor-resources/you-ascd-blog/Lists/Posts/Post.aspx?ID=63 and Mr.Elford's associated commentary https://unpublishedottawa.com/letter/81644/alberta-securities-commission-pressured-consumer-warning We are talking about salesperson registration not personalized professional financial advice.

A component of the proposed rules, which involves updating "best interest" and "suitability'" rules, largely amplify/ clarify existing regulations. Because there is so much wiggle room around what makes a specific recommendation suitable – depending on a client's account size, age . risk profile , time horizon and financial knowledge, among other things – the guidelines have historically proved to be tough to enforce. Adding the cost component to suitability criteria should reduce the impact of conflicted compensation if implemented properly. I note that using the term "best interests" in relation to certain processes is NOT equivalent to the introduction of a overarching Best interest standard for personalized financial advice.

The retirement income security of millions of Canadians depends on a robust platform for the distribution, sale and advice tied to the sale of mutual funds. It is truly a national socio-economic issue.

The primary issues facing retail investors involve mis-selling, unsuitable investments, poor portfolio construction, wrongdoing / fraud and deficient Complaint handling. While enhanced KYC and other reforms are positive, the root cause of most mis-selling remains

advice skewing financial incentives. It remains an open question whether the proposed reforms can mitigate the powerful inducements.

My main observations:

As a general comment I find too many important issues are in guidance rather than in rules. I urge the CSA to place key points of this proposed reform package into rules .Here are my high level comments

- **KYC** – A better designed KYC will be helpful, but increased dealer representative proficiency is-essential to ensure the enhanced KYC information actually translates into improved suitability determinations and recommendations. All Key terms on the NAAF should be defined in plain language. **The KYC Process Needs An Overhaul**: SIPA http://sipa.ca/library/SIPAsubmissions/500%20SIPA%20REPORT%20-%20KYC%20Process%20Needs%20Overhaul%20-%20201607.pdf I believe these simple KYC process changes will yield disproportionate investor protection benefits.
- **KYP** I appreciate that representatives can't be expected to be familiar with every investment product on offer, but Reps should have a sufficient basic understanding of how the products on their firm's shelf compare to similar products readily available in the marketplace.
- **Suitability** The Rules should make it crystal clear that the suitability determination for investments, strategy and account type is the sole responsibility of the dealer.
- **Conflicts-o- Interest** – To improve investor outcomes, the CSA's reforms need to reflect a cultural mindset that no longer considers conflicts of interest as the norm, discards the outdated notion that conflicts of interest can be "managed and understands the limitations of disclosure. The CSA's proposal in this area requires clearer language to ensure conflicts are actually mitigated/avoided and to ensure this is done in a manner in the best interests of clients. The term "addressed" is simply too imprecise and not actionable. A CSA vision statement for financial advice would be very useful.
- **Referral arrangements** – The CSA's proposals are a start but more research may be needed as to how referrals impact the recommendations made and client outcomes. Referral arrangements for leveraging should be banned outright and now.
- **Misleading communications** – The proposals should be expanded to cover all communications with the public including marketing materials, "free lunch" seminars and the like. Many prevailing communications are deceptive, mislead clients and create false trust.

- **Impact of costs** – Consideration of the impact of product and account costs, especially over time, should extend beyond dealer disclosure obligations. Costs should be a defined factor in suitability determinations. I recommend that the CSA support the MFDA proposal (CRM3) as greater knowledge of overall investing costs will greatly increase investor empowerment.

While I recognize that a separate consultation on NI81-105 is underway, it does not deal with a number of issues related to this consultation. e.g. Collaborative marketing arrangements. I believe co-operative marketing payments from fund assets and non-monetary benefits can only lead to trouble and should be prohibited. Wealth managers should not receive payments or other benefits from product suppliers. Co-operative marketing ventures like "Free lunch" seminars have been shown to lead to several problems. A number of recent OSC enforcement actions demonstrate how pernicious such payments can be. The influence on recommendations can only be negative. I recommend that mutual funds be prohibited from providing cash for promotional marketing and Rep "education" and that such dealer/Rep influencing activities be banned regardless of cash source *Re Part* 5 of NI 81-105.

I urge the CSA.to update NI81-105 and extend its applicability to all sales practices including those for closed-end funds , ETF's , structured products etc. and to GIC's , PPN's and other products not classified as securities.

The payment of trailers by Mutual fund companies to discount brokers appears to me as a blatant misappropriation of investor Fund assets and should be dealt with immediately.

As regards para 13.4.2 [A registered firm's responsibility to address conflicts of interest] -- new section requiring registered firms to address all conflicts of interest between the firm (including each individual acting on its behalf), and the firm's client, in the best interest of the client. If a conflict is not, or cannot, be addressed in the best interest of the client, then the registered firm must avoid that conflict]. For greater clarity I strongly recommend the last sentence be changed to **"If a conflict is not, or cannot be mitigated in the best interests of the client, then the registered firm must decline to provide the service associated with the conflict".**

I am very disappointed that title deception is not integral to this consultation. Misleading titles have been used to deceive seniors to their detriment. Clients should be able to readily identify those individuals who can supply the services they require. The titles issue must be resolved in synchronization with the introduction of these reforms for the reforms to work. Investors expect the CSA to address this long standing issue on a priority basis.

I recommend that the CSA should prohibit dealers and their Representatives from obtaining any types of fees or commissions in respect of investments made from

borrowed (leveraged) funds so as to prevent unsuitable recommendations to borrow to invest in securities, such as mutual funds. This should be the case whether the account is fee -based or otherwise. For fee -based accounts, dealers should be precluded from charging asset based fees on monies that are borrowed for investment purposes, as is done by ASIC in Australia

I recommend that regulators commit to more robust enforcement by putting more resources into their efforts and imposing more substantial sanctions that will actually act as a general deterrent .In many Settlement Agreements I observe long periods of obvious Rep exploitation of clients unaddressed by supervision or compliance. In fact, according to regulator compensation research, some of these supervisors receive commission over-rides on the salespersons they oversee. An easy fix here would be for regulators to make it crystal clear that dealers are accountable for the actions and inactions for whom they have supervisory accountability. In my opinion, that would quickly lead to better dealer compliance and supervision and greatly increased investor protection. After all, a client signs a contract for service with dealers, not individuals.

I would like to make it very clear that dealer Reps should not be permitted to act as trustees/ executors or Act under POA's. for clients .It took considerable effort to defeat a prior IIROC proposal that would have permitted this. There should be no exception or exemption on this critical point.

I remain constructively critical that these proposals will have the intended effects. After all, many provisions are already enabled in current MFDA and IIROC. Rules Some conflicts are irreconcilable with best interests. . I believe that until the conflicts-of interest issue is dealt with head on, non- optimum outcomes for investors will prevail. I therefore recommend that the CSA take steps to prohibit certain conflicts outright for those offering personalized financial advice. An example would be referral payments from lenders to registrants that recommend borrowing to invest.

I would like to express my concern re reverse churning. This could be the next big minefield for the retail investor.

On the planning side I recommend that some fences be put around what constitutes financial planning, what a financial plan should contain and who can use the title *financial planner.*

I also urge the CSA to act upon FAIR Canada's Report on the protection of vulnerable Investors. See https://faircanada.ca/submission-category/report-vulnerable-investors-elder-abuse-financial-exploitation-undue-influence-diminished-mental-capacity/

I believe any client-focussed initiative should include dispute resolution .it has been over two years since release of the Battell report on OBSI and the CSA has not acted upon its sound recommendations. I urge the CSA to include retail investor representation on its

board of directors and to provide OBSI a binding recommendation mandate.
See **Complaint Handling and Best Interests**
http://www.canadianfundwatch.com/2017/10/complaint-handling-and-best-interests.html

One major element missing from the KYC consultation section is a requirement that a registrant maintains evidence of the process used to collect and analyze the information. There is discussion in the CP but the CP is not enforceable. Therefore, unless there is a rule, dealers can let their Dealing Reps ask whatever questions they want as long as the KYC form is filled out. But what questions were asked to determine risk tolerance for example? Not required to be documented. Just the outcome has to be documented. In our experience, the biggest systemic problem relating to unsuitable advice is improperly assessing KYC (particularly risk tolerance). It's hard to figure out what happened after the fact if there is no documentation of what was asked. This record would make complaint and OBSI investigations much easier.

In parallel with the implementation of these reforms, I recommend a dramatically enhanced national investor education program that will explain investor rights and dealer obligations.

Finally, I conclude by stressing the need for timely, effective enforcement and sanctions that have a demonstrated individual and general deterrence effect. The CSA is no doubt aware of what needs to be done to improve the credibility of regulatory enforcement, especially those of the SRO's.

I urge the CSA to give this initiative top priority as every day that passes, the financial lives of Canadians are threatened by the Caveat Emptor environment they face today. My core position is that a fiduciary standard is needed as the fundamental principle in the provision of personalized financial advice and that embedded commissions inherently undermine this principle. The CSA needs a vision for establishing a professional financial advice industry in Canada.

I cannot agree that an SRO rule should ever allow a registrant to lend money, provide a guarantee in relation to a loan of money, extend credit, provide margin or lend securities or any other asset, to a client but para 13.4.4 (2) would not disallow this. The exceptions are a booby trap awaiting the unsuspecting investor and must be revised. I also do not agree that a SRO rule should ever permit a registrant to act under a Power of Attorney from a client, act as a trustee with respect to a trust in which a client is the settlor or beneficiary, or act as a trustee or executor in respect of the estate of a client, or otherwise have full or partial control or authority over the assets of a client as might be permitted by Para. 13.4.4 (c). Such arrangements are just a problem waiting to happen. I agree that a registrant must not borrow money, arrange a guarantee in relation to money the registrant has borrowed, or borrow securities or any other assets, from a client. The sanctions for such activity should be severe.

The proposed new rules includes measures requiring dealers to train Dealing Reps on "compliance with securities legislation, including conflicts of interest requirements, the KYC and KYP obligations, the obligation to make a suitability determination and prescribed elements of the securities available through the firm." That is long overdue. I strongly recommend the training include a discrete module on ethics. Dealers must also train Reps on products they approve their Reps to sell. A prime example where this did not happen involved the sale of leveraged and reverse ETF's resulting in a significant number of client complaints. A current example would be Alt funds.

Summary and Conclusion

This is a critically important consultation for retail investors. There may not be another one on this subject for a decade. The consultation paper is written in legally correct language and riddled with bear traps that ordinary investor commenters may not detect. An example is the use of Dealing Reps as executors. At first glance it appears the CSA has banned such duties except that a careful eye will detect that the door is wide open for an SRO to allow such duties by the exception permitted in 13.4.4 (3). Exceptional expertise is required to wade through hundreds of pages, each page perhaps containing a key word or phrase that negates the value of the claimed protection. I therefore strongly recommend that the CSA and the SRO's utilize their restricted funds to finance an independent qualified firm to make Comments representing investor interests. This firm would consult with individual investors and consumer groups

In this environment, prospects of additional consultations involving regulators that appear to have been co-opted by industry and advocates that have been sapped of their will to advocate are worrisome. It appears that the CSA has determined, despite protestations to the contrary, that while investor interests are important the interests of the industry are more important. I would not expect a fundamental change of corporate culture to result from these reforms.

If these modest reforms are not deployed, and it appears likely they will not, I think it is time to seriously consider the establishment of a national financial. Maintaining the status quo and expecting different, let alone better, outcomes is the very definition of insanity.

Permission is granted for public posting.

Respectfully,

Art Ross

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