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New Brunswick Securities Commission
Registrar of Securities, Prince Edward Island
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Dear Sirs/Mesdames:

Re: Canadian Securities Administrators Consultation Paper 33-403: The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness Of Introducing A Statutory Best Interest Duty When Advice Is Provided To Retail Clients

We are writing in response to the Canadian Securities Administrators' ("CSA") Consultation Paper 33-403 (the "Consultation Paper") entitled *The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness Of Introducing A Statutory Best Interest Duty When Advice Is Provided To Retail Clients*.

Table of Contents

A. About Advocis

Advocis, The Financial Advisors Association of Canada, is the country's largest and oldest professional membership association of financial advisors and planners in Canada. Through its predecessor associations, Advocis proudly continues over a century of uninterrupted history of serving Canadian financial advisors and their clients. Our over 11,000 members are licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across Canada.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members adhere to our published Code of Professional Conduct, uphold standards of best practice, participate in ongoing continuing education programs, maintain professional liability insurance, and put their clients' interests first. Across Canada, no organization's members spend more time working one-on-one with individual Canadians on financial matters than do ours. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future.

B. Introduction and Executive Summary

Financial advisors play a critically important role for millions of Canadians. They provide comprehensive financial planning and investment advice, disability coverage, long-term care, critical illness insurance, and retirement and estate plans, all of which help millions of Canadian households and businesses prepare financially for life's events. This is ever more important in an economic climate where governments, facing their own fiscal challenges, are expecting Canadians to be increasingly self-reliant.

Academic studies have confirmed that Canadians derive tremendous benefits from financial advice, and are substantially better off than their non-advised peers. Given their critical role and impact, Canadians should be able to trust that financial advisors are proficient, up-to-date in their knowledge and in compliance with the highest standards of conduct and ethics. Advocis supports sensible regulatory initiatives that elevate the professionalism of advisors and enhance consumer protection. At the same time, regulators must ensure that initiatives intended to protect consumers do so without inadvertently creating barriers to Canadians' ability to access financial advice.

Over the years, achieving the "best interests of the client" has often been cited as a motivating factor behind regulatory initiatives – including in the CSA's current Consultation Paper. We agree with this objective wholeheartedly. But too often, the concept of the client's best interest is conflated with a notion that consumers can somehow be insulated from harm by creating layers of additional regulations. The cumulative effect of this approach has created a heavy and costly compliance burden on advisors, without (in many cases) meaningfully enhancing consumer welfare. As a result, existing advisors are leaving the industry and fewer new advisors are entering, leaving consumers less able to access the financial advice that they require.[1] We believe that this outcome is clearly not in the best interests of consumers.

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[1] For example, the MFDA's 2012 Annual Report (available at http://mfda.ca/about/AnnReports/AR2012.pdf) indicates that the number of Approved Persons under its supervision has been flat or declining in recent years: 74,768, 73,291 and 73,289 Approved Persons in 2009, 2010 and 2011, respectively.

The statutory fiduciary standard considered in the Consultation Paper would further exacerbate the burden on advisors and provide little benefit to consumers. This is especially true in Canada, where we already enjoy a principles-based fiduciary standard that is well established in common law. This common law duty serves clients and advisors alike extremely well, as it allows for the consideration of the specific relationship at issue and other important factors in context. Canada's common law fiduciary duty represents the type of principles-based regulation that regulators should be striving for more broadly.

Supplanting Canada's common law fiduciary standard with one based in statute would: (i) fail to recognize important differences among "retail" clients; (ii) impose significant additional costs on financial advisors; (iii) put well-accepted business models into jeopardy; (iv) detract from principles-based regulation; and (v) cause a misalignment of standards in the financial services industry. Cumulatively, these problems would force many financial advisors out of the industry, harming the ability of lower- and middle-net worth Canadians to access financial advice and running counter to the CSA's stated objective of improving consumers' financial literacy. A statutory fiduciary duty would also fail to address the most serious consumer risks, including fraud or incompetence.

Furthermore, although other jurisdictions such as the United Kingdom, Australia and the United States are considering, or have implemented, some form of statutory fiduciary duty, a review of the evidence demonstrates that those jurisdictions have their own unique structural problems that have harmed millions of domestic retail investors. Regulators in those jurisdictions face enormous pressure to react on a grand scale, even if that reaction is flawed. In contrast, Canada has not experienced similar problems and can be considered a world leader in that regard. Therefore, importing foreign jurisdictions' regulatory proposals into our domestic market is not in the best interests of Canadian consumers.

We believe that the interests of average, middle-income consumers are best served (i) when they can access high quality and affordable financial advice; (ii) that is delivered by professional and proficient financial advisors; (iii) within a regulatory framework that encourages transparency and accountability for unscrupulous behaviour. Therefore, rather than imposing a statutory fiduciary standard, we propose a better solution that is based on enhancing advisor professionalism. We believe that our proposal would achieve the CSA's objective of improving consumer protection, while ensuring a thriving and accessible market for average Canadians and advisors alike.

C. The Value of Financial Advice

Academic studies have confirmed that Canadians benefit tremendously when they are able to access financial advice. In July 2012, Professor Claude Montmarquette and Nathalie Viennot-Briot of the Montreal-based Centre for Interuniversity Research and Analysis on Organizations ("CIRANO") released Canada's largest and most scientific independent study to date on the value of advice. The study, entitled *Econometric Models on the Value of Advice of a Financial Advisor* (the "CIRANO Study"), is based on data collected from over 10,000 households in 2010 and 2011 and provides strong evidence of the connection between financial advice and the accumulation of financial wealth.

After accounting for more than 50 other variables that could also influence wealth accumulation, the CIRANO Study reported the following:

1. ***Advice has a positive and significant impact on wealth accumulation, relative to non-advised persons.*** Notably, the researchers found that the longer the relationship with the advisor, the greater the beneficial impact for consumers: households with four-to-six year long relationships accumulated 58% greater assets than non-advised households, whereas households with 15+ year relationships accumulated 173% greater assets.

2. ***Advice is not exclusively for the wealthy.*** Despite consumers' general misconceptions, financial advice is not only beneficial for high net worth clients. In the CIRANO Study, the median initial investment for advised households was only $11,000, demonstrating that financial advice is beneficial to the lower- and mid-net worth segment of the market, and that advisors are serving this segment under the current regulatory regime.

3. ***Advice positively impacts savings and retirement preparedness.*** The researchers found evidence that points to improved savings behaviour being the key to the success of advised households in accumulating assets relative to their non-advised peers, and the important role of the financial advisor in encouraging this behaviour. There was a significant gap between advised and non-advised households in their reported feelings of confidence regarding their preparedness for retirement.

4. ***Advice positively impacts levels of trust, satisfaction and confidence in financial advisors.*** The CIRANO Study found that advised households reported a higher degree of trust and confidence in financial advisors, relative to non-advised households. This demonstrates that even if consumers are initially apprehensive about the value of advice and question what financial advisors can offer, actually working with an advisor and seeing the results first hand confirms, from the consumer's perspective, the value of the advisor.[2]

The CIRANO Study confirms previous research conducted by the Investment Funds Institute of Canada ("IFIC"). In each of 2010 and 2011, IFIC released studies (the "IFIC Studies") that indicate a likely correlation between financial advice and higher levels of financial assets, retirement readiness and financial literacy among consumers.[3]

Amongst their findings, the IFIC Studies reported that advisors: promote values that benefit clients throughout their investing lifetimes (such as the early adoption of a savings and investment mindset); help clients build wealth through tax-efficient plans based on asset mixes that are sensitive to clients' particular circumstances and risk tolerances; and contribute to the financial literacy of Canadians by taking the time to explain important concepts. The 2011 IFIC Study concluded that these and other factors "provide net return advantages that exceed the additional cost for advice that is contained within the mutual funds or other financial products used by the investor."

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[2] For more details about the CIRANO Study, including the methodology used, we encourage the CSA to review the document in its entirety, which is available at www.cirano.qc.ca/pdf/publication/2012RP-17.pdf.
[3] The 2010 and 2011 IFIC Studies are available at https://www.ific.ca/Content/Document.aspx?id=5906& LangType=1033 and https://www.ific.ca/Content/Document.aspx?id=6921&LangType=1033, respectively.

The IFIC and CIRANO Studies confirm that financial advice provides tremendous value to Canadians. This value is manifested not only in quantitative terms, such as the substantially greater accumulated wealth enjoyed by advised households, but also in the peace-of-mind and confidence in knowing that one is prepared to deal, at least financially, with life's most significant events. The fact that working with a financial advisor increases trust and satisfaction in financial advice demonstrates that non-advised Canadians may undervalue what financial advisors can offer, leading to sub-optimal outcomes. While it is up to the industry to solve this informational inefficiency, regulators should be careful not to exacerbate the issue by enacting policies that would act as a further barrier to Canadians' ability to access advice.

D. <u>The Current Regulatory Framework</u>

Current securities laws governing advisors' standard of conduct state that financial advisors must deal fairly, honestly and in good faith with their clients, and includes an advisor's obligation to assess suitability.[4] Further, depending on the facts of each relationship, a common law fiduciary duty may arise.

i. The suitability standard

The suitability obligation requires that advisors apprise themselves of both:

(i) the general investment needs and objectives of their client and any other factors necessary to determine whether a proposed investment is suitable (*know your client*); and

(ii) the attributes and associated risks of the products they are recommending to their clients (*know your product*).[5]

Based on this information, before proceeding with a transaction, advisors must ensure that a product that is recommended to or requested by a client is a "match" for that client, given the client's financial situation and risk tolerance. The CSA states that "the suitability obligation requires that a dealer or adviser ensure that an investment is suitable or appropriate. This does not necessarily mean that the product must be the "best" product for the client."[6]

The tone of the CSA's commentary suggests that it believes that the suitability standard is wanting, and that it would be better if advisors only provided clients with products that are, *in the advisor's opinion*, "best" for the client. But such a change would actually eliminate an important degree of flexibility that allows advisors to serve experienced clients who wish to retain greater investing autonomy. As further explored in Section E below, there is a wide variety of retail clients, some of whom are very sophisticated. Naturally, there will be occasions when a sophisticated client disagrees with the advisor's good faith opinion; but as long as the advisor believes the sophisticated client's decision is suitable, the advisor can continue to assist that client – even if the course of action would not have been the advisor's first choice.

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[4] (2012) 35 OSCB 9563.
[5] See CSA Staff Notice 33-315 *Suitability Obligation and Know Your Product* (September 4, 2009) at 32 OSCB 6890.
[6] (2012) 35 OSCB 9568.

This outcome makes sense because, ultimately, it is the client's money that is invested, so the client should have greater say as his or her sophistication reasonably allows. This flexibility to better serve a wide range of clients, combined with the common law fiduciary duty discussed below that applies for vulnerable clients, is one of the greatest strengths of our current regulatory framework.

ii. The common law fiduciary standard

As acknowledged by the CSA, even though the advisor-client relationship does not give rise to a *per se* fiduciary duty, an *ad hoc* duty may apply in certain relationships, depending on the characteristics of that relationship. In *Varcoe v. Sterling,*[7] the court stated that this determination is dependent on the circumstances of each individual case, with the presence of certain elements, including trust, confidence and reliance, being determinative.

Varcoe was cited with approval by the Supreme Court in *Hodgkinson v. Simms*,[8] where La Forest J. noted that:

> "[*Varcoe*] represents an accurate statement of fiduciary law in the context of independent professional advisory relationships, whether the advisers be accountants, stockbrokers, bankers, or investment counsellors. Moreover, it states a <u>principled and workable</u> doctrinal approach. Thus, where a fiduciary duty is claimed in the context of a financial advisory relationship, <u>it is at all events a question of fact as to whether the parties' relationship was such as to give rise to a fiduciary duty on the part of the advisor."</u>[9]
>
> [Emphasis added.]

Over the years, courts have developed a set of well-defined principles to help inform the factual analysis as to whether a particular relationship is elevated to having fiduciary status. The Consultation Paper references *Hunt v. TD Securities Inc.*,[10] where Gillese J.A. discussed the following five factors:

1. ***Vulnerability*** — the degree of vulnerability of the client that exists due to such things as age or lack of language skills, investment knowledge, education or experience in the stock market.
2. ***Trust*** — the degree of trust and confidence that a client reposes in the advisor and the extent to which the advisor accepts that trust.
3. ***Reliance*** — whether there is a long history of relying on the advisor's judgment and advice and whether the advisor holds him or herself out as having special skills and knowledge upon which the client can rely.
4. ***Discretion*** — the extent to which the advisor has power or discretion over the client's account.
5. ***Professional Rules or Codes of Conduct*** — help to establish the duties of the advisor and the standards to which the advisor will be held.[11]

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[7] (1992), 7 O.R. (3d) 204 (Gen. Div.) [*Varcoe*]; affirmed (1992), 10 O.R. (3d) 574 (C.A.); leave to S.C.C. denied.
[8] [1994] 3 S.C.R. 377 [*Hodgkinson*].
[9] *Ibid.* at p. 420.
[10] (2003), 66 O.R. (3d) 481 (C.A.) [*Hunt*].
[11] *Ibid.* at para. 40.

As acknowledged in the Consultation Paper, the inherent flexibility and fluidity of the fiduciary duty doctrine at common law has allowed it to be applied often,[12] resulting in the creation of a robust body of case law. This in turn gives market participants confidence in their understanding of their rights and obligations in any given relationship, as they know the circumstances under which fiduciary obligations are likely to apply.

iii. A principled foundation

We believe that this framework governing the standard of conduct, based at its core on suitability, and enhanced to a fiduciary relationship where warranted based on the facts, represents a strong, principled foundation for the advisor-client relationship. It is flexible to accommodate the wishes of sophisticated clients while ensuring the highest protections for vulnerable ones. In fact, we do not believe that there can be a more sensible and straightforward principle than "clients who require a higher duty of care receive it, and those who do not require the duty do not receive it." Therefore, we disagree with the CSA's expressed concern in the Consultation Paper that there currently exists an inadequate principled foundation for the advisor-client relationship.

While we certainly agree that "advice for investing in securities is arguably not just like any other business transaction or interaction", the existing principled foundation is not at all like that of "any other business transaction or interaction where the principles of 'buyer beware' … are sufficient".[13] In other business transactions or interactions, the counterparty cannot be deemed to be a fiduciary where circumstances call for it. This is a fundamental difference that the CSA must recognize in furtherance of a productive and open dialogue.

iv. Fiduciary duty warrants a principles-based approach

Canada's context-based common law approach to fiduciary duty, through its use of well-established principles, is an excellent example of the type of principles-based regulation that regulators are increasingly attempting to adopt. Principles-based regulation is outcomes-focused and based on high-level principles. As articulated in the Consultation Paper, "[t]he advantage of any principle-based approach to regulation is that regulators do not have to introduce detailed rules for every element of a relationship being regulated."[14] Further, by focusing on the spirit of the regulation, principles-based regulation is also harder to evade by those actors who would attempt to adhere minimally to the letter of the law.

As mentioned, courts have established that *certain* advisor-client relationships warrant fiduciary protections, while other relationships do not merit this standard of care. Rather than simply labeling any relationship as fiduciary, courts take a context-driven approach because the determination of a fiduciary relationship creates significant repercussions for both the advisor and the client.

This is because the fiduciary standard is the *highest* standard of care in law, requiring the fiduciary to act solely in the beneficiary's interests, without regard to one's own. It suggests a significant imbalance of power between the parties: the beneficiary of the duty is characterized

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[12] (2012) 35 OSCB 9585.
[13] (2012) 35 OSCB 9579.
[14] *Ibid.*

as vulnerable and the fiduciary acts as a caretaker on the client's behalf. In the Supreme Court's judgment in *LAC Minerals Ltd. v. International Corona Resources Ltd.*,[15] Sopinka J. stated that fiduciary obligations "must be reserved for situations that are truly in need of the special protection that equity affords."[16]

Clearly, a fiduciary duty is not one to be taken lightly. It is not a duty that applies to most commercial relationships, including from most professional service providers. Courts have prudently recognized that advisors can play a critical role in the lives of the public, and we would agree. So there are indeed certain advisor-client relationships that merit fiduciary protections – but others do not and the context is critical. By making such determinations on a case-by-case basis, guided by the balancing of well-established principles, the common law approach to fiduciary duty exemplifies the type of principles-based regulation that benefits regulators and market participants alike, and its use should be encouraged.

E. Problems with a Statutory Fiduciary Duty

The Consultation Paper discusses the merits of introducing a statutory fiduciary duty for financial advisors. We strongly recommend that the CSA not proceed with this initiative, as we believe that such a standard would create significant deleterious effects that would leave both advisors and clients worse off. As noted securities litigation lawyer Joseph Groia states, a statutory fiduciary duty:

> "… will put all honest financial advisors and brokers in the same position, regardless of the sophistication of their client. The breadth of work which financial advisors and brokers perform is broad and varied, and thus in our view, it would be inappropriate to assign all of them with the same duty and corresponding liability. This will also add significant cost and inefficiency to the relationship."[17]

In the subsections below, we explore several of the reasons why a statutory fiduciary duty would not be in the best interests of clients or advisors.

i. Retail clients are not homogeneous

In recognition that a fiduciary duty is not appropriate for all advisor-client relationships, the CSA's proposed articulation of the statutory duty would apply only in respect of retail clients. In making this distinction, the CSA may be acknowledging that institutional clients lack the vulnerability that warrant fiduciary protections: after all, institutional clients likely have substantial investing experience and knowledge, are therefore fully cognisant of the risks posed by undertaking a particular investment, and are able to absorb losses stemming that are a foreseeable consequence of those risks. Advocis believes that this distinction is sensible given the principles behind fiduciary obligations, articulated above.

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[15] [1989] 2 S.C.R. 574.
[16] *Ibid.* at 312.
[17] Groia, Joseph and Owais Ahmed, *Extending a Fiduciary Duty to all Financial Advisors and Brokers: Will it make a difference?* (March 25, 2010), online: http://www.groiaco.com/pdf/Extending_a_Fiduciary_Duty_to_all_Financial_Advisors_and_Brokers.pdf.

However, even restricting fiduciary obligations to "retail" clients is overbroad, as retail clients themselves are not a homogeneous group. Many retail clients possess the sophisticated knowledge and experience that is characteristic of the institutional class of investor. In *Varcoe*, a case concerning a retail client, the court pointed out that when it comes to the advisor-client relationship, "the circumstances can cover the whole spectrum from total reliance to total independence."[18]

Indeed, retail clients can range from neophytes who completely depend on their advisor's expertise and guidance, to seasoned veterans who may value their advisor's informed second opinion but ultimately wish to make their own decisions. Case law that has considered the common law fiduciary duty illustrates real-world examples of this wide range, key examples of which are canvassed below.

(a) <u>Vulnerability and discretion</u>

At one end of the spectrum is the vulnerable client who has little understanding of financial products and is completely reliant on the advisor. In such cases, courts have rarely hesitated to find that a fiduciary duty exists. *Ryder v. Osler, Wills, Bickle Ltd.*[19] is an extreme example of a situation where an unsophisticated client, an elderly widow who became the beneficiary of a trust, was completely reliant on a dishonest advisor who churned and margined the account despite the direction that the investments be conservatively managed.

At the other end of the spectrum is the situation in *Srdarev v. McLeod Young Weir Ltd.*[20], where an experienced client used his advisor as an order-taker to execute the client's aggressive investing strategy. The advisor's advice was not sought and written warnings from the advisor were ignored. After suffering losses, the client sued the advisor for breach of fiduciary duty. The claim failed as the court found the client had made his own decisions and had not reposed trust and reliance on the advisor.

Somewhere in the middle of these two extremes is a situation where a relatively sophisticated client sees the advisor as a "sounding board" to discuss potential investing strategies, while retaining ultimate control of the account. This situation arose in *Bishop v. Richardson Greenshields of Canada Ltd.*,[21] where the Court concluded that there was no fiduciary relationship between the parties because the client exercised his independent judgment, based upon which he gave instructions to his advisor.

The distinction between a discretionary and non-discretionary account was also persuasive in *Hunt*;[22] there, because the clients were knowledgeable in financial matters and operated their account as non-discretionary, the Court did not find the relationship to be fiduciary, despite the fact that the clients were elderly and their entire life savings were at stake. Further, in *Kent v. May*,[23] although the client never rejected the advisor's recommendations, the relationship was not fiduciary because at all times, the client retained discretion for each decision and was kept fully informed through frequent contact with the advisor.

[18] *Supra,* note 7 at para. 87.
[19] (1985), 49 O.R. (2d) 609 (H.C.).
[20] [1992] O.J. No. 70 (Gen. Div.).
[21] (1993), 50 C.P.R. (3d) 66 (Ont. Gen. Div.).
[22] *Supra*, note 10.
[23] (2001) A.R. 71 (Q.B.), aff'd 2002 ABCA 252.

In these cases, the fact as to whether the advisor has discretion to manage the account weighs heavily. This holds true even when the type of client is traditionally thought of as "vulnerable", such as the elderly or clients who have invested a significant portion of their wealth. We believe that this distinction is sensible because in a non-discretionary situation, it would be perverse to judge whether fiduciaries have met the highest duty of care in managing accounts over which they are not actually permitted to use their own skill or judgment.

(b) *Inducement and special instructions*

Courts have also found that fiduciary duties may apply if advisors induce clients into action based on the advisor's purported possession of special skills or knowledge, even when dealing with sophisticated retail clients. See, for example, *Burke v. Cory*,[24] where an advisor had represented to a client that a particular investment in a resource company was a "very good buy" due to positive initial drilling tests when in fact, no tests had been conducted. The court found that the advisor's behaviour had induced the client's reliance and, in so doing, had created fiduciary obligations.

Retail clients who retain discretion over their account and use their advisor as an order-taker may still be protected by fiduciary obligations where the advisor fails to carry out the client's specific instructions and the advisor knows that those instructions are of unique and particular importance to the client. This was the case in *Laskin v. Bache & Co.*,[25] where the client expressly required the advisor to deliver physical share certificates. The advisor failed to do so, and as a result, the client was unable to close on a subsequent transaction.

(c) *No statutory articulation can capture the variety of retail clients*

These cases serve to illustrate the wide variety of clients that fall within the retail category; some warrant fiduciary protections and others do not, and it is not a determination that can be made algorithmically based on the "retail" label. Even a more granular classification of retail clients (such as elderly clients, knowledgeable clients or clients investing their life savings) is not an effective means of sub-dividing the group. In the Consultation Paper, the CSA proposes to define retail clients and have its statutory fiduciary duty apply only to that group.[26] But a review of case law quickly demonstrates the impossibility of defining the category – there will inevitably be exceptions that arise.

Instead, the best, fairest and only way to properly assess whether a fiduciary duty should apply is the context-based common law approach that the Supreme Court in *Hodgkinson* described as both "principled and workable."[27] This approach, which is the culmination of decades of case law considered by Canada's most prominent jurists, makes abundantly clear that the advisor-client fiduciary issue must be considered on a case-by-case basis.

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[24] (1959), 19 D.L.R. (2d) 252 (Ont. C.A.).
[25] [1972] 1 O.R. 465 (C.A.).
[26] See (2012) 35 OSCB 9583, where the CSA suggests proposed limitations to the application of a statutory fiduciary duty, such as a threshold dollar value of a client's net assets, or specific situations where the duty may not apply. While we understand and commend the CSA's motivation behind sensible carve-outs to the application of the standard highest of care to reflect business realities, we believe that no one factor (or set of factors) can ever be determinative, based on the jurisprudence. A balancing of all factors is required, based on overarching principles.
[27] *Supra*, note 8.

It is for this reason that a statutory fiduciary duty is not workable: *there is no statutory articulation that can capture every permutation of the client-advisor relationship*, so any attempt to codify fiduciary duty in this manner is a disservice to clients and advisors alike. A statutorily-codified fiduciary duty will inevitably over-include certain clients who do not warrant the law's highest standard of care, while being under-inclusive to other clients. Given the ramifications of fiduciary obligations, this mismatch is so problematic as to make the CSA's statutory effort harmful and untenable.

Additionally, as noted earlier in our submission, the current suitability standard allows advisors to serve sophisticated retail clients, such as those described in the cases above. These clients may use their advisor as a sounding board for potential investments and as a conduit to execute orders, while retaining ultimate decision-making authority. Even if the advisor disagrees with the client's view and believes that another strategy would be better for the client's interests, the advisor can still assist as long as the investment is, in the advisor's opinion, suitable given the client's situation.

Trumping the suitability standard with a statutory best interest standard would effectively eliminate the ability to serve this portion of the market. It would result in a polarization of the market: retail clients could either benefit from advice but have to give up investing discretion to their advisor, or would have to forego advice and invest alone, such as through a discount online-only broker.[28] Given the tremendous benefits of advice detailed in Section C above, we believe that many consumers would be much worse off as a result of this polarization.

ii. A statutory fiduciary duty will increase costs

A statutory fiduciary duty will increase costs for all market participants. It will greatly increase the volume of litigation in the courts, create new compliance obligations for advisors and dealers alike and result in greater uncertainty in the marketplace.

(a) Increased litigation

A statutory fiduciary duty is likely to increase the volume of litigation brought against financial advisors. Currently, under the common law, if a client wishes to sue an advisor for breach of fiduciary duty, that client must first establish that fiduciary obligations apply in accordance with the principles articulated above. This exercise is supported by a large body of case law that quickly allows for the evaluation of the merits of a claim. A statutory fiduciary duty would shift the evidentiary onus: the client would no longer be required to establish the duty. Instead, the duty would be presumed, and if the defendant advisor wished to disprove the existence of the duty, the defendant would be responsible for adducing evidence to that effect.

The plaintiff's requirement to establish a fiduciary duty acts as a reasonable barrier to litigation, so its removal will almost certainly encourage additional lawsuits. Some commentators may argue that easy access to litigation is beneficial as a consumer protection measure on two fronts: (i) to discourage bad behaviour by advisors; and (ii) to increase the quantum of damages payable to the client where the fiduciary duty is breached.

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[28] The feasibility of the Consultation Paper's statement regarding the client retaining discretionary control in the presence of a statutory fiduciary duty is discussed below in Section E(ii)(c).

Regarding the first point, we believe that a statutory fiduciary duty will only marginally deter bad behaviour: honest advisors will continue to act in good faith, and fraudsters who are already breaching the common law fiduciary duty or other statutory, contractual or tortious obligations will not be motivated into compliance by a statutory fiduciary duty. In fact, it is likely that honest advisors are the ones who are likely to face a disproportionate barrage of new litigation.

Regarding the second point, we believe that fiduciary duty does increase the quantum of damages and over-incentives lawsuits. Since fiduciary duty is the highest standard of care in law, a breach of that standard carries severe consequences – including the fact that defences such as contributory negligence are unavailable, mitigation of losses by the plaintiff is not expected and punitive damages may be awarded. By eliminating these defences or allowing for exceptional damages, the CSA is effectively increasing plaintiffs' expected value of pursuing a claim, which renders claims on the margin suddenly worthwhile to litigate.

This misplaced incentive is exacerbated by the fact that the additional cases that would be brought forward due to the statutory codification would likely be of questionable merit. They would represent the marginal cases that would not be pursued under the common law regime due to the plaintiff's lack of ability to bring forward evidence establishing that fiduciary obligations are warranted.

Adding to this wave of litigation would be the perception by many clients that, owing to the higher standard of care expected of fiduciaries, advisors should be responsible for losses suffered in the client's portfolio – even where the losses are due to market outcomes and not any fault of the advisor. While the courts have made clear that advisors, even when fiduciaries, are not guarantors of positive outcomes for their clients,[29] we already see claims for breach of fiduciary duty thrown into many lawsuits as a general "catch all" after specific allegations, simply due to the gravity that fiduciary duty connotes. If the CSA were to introduce a statutory fiduciary duty, it is signalling to the market its belief that advisors should be liable for a wider range of outcomes; this will encourage lawsuits from clients who conflate the highest duty with an obligation to somehow eliminate market risk.

Cumulatively, will result in a flood of nuisance claims, which will harm both advisors and clients. Advisors will suffer under the weight of having to respond to all these claims – even if the claims are without merit, allegations of breaching fiduciary duty are serious and demand a careful and thorough response. Advisors will be unable to dedicate as much time to productive work and will incur significant additional costs, through legal fees to defence lawyers and through higher errors and omissions insurance premiums.

Clients will experience decreased levels of service from their advisors, as advisors will be increasingly preoccupied with the administrative hassles of managing litigation and will be drawn away from productive work. Additionally, clients who have truly been wronged by a dishonest advisor and therefore have a legitimate claim will find the courts less accessible and unable to handle their claims in a timely manner, as the courts will be saturated with competing nuisance claims in the queue.

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[29] In *Varcoe*, *supra* note 7, the Court stated that "[s]o long as the broker applies the skill and knowledge relied upon and advises fully, honestly and in good faith, the broker has discharged his or her obligation and is not responsible if the transaction proves unfavourable."

(b) Increased compliance obligations

A statutory fiduciary duty will create significant additional compliance obligations on advisors. As noted in the Consultation Paper, under the current framework, advisors require more extensive KYC information from certain clients relative to others, with more vulnerable clients generally requiring an in-depth consultation. A statutory fiduciary duty would necessitate the advisor conducting an extensive KYC consultation for every client, regardless of their sophistication, as anything less under the highest standard of care would create too great a litigation risk down the road.

This will create tremendous overhead that will not appreciably improve outcomes for consumers. A wealthy client who would like to invest a small amount relative to his overall financial position should not have to justify and document his decision to the same extent as an elderly person who is proposing a high-risk leveraged investment; the risk is simply not the same. But under a statutory fiduciary duty, there is a very real possibility that this context would be lost due to the blanket statutory expectation. The KYC process would become an onerous wave of paperwork that is more about justifying straightforward decisions for fear of regulatory sanctions and litigation rather than serving the client efficiently.

In regards to whether a statutory fiduciary duty would be an ongoing duty or one that is owed at a particular point in time, the Consultation Paper's proposed articulation states that the duty shall apply "when providing such advice".[30] This suggests that the duty would be event-specific. Later on that same page, however, the Consultation Paper describes the duty as an "on-going duty in the case of advisers and dealers other than exempt market dealers and scholarship plan dealers. The duty would terminate only upon the termination of the client relationship."

This latter articulation, with the duty applying at all times, would represent a drastic departure from the current suitability standard. Currently, an advisor must assess suitability upon the occurrence of specific events, such as when making a recommendation, accepting an instruction from a client, or, where discretionary authority is given, buying or selling a security for clients. By moving to an ongoing duty, advisors' obligations would become exponentially more arduous. Advisors would have to review around-the-clock changes in multiple markets (such as for corporate bonds, government bonds, foreign equities, money markets, and many more) and analyze, in regards to a specific client, whether any such development warrants any action by the client. This exercise would have to be repeated for dozens or hundreds of clients.

With so many moving parts that are beyond the advisor's control, the compliance obligations demanded by an ongoing statutory fiduciary duty would simply overwhelm advisors and choke their ability to conduct business. Note that the untenable nature of an ongoing duty, even in respect of the current standard of care, is recognized by both IIROC and the MFDA: the Consultation Paper acknowledges that these regulators have expanded their *suitability* assessment requirements by requiring reassessment at specific triggering events – not by requiring reassessment on a continuous, rolling basis.[31]

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[30] (2012) 35 OSCB 9583.

[31] IIROC, *IIROC Notice 12-0109: Know your client and suitability – Guidance* (March 26, 2012), online: http://www.iiroc.ca/Documents/2012/d21b2822-bcc3-4b2f-8c7f-422c3b3c1de1_en.pdf, and MFDA, *MFDA Bulletin #0459: Transition Periods for MFDA Rule and Policy Amendments Implementing the Client Relationship Model Proposals* (December 3, 2010), online: http://www.mfda.ca/regulation/bulletins10 /Bulletin0459-P.pdf.

(c) *Increased uncertainty*

The Consultation Paper states the CSA's belief that a statutory fiduciary duty would decrease uncertainty in the marketplace. Specifically, it suggests:

> "A statutory best interest standard may clarify that such a duty applies in most instances when an adviser or dealer provides advice to a retail investor. This may help clarify some of the uncertainty currently experienced by both clients and their advisers and dealers regarding what standard of conduct the adviser or dealer will be held to."[32]

We believe that, in actuality, the opposite is true: the CSA's proposed statutory fiduciary duty would significantly "muddy the waters" regarding the standard of conduct in the industry, leaving advisors and their clients uncertain about their respective rights and obligations. This is largely because, as the Consultation Paper acknowledges, any statutory fiduciary duty would have to be peppered with a series of carve-outs to accommodate the multitude of existing business models:

> "A statutory best interest standard does not have to impose an unqualified common law fiduciary duty on all advisers and dealers in respect of all facets of the client relationship. <u>Distinctions can be made among the constituent elements of a fiduciary duty and addressed in different ways to meet the needs of all stakeholders.</u> That is to say, the elements of a statutory fiduciary duty can be qualified to accommodate specific circumstances including the particular circumstances and business model of the adviser or dealer."[33]
>
> [Emphasis added.]

We agree that any attempt to establish a statutory fiduciary duty requires a series of qualifications to meet the needs of all stakeholders. However, this is much easier said than done: there are so many variations amongst each of the constituent elements of a fiduciary duty that, despite the CSA's best efforts, it would be exceptionally difficult to codify every type of situation in a manner that is both predictable and not over- or under-inclusive. In Section E, we explored the challenge of defining "retail clients", and that is just one of many aspects that would have to be addressed. Other aspects, as noted in the Consultation Paper, include the role of scaled advice, restricted advice, ongoing duties and so on.

We would like to draw attention to yet another aspect of the duty that we believe would result in great confusion, disputes and litigation in the courts. The CSA states that:

> "[A] retail client would retain complete discretion whether to follow any advice received; an adviser or dealer who disagrees with the investment decision of a retail client and who has so advised the client, would have no further obligation to dissuade the client or to refuse to facilitate an order."[34]

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[32] *Supra*, note 12.
[33] (2012) 35 OSCB 9586.
[34] General Scope, *supra*, note 30.

We understand the CSA's reasoning behind this qualification; in many advisor-client relationships (especially those involving sophisticated clients), the client prefers to maintain control of the account – and in the case of MFDA advisors, is *required* to retain control. Neither the CSA nor Advocis wishes to eliminate a client's freedom to do so. However, while this qualification may "allow" the advisor to assist the client even when the advisor disagrees with the client's decision, it does not actually relieve the advisor from the fiduciary obligations based on the statutory language.

Therefore, executing a client's instruction which the advisor does not believe is in the client's best interest would be fundamentally incompatible with fiduciary duty, which has inherent to it the concept of the client's vulnerability to, and reliance on, the fiduciary's skills and judgment. As we stated earlier in our submission, it would be perverse to evaluate fiduciaries on their faithful discharging of the highest duty of care if they are not allowed to use their skills or judgment, but are rather overridden by their clients – but that is the situation that this qualification would effectively create.

Consider this carve-out in light of another proposed qualification, which provides that "the best interest standard could not be waived by a retail client as a contractual matter".[35] Based on this, advisors would not even be able to protect themselves from *ex post* accusations of breach of fiduciary duty through documentation such as risk acknowledgment forms that evidence a client's decision to undertake an action despite the warnings of the advisor.

Ultimately, any codification of a statutory fiduciary duty is likely to contain several intentional ambiguities such as the ones discussed above, to accommodate the wide variety of business models in the marketplace. The CSA has recognized the confusion that these ambiguities will cause, stating that regulators may be required to fill in appropriate guidance as to the application of the standard.[36] Over time, this *ad hoc* approach will be a reactive attempt to fill in the gaps with prescriptive rules, discussed further in Section E(iv) below.

And in the meantime, misunderstandings between advisors and clients as to the content of the duty, in light of its various carve-outs, will inevitably result in disputes, which will lead to litigation. This means it could once again be up to the courts to flush out the ambiguities by developing, over several years, a series of principles to interpret the statutory duty. So at the end of this long, expensive and unproductive process, we could very well end up somewhere that is very close to where we already are today.

The CSA highlights a purported expectation gap between advisors and clients as motivating factor behind its consideration of a statutory fiduciary duty.[37] We believe that under the current system, with its well-established body of regulations and case law, parties reasonably understand their rights and obligations. If this foundation is replaced with a new ambiguity-laded statutory fiduciary duty, any expectation gap will be exacerbated and the CSA's objective of certainty will suffer a severe set back.

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[35] *Ibid.*
[36] *Ibid.*
[37] (2012) 35 OSCB 9581.

iii. Impact on compensation practices

The Consultation Paper states that the proposed statutory fiduciary duty could have an uncertain impact on current compensation practices in the industry, especially those involving embedded commissions paid by third parties to advisors or dealers. While the paper proclaims that a statutory fiduciary duty "does not necessarily mean a change must be made in compensation structures", it also quotes the need for fiduciaries to "scrupulously avoid all actual or potential conflicts of interest involving their beneficiaries."[38]

Clearly, the impact on compensation practices is yet another major area of uncertainty. Embedded compensation does represent, to varying degrees, a conflict of interest, but its beneficial impact of increasing consumers' access to advice usually outweighs the harm, if any, from the conflict. However, depending on the eventual statutory articulation and its interpretation by regulators and courts, a statutory fiduciary duty could result in embedded compensation being deemed incompatible, resulting in its eventual abolishment. This would force all client accounts into the fee-based realm, either under a fee-for-service arrangement, or a billing of clients based on an hourly rate or as a percentage of assets. We believe that such a shift would be extremely harmful to consumers for multiple reasons.

Firstly, for many clients, the embedded fee model represents the most efficient and lowest-cost option. Note that this was the conclusion reached by the U.S. Securities and Exchange Commission (the "SEC"), which reported that "certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, especially accounts that are not actively traded, e.g., fee-based accounts that trade so infrequently that they would have incurred lower costs for the investor had the accounts been commission-based."[39] The SEC Study suggests that passive investors would be disproportionately affected. These are typically the type of investors who are neither wealthy nor interested in speculative trading; instead, these tend to be the type of clients who are saving towards a long-term goal, such as retirement.

The reality is that embedded compensation accounts are less expensive to administer than fee-based ones. A fee-based account requires billing infrastructure for the creation, distribution and collection of thousands of invoices, each for relatively small amounts, such as for $200 every quarter. This costly overhead means either that it won't be economical for advisors and dealers to service the smaller accounts of lower- and middle-income clients, or clients will have to pay higher fees than they currently do, which many will find unpalatable. Either way, there is a serious risk that a significant subset of consumers who currently receive advice would not under a fee-based model.

Secondly, our experience working with clients has demonstrated to us that clients are generally unwilling to pay directly for advice, despite the tremendous benefits that accrue to them. Instead, clients are comfortable and satisfied with the embedded compensation model, which is why a majority choose this form of account. Significant studies have not been performed in

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[38] Mark Vincent Ellis, *Fiduciary Duties in Canada*, looseleaf (Toronto: Carswell, 1988), Ch. 1, para. 4(2)(a).

[39] Securities and Exchange Commission (Staff), *Study on Investment Advisers and Broker-Dealers - As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act* (January 2011), online: http://www.sec.gov/news/studies/2011/913studyfinal.pdf (the "SEC Study").

Canada on this matter, but we can look to the United Kingdom as an example of a jurisdiction that has recently banned embedded compensation.

A study by Deloitte suggests that a ban on embedded compensation could result in up to 5.5 million U.K. consumers being disenfranchised from accessing advice; this represents 11% of the adult U.K. population, which Deloitte describes as "a significant post-[Retail Distribution Review] advice gap".[40] It also finds that advisors and dealers are likely to de-prioritize a large proportion of customers; they are likely to move upmarket to defend profit margins, with the focus turning to customers with at least £50,000 (approximately $80,000) in investable assets. Recall that in the CIRANO Study, Canadians' median initial investment was only $11,000, meaning that *many* consumers could be frozen out of advice if similar metrics apply here.

In terms of a consumer's willingness or ability to directly pay for advice, Deloitte found that the wealth of the consumer is the primary factor in this determination; in fact, consumers with greater than £50,000 in investable assets are twice as likely to stay with a financial advisor in the "advisor charging" world.[41] A report by the EA Consulting Group states that the average cost of advice in a post-commission world is an estimated £670, which is thought to be well beyond the reach of the typical middle or mass market client.[42]

While we in Canada have certainly not had the same problems that led the U.K.'s regulators to ban embedded compensation (more on this in Section F below), it is reasonable to assume that Canadian consumers would, broadly, suffer the same ills from the policy: advice would largely become the purview of wealthier clients. Given the significant benefits of advice to Canadians across the wealth spectrum, as discussed in Section C, we urge the CSA to avoid enacting a policy that would make advice more onerous for the very clients who need it most.

Finally, in any discussion regarding a potential ban of embedded compensation, we must remember that fee-based accounts are already available to consumers today and are offered by many financial advisors. A ban on embedded compensation models would only eliminate an important channel that the majority of consumers willingly select; therefore, if the CSA were to eliminate this option, it would be forcing millions of Canadians out of the investment plans of their own choosing.

iv. Loss of principles-based regulation

As discussed in Section D of this submission, the CSA recognizes the value of taking a principles-based approach to regulation which alleviates the need for prescriptive rules. It also points to the inherent flexibility and fluidity of the fiduciary duty doctrine at common law as an example to be emulated.

However, the CSA goes on to state that "[t]he imposition of a statutory best interest standard constitutes a principle-based approach"[43] to addressing investor protection concerns. We believe the opposite is true: a shift from the current principles-based common law fiduciary duty

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[40] Deloitte LLP, *Bridging the advice gap: Delivering investment products in a post-RDR world* (November 2012), online: http://www.deloitte.com/assets/Dcom-UnitedKingdom/Local%20Assets/Documents/Industries/Financial%20Services/uk-fs-bridging-the-advice-gap.pdf.
[41] *Ibid.*, p. 5.
[42] EA Consulting Group, *RDR – A concise guide to the Retail Distribution Review* (January 2011).
[43] *Supra*, note 12.

to a rigid statutory one prescribed in legislation would be a regressive step backwards that would negatively impact securities regulation.

Exacerbating this problem is the fact that the matter being considered for statutory codification requires, according to the CSA itself, several conditions and carve-outs in order to accommodate the wide variety of clients, relationships and business models in the industry. Extremely complex matters with many moving parts such as fiduciary duty are much better suited to principles-based regulation, because it is nearly impossible to draft legislation that properly addresses all the permutations found in the real world. Too often, the only way to codify these complex matters is to use prescriptive rules and "bright line" tests that are poor at contextualization and therefore create perverse outcomes.

This problem is already evident in the Consultation Paper. While, due to the preliminary stage of the consultation, the CSA does not include the proposed statutory text of most of the carve-outs to be included, it does discuss certain parameters regarding the definition of "retail clients". The serious problems with those parameters are typical of what happens when one tries to reduce complex analysis into rigid statutory text.

As discussed in Section E above, there is no one characteristic that determines whether a particular retail client is "vulnerable" or "sophisticated" – instead, several factors must be weighed in concert. Further, the use of fixed thresholds (such as having net financial assets of $5 million or less[44]), devoid of a contextual analysis, will inevitably be over-inclusive for some, and under-inclusive for others. Similar problems can be expected if and when the CSA attempts to codify other substantive parts of fiduciary duty, such as defining what actually constitutes the "best" interests of a client and the conditions under which an advisor can be reasonably assured that he or she has successfully discharged the duty.

We strongly urge the CSA to consider the challenges of codifying the proposed fiduciary duty, along with its various carve-outs, into statute. Doing so would represent the selection of prescriptive, rules-based regulation that often fails to achieve the overarching objective behind the initiative. And even if all the permutations in the advisor-client world could be codified, at great expense to regulatory resources, many of the "bright line" metrics used as a proxy for analysis would quickly become obsolete in the ever-changing securities markets.

v. Misalignment with the insurance sector's standard of conduct

Financial advisors help consumers develop comprehensive financial plans and recommend products to help achieve those plans. To best accomplish this, Advocis' advisors are typically dual-licensed, since both the securities and insurance sectors offer products with unique attributes that complement each other in a well thought-out plan. This seamless, one-stop access to products is convenient for clients and allows advisors to gain a complete perspective of their client's financial situation, thereby providing more tailored recommendations.

Even though insurance and securities products are offered to clients at one uniform point of sale, in most provinces, they are regulated by different entities. Consumers are generally unaware of this distinction and do not think of their investments as being in different "silos" depending on whether, for example, the product is a mutual fund or a segregated fund; they

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[44] General Scope, *supra*, note 30.

expect to receive quality advice based on the merits of the product, regardless of the product's governing regulatory regime.

Currently, the standard of conduct for insurance advisors is aligned with those of securities advisors: they have the duty to act honestly and in good faith.[45] This means that, when it comes to the standard governing the advice through which products are recommended to clients, both insurance and securities products are on equal footing. However, if the CSA were to implement a statutory fiduciary standard, it would only apply to the securities sector, and for the reasons stated above, securities products would become more costly.

The result of this regulatory arbitrage would be an over-subscription to insurance products, relative to securities products. This deviation from the ideal financial plan represents an inferior outcome for consumers. Given the longstanding business model of offering both securities and insurance products side-by-side, and the benefits that clients derive from this model, the CSA should not create a systemic disincentive against securities products by implementing a statutory fiduciary duty.

vi. The cumulative impact on advisors and their clients

The cumulative impact of all of these additional costs, direct and indirect, financial or otherwise, means that advisors would not be able to provide the comprehensive service that they currently offer. Recall that advisors currently serve all segments of the market, from wealthy, sophisticated clients to low- and middle-income clients, using a variety of models, such as through embedded compensation or through fee-based arrangements.

A statutory fiduciary duty is likely to result in advisors exiting the industry. While numbers for Canada are unclear at this point, a leading U.K. consultancy reports that 18% of advisors there are likely to exit the industry solely due to the Retail Distribution Review (e.g. they were not contemplating retirement anyway).[46] And while we cannot simply apply one jurisdiction's metric to ours with great precision, we believe it is reasonable to argue that the impact in Canada would nonetheless be devastating – especially because one of the major tenets of the U.K. reforms, the banning of embedded compensation, could become a necessity under the CSA's proposed articulation of fiduciary duty.

This will harm communities across Canada, where financial advisors often act as owners of small businesses. Not only do they serve clients' financial needs, they also employ staff and participate in their local economies. It is the smaller communities that are likely to be disproportionately hit, as those communities are not likely to have the scale/client base to absorb the significant additional costs arising from greater litigation, new compliance overhead and operating uncertainty.

These small-business advisors also tend to be independent; i.e., they are not bank-affiliated advisors. Therefore, the remaining advice industry will have a higher concentration of advisors from large institutions, decreasing diversity and competition in the industry and reducing choice,

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[45] See, for example, the Alberta Life Insurance Council's Code of Conduct (available at http://www. abcouncil.ab ca /media/docs/Pdf/COC/2010 LIFE CODE BM.pdf), or the Financial Services Commission of Ontario's Life Insurance Agent Licence Guide (available at http://www.fsco.gov.on.ca/en/insurance/ licensing-registration/documents/lifeinsguide.pdf).
[46] NMG Consulting Group, *Implications for the Adviser Sector Insights Report No 4* (January 2009).

which is not in the best interests of consumers. Further, as demonstrated in the sections above, those advisors remaining in the industry are likely to concentrate on the higher net worth segment of the market. Currently, fee-based advice is largely the purview of high net worth individuals, as lower- and middle-market consumers have shown that they are generally unwilling to pay for advice directly.

With many consumers losing access to financial advice, they are less likely to have financial plans and will be underprepared for life's events. They will not enjoy the valuable benefits of advice that the CIRANO and IFIC Studies demonstrate are achievable for consumers across the wealth spectrum.

Further, as financial advisors are often the best source of financial information for the public, the loss of access to advisors will negatively impact consumers' financial literacy, especially at the lower end of the market. This will exacerbate, rather than improve, one of the CSA's identified concerns behind its current initiative, and we will find ourselves in a situation where those most needing of financial advice will be unable to access it. This outcome is clearly not in the best interests of consumers or regulators.

F. <u>International Proposals are Not Right for Canada</u>

In its Consultation Paper, the CSA discusses regulatory developments in other jurisdictions (including the United Kingdom, Australia and the United States) where regulators have implemented, or are considering implementing, *inter alia* a statutory fiduciary duty or a ban on embedded compensation. We believe that these foreign regulatory responses are based on challenges or structural vulnerabilities that are not, nor have historically been, present in Canada; therefore, it would be inappropriate to take a "one size fits all" approach and apply another nation's purported solutions to the Canadian context.

Furthermore, studies from those foreign jurisdictions demonstrate that those regulatory responses are creating, or are likely to create, severe and deleterious effects in their domestic markets, such as severe job losses, a widening of the advice gap and greater market uncertainty. If Canada were to import those regulatory responses, we would likely experience similar negative effects.

Therefore, given that Canada has not experienced the problems to which foreign regulators are responding, and that we would likely suffer the negative effects of their purported solutions, the CSA should not look to foreign jurisdictions as models for potential regulatory initiatives in Canada. We explore those foreign jurisdictions in greater detail below.

i. United Kingdom

The U.K.'s financial services regulator, the Financial Services Authority (the "FSA"), launched its *Retail Distribution Review* (the "RDR") in 2006 to examine how retail investment products are distributed to consumers. The Consultation Paper provides a summary of the RDR, including its emphasis on clearer tiers of advice, the banning of embedded compensation and increased advisor professionalism. What is missing from the Consultation Paper is a discussion of the serious problems that have plagued the U.K.'s financial services market, which were instrumental in the call for regulatory action.

(a) <u>A scandal-plagued system</u>

In recent decades, the U.K. has experienced a series of scandals that have shaken consumer confidence in the financial system. The largest involves the mis-selling of payment protection insurance ("PPI") policies to retail consumers, beginning in 2005. Financial institutions sold 16 million of these policies, which are intended to cover loan repayments if the borrower falls ill, has an accident or loses their job. PPI policies are often sold at the same time as the underlying loan or extension of credit is made, such as upon the application for a credit card, making consumers particularly vulnerable to high-pressure sales tactics.

A massive number of PPI policies were mis-sold; examples include sales to self-employed people who would never be eligible to claim on them, to borrowers who were wrongly told that taking PPI was a condition for being granted their loan, and even to consumers who did not realise they were purchasing a policy at all alongside the other financial product. The PPI scandal is the largest retail mis-selling scandal in the history of the U.K., with damages estimated to be a staggering £12 billion, or almost $20 billion.[47] There has been justifiable public outrage that has put enormous pressure on regulators to take action.

PPI took the title of largest mis-selling scandal from its previous record holder: the pension scandal of the 1980s and 1990s. In that scandal, more than one million consumers were improperly advised to take out personal plans when they would have been better off in a company scheme, costing consumers £11.8 billion and resulting in disciplinary action against 346 firms.[48] And problems still persist to this day, with new scandals uncovered with alarming regularity: scandals involving interest rate swap arrangements[49] and unregulated collective investment schemes[50] are just coming to light, with the scope of their damage yet to be fully assessed.

These examples evidence a systemic problem in the U.K. that has fundamentally rattled retail investors' faith in the markets. It demands a response from its regulators, even an imperfect one (as discussed below). In short, the RDR is designed to fundamentally reform a dysfunctional system. But the situation in Canada is distinctly different: the CSA has not demonstrated that Canada is afflicted by systemic fraud and our retail investors have not suffered in any manner that approaches what U.K. consumers have experienced. By and large, our system is both fair and accessible, so we should be cautious about importing solutions that are designed to fix another jurisdiction's problems.

(b) <u>The RDR's impact</u>

The RDR is predicted to cause significant disruption to the U.K. financial services industry. Earlier, we quoted studies by Deloitte and NMG Consulting Group which concluded that many

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[47] Catherine Boyle, "UK Banks' Scandal Bill Now Costliest Ever" *CNBC* (November 2, 2012), online: http://www.cnbc.com/id/49655637/UK_Banks_Scandal_Bill_Now_Costliest_Ever.

[48] BBC News, *Pensions scandal costs £11.8 billion* (June 27, 2002), online: http://news.bbc.co.uk/2/hi /business/2070271.stm.

[49] Ed Monk, "ANOTHER banking scandal as FSA orders refunds to firms mis-sold loan insurance" *This is Money* (June 29, 2012), online: http://www.thisismoney.co.uk/money/news/article-2166354/IRSA-scandal-ANOTHER-banking-scandal-FSA-orders-refunds-firms-mis-sold-rate-protection.html.

[50] Julian Knight, "Commission - The root of another mis-selling scandal" *The Independent* (August 26, 2012), online: http://www.independent.co.uk/money/spend-save/julian-knight-commission--the-root-of-another-misselling-scandal-8080991.html.

advisors are likely to exit the industry, and those that remain will concentrate on the high net worth segment.[51] Middle- and lower-income consumers will struggle to access advice, with Skandia, a leading U.K. investing house, estimating that 40% of clients could be affected:

> "If you take this as a proxy for the whole advised marketplace, then 1.8 million people could be disadvantaged… A prime concern for the advisers in our survey is that those customers who are unable or unwilling to pay separately for ongoing advice on existing products would lose a valuable relationship with their financial adviser."[52]

Commenting on this RDR-created problem, Lord Howard Flight, a former Conservative shadow economic secretary to the Treasury, recently stated that:

> "RDR is an elitist concept. The wealthy will not have a problem in paying advisory fees. But somewhere between 2.5 and 5 million people will find themselves without access to financial advice, for which the in-house products of the banks, which charge commission, will be the only option.
>
> Much of the historic financial advice industry in the U.K. will be destroyed with major job losses. If the 1st January deadline is not delayed, for the industry at large, there will also be a period of chaos which will benefit no one, and especially the consumer, in whose name this policy has been created."[53]

There is widespread consensus that the RDR will have a serious and negative impact on the ability of average consumers to access advice, with the implementation of "advisor charging" being a key cause of the disruption. Perhaps, given the U.K.'s systemic problems, the FSA has deemed these costs justifiable for its own situation. But that calculation is drastically different in Canada, where comparable costs would be incurred, without the benefit of rehabilitating our non-existent systemic problems.

On a positive note, we are in full support of one of the other key tenets of the RDR: the drive to improve advisor professionalism through enhanced qualifications, continuing education and codes of ethics. We believe that professionalism is the cornerstone of consumer protection, but it is not adequately addressed by the CSA's proposed statutory fiduciary duty. Therefore, in Section H below, we provide our solution to enhancing advisor professionalism in Canada.

(c) <u>Administering the RDR</u>

Unlike in Canada, the FSA is a unified regulator of financial services, with the conduct of both securities and insurance sales and advice being under its domain. This has allowed it to implement the RDR across the spectrum of most retail investment products, providing regulatory consistency to advisors.

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[51] *Supra*, notes 40 and 46.
[52] Peter Mann, "The great unadvised" *Skandia UK*, online: http://www2.skandia.co.uk/Adviser/ adviser-support/Informer/Articles-By-Topic/Blog/Our-Mann-onthe-great-unadvised/.
[53] Lord Howard Flight, "The pending financial advice shake-up shambles and why RDR must be stalled" *This is Money* (September 23, 2012), online: http://www.thisismoney.co.uk/money/news/article-2206826/LORD-HOWARD.

This is a critical difference from the regulatory framework in Canada, where securities and insurance products are regulated by their own separate provincial regulators. As previously discussed in Section E above, if the CSA were to implement a statutory fiduciary duty, that standard of conduct would only apply to the securities side of an advisor's business. This creates a nonsensical outcome where advisors, the majority of whom offer both insurance and securities products side-by-side as part of a comprehensive financial plan, would be subject to different standards of care depending on the product they were discussing with their client. It is clear that the RDR's unified approach to financial services effectively disqualifies it as a reform model for Canada.

ii. Australia

Australia's regulator, the Australian Securities and Investments Commission ("ASIC") introduced a reform package entitled the *Future of Financial Advice* ("FOFA") in 2010. FOFA is ASIC's response to the 2009 Australian Parliamentary Joint Committee on Corporations and Financial Services report (the "JPC Report"), which inquired into issues regarding the global financial crisis generally, and specifically into the collapse of two prominent domestic firms, Storm Financial and Opes Prime.

(a) Homegrown collapses

The collapse of these and other firms during the financial crisis caused widespread chaos in Australia's financial markets. Storm Financial had advised many of its clients to take out large margin loans, often pledging their homes as security, in a bid to enhance their returns. As markets plummeted in 2008, many clients were left with huge debts and were unable to satisfy margin calls, causing losses of AUD $3 billion (CAD $3.1 billion).[54] In the case of Opes Prime, both sophisticated and retail investors were sold unregulated financial instruments that were unsuitable to their needs. Compounding matters was the fact that several prominent public figures were victims, including a high-profile sporting personality, which generated a disproportionate amount of press coverage.

Also cited by ASIC as a motivating factor behind FOFA was the fiasco involving the 2009 collapse of Trio Capital.[55] This involved the loss of roughly $176 million in Australians' superannuation funds due to fraudulent managed-investment schemes, which was the largest superannuation fraud in Australian history. A 2012 Parliamentary Joint Committee report on Trio's collapse essentially placed the blame at ASIC's feet, finding that key checks and balances in the Australian financial and superannuation system failed to identify the existence of fraudulent conduct.[56]

While advisor mis-selling was a contributory factor in the Australian collapses, many commentators, including then-ASIC chairman Tony D'Aloisio, have argued that even if FOFA

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[54] Stephanie Smail, "Storm Financial compensation claim stalls" *Australian Broadcasting Corporation* (September 17, 2012), online: http://au.finance.yahoo.com/news/storm-financial-compensation-claim-stalls-055438183.html.

[55] Commonwealth of Australia, *Future of Financial Advice 2011 Information Pack* (April 28, 2011), online: http://ministers.treasury.gov.au/Ministers/brs/Content/pressreleases/2011/attachments/064/064.pdf.

[56] Parliamentary Joint Committee on Corporations and Financial Services, *Inquiry into the collapse of Trio Capital* (May 2012), online: https://fraud.govspace.gov.au/files/2011/03/Inquiry-into-the-collapse-of-Trio-Capital.pdf.

had been in place prior to the financial crisis, it would not have prevented the crisis from occurring. D'Aloisio has also made it clear that, if confronted with another Storm Financial situation, he would not have done things any differently: ASIC would not close the company down and it would not warn investors, as it is not within the scope of ASIC's power to do so. In a speech, D'Aloisio noted that:

> "The challenge for ASIC is—firstly—to make clear (particularly to retail investors) just what we can and cannot do. For example, you get with the benefit of hindsight calls that ASIC was aware that Storm Financial was in the market and we should have closed it down. This disregards just what powers ASIC has. At the height of the stock market, investors with margin loans were in the 'black'. How would they have reacted to ASIC (if we had the power, which we do not) seeking to close them out?"[57]

Other commentators have stated that "the FOFA reforms will represent only so much window dressing and will certainly not prevent history repeating itself… The problem is that there is nothing in either the FOFA legislation nor the Stronger Super policy to suggest any of this will change or that the Trio collapse will not be repeated."[58]

In fact, there is widespread consensus that the underlying cause of the collapse was the sale of unsuitable products, and had existing suitability obligations[59] been properly enforced, the collapse could have been avoided. A key finding in the JPC Report itself stated: "It would appear Storm were doing a one-size-fits-all approach to advice… whilst they might have been doing the right thing around disclosure and so on, that is not in line with section 945A of the *Corporations Act* where there has to be a sound basis for the advice."[60] Further, a recent Thomson Reuters review pointed to superannuation, a retirement planning mechanism particular to Australia, as a key structural factor behind the country's problems:

> "Recent incidents such as the collapse of Storm Financial and the Astarra/Trio funds have highlighted the risk to superannuation investors, who typically invest for the long term. As such, they are often inclined to take greater risks and any fraudulent activity can take a long time to emerge because of the mandated age limit on redemptions."[61]

Clearly, there is skepticism as to whether FOFA is the right response to Australia's crisis – or whether ASIC should focus on improving its enforcement of existing securities laws or on reforming areas of structural weakness in Australia's system. We understand the enormous

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[57] Tony D'Aloisio, "Responding to the global financial crisis: the ASIC story" *Australian Securities and Investments Commission* (November 30, 2010), online: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/speech-responding-global-crisis-nov-2011.pdf/$file/speech-responding-global-crisis-nov-2011.pdf.
[58] Mike Taylor, "Can the regulators prevent another Storm Financial?," *Money Management* (April 26, 2012), online: http://www.moneymanagement.com.au/opinion/news-in-focus/can-the-regulators-prevent-another-storm-financial.
[59] *Corporations Act 2001* (Cth), s. 945A(1).
[60] Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into financial products and services in Australia (November 2009), online: http://www.aph.gov.au/binaries/senate/committee/corporations_ctte/fps/report/report.pdf, at p. 27.
[61] Thomson Reuters, *Special Report - ASIC: The outlook for enforcement 2012-13*, online: http://accelus.thomsonreuters.com/content/asic-outlook-enforcement-2012-13.

pressure regulators face to deliver wholesale new initiatives after major crises, but as Australia demonstrates, a populist response is not always the best response. We ask that the CSA carefully consider whether emulating Australia's response, particularly in light of its attendant disruptive effects discussed below, is really in the best interests of Canadians.

(b) FOFA's effects

In terms of the disruption that FOFA is likely to cause, the Dissenting Report from the JPC predicted that 25,000 jobs would be lost, and FOFA would cost $700 million to implement and $350 million annually to maintain.[62] The Dissenting Report found that FOFA would: impose high additional costs on industry participants, resulting in increased costs of advice for consumers; reduce employment levels in the financial services sector; reduce availability and access to affordable high quality advice; and cause a further concentration of advice providers which would lead to an undesirable reduction in competition and choice for consumers. It warned that advice could become a service for the wealthy, with working families and lower- to middle-income Australians who truly need advice being priced out of the marketplace.[63]

Regarding the content of FOFA's best interest duty, the ASIC has included, in the interests of making the standard more workable in the marketplace, a statutory "reasonable steps" safe harbour provision that purports to clarify that the advisor does not need to provide perfect advice and does not need to canvass the whole universe of products. Interestingly, the content of the safe harbour is largely composed of Australia's existing suitability obligations, simply transplanted into FOFA. And while the safe harbour seems to be well intended, it is undermined by the "catch all" requirement in subsection 961B(2)(g) which provides that an advisor must take "any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances."

This ambiguity is almost certain to lead to disputes and litigation. Consequently, the safe harbour does little to quash uncertainty. Indeed, recent cases on the fiduciary duties of advisors under Australian common law suggest that FOFA's best interest duty will be more open-ended and uncertain than common law jurisprudence. The CSA should note how good faith attempts to accommodate business realities can generate such confusion.

Finally, like the U.K.'s FSA, Australia's ASIC is a regulator of both the securities and insurance sectors. Therefore, the FOFA reforms, whether or not they are Australia's best course of action, will at least be applied equally across sectors. This is a key distinction that puts ASIC on different footing from Canadian securities and insurance regulators.

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[62] Senate Committee on Corporations Amendment (Future of Financial Advice), *Dissenting Report by Coalition members of the Committee* (February 29, 2012), online: http://www.aph.gov.au/Parliamentary_Business/ Committees/Senate_Committees?url=corporations_ctte/completed_inquiries/2010-13/ future_fin_advice/d01.htm (the "Dissenting Report").
[63] *Ibid.*

iii. United States

The Consultation Paper notes that the SEC is considering whether to implement a form of statutory fiduciary duty on financial advisors in the United States. However, once again, a review of the facts demonstrates that the context behind the initiative is very different from the Canadian experience.

(a) <u>A bifurcated retail channel</u>

In the United States, there are two distinct categories of market intermediaries in the retail investment channel. The first category is *broker-dealers*, who are licensed to sell securities, are typically paid a commission on each transaction and are not licensed to provide advice. Currently, broker-dealers are subject to the suitability standard: they must have a reasonable basis for believing that the product sold is suitable, based on the facts of the customer's situation.

The second category is *registered investment advisers* ("RIAs"), who are able to provide investment and product advice and are usually paid a fee for their advisory services. RIAs are subject to a fiduciary duty of care: they are required to act in their client's best interests at all times. As fiduciaries, RIAs are required to disclose much more to clients relative to broker-dealers, including information about fees and past disciplinary actions.

This bifurcated situation arises from an historical patchwork of regulation, some of which dates back nearly 80 years. Until the 1980s, the dividing line between broker-dealers and RIAs was reasonably easy to discern. However, trends in the financial services market since the early 1990s have blurred that line and the parties' positions have begun trending towards convergence. Firms are continuously creating and bundling diverse products and services in response to market opportunities and regulatory strictures. There has been a significant rise in the number of brokers who hold themselves out as financial advisors, offer financial planning services, and use two-tiered pricing arrangements and fee-based compensation structures which were previously more common to the RIA industry.[64]

This blurring of distinctions between the two types of intermediary raises difficult questions regarding the application to broker-dealers of the *Investment Advisers Act of 1940*, as promulgated by the U.S. Congress over seven decades ago.[65] Accordingly, several times in the last two decades, the SEC has attempted to clarify the boundary between RIAs and broker-dealers, most prominently with a 1999 proposed rule which, by 2005, had evolved into rule 202(a)(11)-1, *Certain Broker-Dealers Deemed Not to Be Investment Advisers*.[66] This rule, in turn, was challenged and eventually overturned. This is where the matter of harmonizing the standards rested, until the recent and halting efforts made pursuant to *the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010*[67] ("*Dodd-Frank*") to study and possibly implement a uniform fiduciary standard.

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[64] Arthur B. Laby, *Reforming the Regulation of Broker-Dealers and Investment Advisers*, 65 Bus. Law. 395, 403 (2010), pp. 404 - 407.
[65] Angela A. Hung et al., "Technical Report: Investor and Industry Perspectives on Investment Advisers and Broker-Dealers" *RAND Institute for Civil Justice* (2008), online: http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf.
[66] SEC 17 CFR Part 275, online: http://www.sec.gov/rules/final/34-51523.pdf.
[67] H.R. 4173, 111th Cong. (2010).

It must be noted that this issue of bifurcation and consumer confusion regarding which standard of care applies to them is not relevant in Canada. In our mass-market retail channel (i.e., beyond limited niche categories that are relevant only to high net worth investors), using a principled approach, financial advisors can be deemed fiduciaries if the requisite vulnerability, trust and reliance are in place. We do not have separate categories of advisors that provide consumers with different standards of care from the outset.

(b) <u>The SEC Study lacks an evidentiary basis</u>

On January 21, 2011, the SEC delivered to Congress its *Study on Investment Advisers and Broker-Dealers*[68] prepared pursuant to Section 913 of *Dodd-Frank*. It was, not surprisingly, the starting point for a wider public debate. Two SEC Commissioners jointly published a statement criticizing the SEC Study's analytical shortcomings, pointing to in particular a lack of evidence of investor harm caused by the current regulatory regime, and the failure to undertake a reasonable cost-benefit analysis relating to implementation of the proposed standard.[69]

They noted that a basic premise behind the recommendation to impose a uniform fiduciary duty is a concern that investors are confused about the differences between broker-dealers and RIAs and the duties owed by each – but there is no evidence adduced by the SEC that such confusion causes harm, or that the SEC Study's own recommendations will resolve or eliminate investor confusion. Rather, the Commissioners argue, they may in fact create new sources of confusion. Further, the SEC Study does not identify whether retail investors are systematically being harmed or disadvantaged under one regulatory regime as compared to the other and, therefore, it lacks a basis to reasonably conclude that harmonization based on expanding the RIA standard to broker-dealers would enhance investor protection.[70]

It is worth noting the intention of *Dodd-Frank* was to empower the SEC to draft a *new* standard of conduct that would account for the distinctions in the business models and the services provided by various financial professionals, rather than simply extending the existing fiduciary responsibilities of RIAs onto broker-dealers. Congressman Barney Frank, one of the namesakes behind *Dodd-Frank*, explicitly stated so in a letter to the SEC, adding that "if Congress had intended the SEC to simply copy the '40 Act and apply it to broker-dealers, it would have simply repealed the broker-dealer exemption – an approach Congress considered but rejected."[71]

(c) <u>Implications of the SEC's fiduciary duty</u>

According to commentators, the SEC's proposed fiduciary duty could end up harming investor protection. Broker-dealers currently adhere to rigorous and strictly-enforced standards of care, and are subject to an elaborate oversight system to ensure that they follow both the spirit and the letter of the suitability standard. Typically, broker-dealer firms are audited by either the SEC

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[68] *Supra,* note 39.
[69] Commissioners Kathleen L. Casey and Troy A. Paredes, *Statement by SEC Commissioners: Statement Regarding Study On Investment Advisers And Broker-Dealers* (January 21, 2012), online: http://www.sec.gov/news/speech/2011/ spch012211klctap.htm.
[70] *Ibid.*
[71] Barney Frank, Letter to Mary Schapiro (May 31, 2011), online: http://media.advisorone.com/advisorone /files/ckeditor/Barney%20Frank%20Letter.pdf.

or FINRA, the Financial Industry Regulatory Authority, once every two years, and most individual states provide another layer of scrutiny. By comparison, RIAs are regulated by either the SEC or their home state, but not both.[72] Moving to the RIA standard could reduce accountability and oversight.

Notably, the SEC's proposed fiduciary duty, through the explicit direction of *Dodd-Frank*, does not include a ban on embedded compensation, although *Dodd-Frank* also states that the SEC can prohibit or restrict compensation schemes that the SEC deems contrary to the public interest and the protection of investors.[73] This is yet another example of the confusion caused when a statutory fiduciary duty is meshed with the pretense of preserving business models. As discussed above in Section E(iii), embedded compensation may ultimately be deemed incompatible with fiduciary duty, and it will be a long and costly process before the matter is settled.

Ultimately, *Dodd-Frank* represents a massive political response to a wide set of economic problems in the United States, and advisors are a convenient target that the public can understand. The true causes of the financial crisis, including synthetic CDOs, the robo-stamping of residential mortgages for people with negligible incomes and the failure of ratings agencies to issue proper evaluations, are not issues the voting public can understand *en masse* on a legal/regulatory level. The glacial progress of *Dodd-Frank* reforms demonstrates what happens when a populist approach dominates the regulatory agenda.

iv. Canada must chart its own path

Advocis urges the CSA not to import a statute-based fiduciary duty simply because of trends in foreign jurisdictions, each of which (i) faced unique challenges more severe than anything experienced in Canada; (ii) has its own legal and regulatory traditions to draw on; and (iii) has governments looking for regulatory responses based in part on political expediency.

As laid out above, millions of consumers in the U.K., Australia and the U.S. have suffered due to regulatory failures in the securities markets that have put enormous pressure on the FSA, ASIC and the SEC, respectively, to be seen as responding on a grand scale to their domestic challenges. A statutory fiduciary duty or a ban on embedded compensation may not be the correct solutions for those countries, especially given the enormous disruption these policies will have on consumers' ability to save and invest – but such initiatives are politically saleable.

Canada should not follow down the mistaken path of the U.K., Australia and the U.S. We have not had the massive mis-selling scandals, prominent firm failures or confusing bifurcated channels that plagued those nations. Indeed, in terms of the probity of its financial services, Canada is an international leader. Granted, like retail investors in all countries, some Canadians did suffer as a result of the financial crisis; but in our highest-profile collapse emerging from the crisis, the failure of the asset-backed commercial paper market, only about

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[72] Elizabeth Ody, "Whose Investment Advice Can You Trust?" *Kiplinger's* (December 2010), online: http://www.kiplinger.com/article/business/T008-C000-S002-whose-investment-advice-can-you-trust.html.
[73] *Dodd-Frank*, *supra* note 67 at para. 913(h)(2).

2,000 retail investors holding less than 1% of the total value were affected.[74] This pales in comparison to the massive and systemic problems suffered by consumers elsewhere.

Indeed, if one bases the need for a statutory fiduciary duty on recent regulatory failures and harm to retail investors, then one must conclude that Canada's regulatory environment has been exceptionally effective in averting the problems faced in the U.K, Australia and the U.S. Advocis, like the CSA, believes that scarce regulatory resources should not be spent in the pursuit of merely doing as other regulators have done, in the absence of a real and identified problem existing in Canada.

G. <u>Consumers Would Still Be Exposed</u>

A statutory fiduciary standard would increase costs significantly for advisors, with dubious benefits to the public. It would also harm consumer welfare, as financial advice would be less accessible to lower- and middle-income Canadians. But beyond this, a statutory fiduciary standard would fail to address the most serious gaps in the current regulatory framework. We believe that the following concerns represent a much larger risk to consumers and warrant the attention of the CSA:

i. Fraud and use of the title "financial advisor"

The biggest risk to the public comes from unscrupulous actors who have the intent of defrauding the public from the outset. Consider that in nearly every province, *anyone* can hold themselves out as a financial advisor, regardless of their training or licensing. The only existing prohibition on making such a representation applies when selling financial products. In our experience, we have consistently found that consumers and politicians alike are surprised to learn that the title of "financial advisor" is not indicative of any credentials.

This dangerous loophole was exploited by fraudsters such as Earl Jones and Bernie Madoff, both of whom represented themselves as financial advisors despite not being registered with securities authorities. These are two extreme examples, but they highlight the significant harm that consumers could suffer when they place their trust in a fraudster who is hiding behind an unregulated title. As such actors are blatantly uninterested in adhering to existing laws, creating a statutory fiduciary duty would do nothing to disrupt them.

ii. Advisor proficiency: the quality of advice

A statutory fiduciary duty would also do nothing to enhance the proficiency of financial advisors: it addresses the duty of the advisor when providing advice, but does not address the *quality* of that advice. Since the universe of financial products is complex, diverse, and constantly evolving, an advisor's ability to deliver quality advice (which is in the clients' best interests) is directly related to his or her commitment to continuing education ("CE").

The CSA states that fiduciaries "must ensure that they perform their services with the degree of care, diligence and skill that a reasonably prudent person would exercise in the

[74] Fraser Milner Casgrain LLP, *Court Approves Restructuring Plan for Failed Asset-Backed Commercial Paper* (June 17, 2008), online: http://www.fmc-law.com/upload/en/publications/2008/Dispute_ShaflerM_NaA_Court_Approves_Restructuring_Plan_Jun2008.pdf.

circumstances."[75] In our view, this is insufficient – advisors should be up-to-date in best practice methods and be experts on the products in the market. But current MFDA Rules speak only vaguely to CE, stating that it "should be provided".[76] IIROC takes a clearer stance regarding its expectations, but allows for the advisor's knowledge to become stale-dated over nearly three years.[77] We believe that it would be in the best interests of consumers if advisors were explicitly required to complete focused CE each and every year.

iii. Hopping between industry sectors

As discussed above, financial advisors help consumers develop comprehensive financial plans and recommend products to help achieve those plans. Along with securities instruments, these plans also often include insurance products, which are regulated by separate provincial authorities.

If an unscrupulous advisor is found guilty of misconduct while acting in the insurance sector (for example, by mis-selling an insurance product), the relevant insurance regulator is empowered to impose a variety of sanctions, including stripping the advisor's license. The same is true if the advisor is operating in the securities sector, in regards to the advisor's registration. However, a regulator's enforcement powers are generally limited to its respective sector, and there is no mechanism that allows for the quick and coordinated application of regulatory sanctions across sectors.

This sectoral approach leaves consumers exposed. While we appreciate that misconduct in the insurance sector is not within the purview of the CSA, the types of serious misconduct that warrant an advisor's outright expulsion from one sector, such as fraud or gross negligence, speak to that advisor's conduct and ethics and are not sector-specific concerns. For example, under the current fragmented framework, if an advisor is banned from selling segregated funds in the insurance sector, that advisor can simply switch to selling mutual funds. Advocis believes this type of "sector hopping" must be eliminated.

Also currently lacking is an easy mechanism for the public to verify their advisor's registration credentials and disciplinary history. Regulators maintain their own individual websites where the public can verify their advisor's registration, but the information is valid just for that sector. Generally, the public does not understand the product-centred approach to regulation and the need to verify their advisor's status with each *type* of regulator. In the example above, if the consumer had only reviewed the advisor's standing with the provincial securities regulator, he or she would not have become aware of the serious sanction in the insurance sector.

H. <u>A Better Solution: Professionalized Advice</u>

Advocis proposes a solution (the "Proposal") that we believe would address the CSA's most pressing investor protection concerns; it would also address the additional concerns identified in

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[75] (2012) 35 OSCB 9561.
[76] MFDA Policy No. 2, Part I states that, "[i]ntroductory training and continuing education should be provided for all registered salespersons."
[77] IIROC Dealer-Member Rule 2900, Part III states that, some time between three and five years after the IIROC approval, registered representatives must complete 12 hours of courses dealing with compliance matters and 30 hours of courses dealing with professional development matters, all in three year cycles. There are exceptions for longstanding registrants.

Section G, for which a statutory fiduciary duty would be ineffective. Simply, all persons who hold themselves out to the public as financial advisors, regardless of whether they sell particular financial products, would be required to maintain membership in a recognized professional association.

To be accredited, the professional association would be required to possess the following characteristics:

- a **code of conduct** and ethics requiring, *inter alia*, the prioritization of the client's best interests;
- a requirement that members maintain **errors and omissions insurance**;
- elevated minimum initial **proficiency standards**;
- **continuing education** requirements that address both substantive and professionalism matters;
- **best practices** guidance and information resources for members;
- a **complaints and disciplinary** process that empowers the association to suspend or terminate the advisor's membership; and
- a **public-facing database** whereby clients can conduct a "one-stop" check of their advisor's credentials and disciplinary history.

i. Benefits for consumers

The Proposal would enhance consumer protection across both the securities and insurance sectors by raising the professional bar for all financial advisors. In contrast to existing regulation, which is based on the sales and distribution of financial products, the Proposal focuses on the relationship between the advisor and the client by emphasizing proficiency, ethical standards and accountability. The following points highlight some of the key benefits to consumers:

1. ***Initial proficiency and continuing education.*** Consumers would be able to rely on the fact that, having gained membership in a recognized association, their advisor had satisfied rigorous proficiency standards regarding the advisor's training and education. Currently, while initial proficiency standards must be satisfied before an advisor can sell financial products, there is no proficiency requirement for fee-only planners who do not sell products. Advisors would also be required to complete, on a yearly basis, CE credits that address both professionalism and substantive topics, ensuring that clients benefit from the most up-to-date knowledge in an evolving market.

2. ***An enforceable code of conduct.*** Advisors would adhere to a mandatory code of professional conduct and ethics which explicitly codifies the advisors' duties to their clients. These include duties respecting the management of conflicts of interest, the duty to perform competently, honesty and with integrity and the duty to respect client confidentiality. The code would be backed up by an accessible enforcement mechanism for disciplining members for misconduct, with sanctions that could include expulsion from the association. As membership in an association would be mandatory for remaining in the industry, advisors would be inclined to take the code of conduct very seriously.

3. ***Accountability across sectors.*** An association's disciplinary action would have consequences for a member's ability to sell financial products as a provincial licensee or registrant. If a member of the association is expelled, that individual would be prevented from selling financial products. As well, if any regulator revoked or imposed conditions on a member's ability to sell financial products, that member's association would take appropriate action to suspend, revoke or impose conditions on his or her membership. Such measures would further buttress the actions of the particular regulator by imposing conditions on selling products or providing advice.

4. ***One-stop source for public inquiries.*** Professional associations would be required to make information about their members conveniently accessible in a single public database. This would enable the public to easily determine if an individual is a member of a professional association and review his or her credentials.

As noted above, a regulatory requirement that advisors must be in good standing with a professional association would prevent unscrupulous individuals from simply moving to a different financial sector and seeking licensing or registration.

The resulting regulatory umbrella created by professional associations would close current gaps in the enforcement and disciplinary reach of regulators, by ensuring that individuals who violate industry requirements in any one sector would not be permitted to continue activity in the industry without proper review.

ii. Benefits for other stakeholders

Other stakeholders would also benefit tremendously from the Proposal.

1. ***Financial advisors*** would benefit from enhanced public trust, status and confidence in advisors as true professionals; access to "best practices" resources that complement and facilitate compliance with regulatory requirements; and a raised professional bar, through improved education and proficiency standards and the ready removal of unethical colleagues who tarnish the industry as a whole.

2. ***Governments and regulators*** would benefit from the delivery of enhanced consumer protection and the "reining in" of unethical advisors who move from sector to sector; professional support for the policy objective of increasing private financial independence and financial literacy; a reduced regulatory burden through the complementary, proactive work of various professional associations; and the expertise of professional associations which will contribute to the development of policy and implementation of effective regulation.

3. ***Product providers and distributors*** would benefit from the reliable professionalism of financial advisors representing their firms and products; the prevention of unethical advisors moving from one company to the next; and the development of a stronger platform to support the recruitment of new advisors into the industry through enhanced professional standing.

We have enclosed, as Appendix "A", a document that provides information regarding our Proposal in greater detail. This document is, as of the date of this submission, also available on our website, at http://www.advocis.ca.

I. <u>Conclusions</u>

The idea of implementing a statutory fiduciary duty is not a new one: the Consultation Paper notes that the issue has been studied for years, dating back to at least 2004 with the publishing of the Fair Dealing Model by the Ontario Securities Commission.[78] As it has done in the past, we strongly recommend that at the conclusion of this consultation, the CSA should declare that *implementing a statutory fiduciary duty is <u>not</u> in the best interests of either consumers or advisors*. Therefore, the CSA should not proceed with this initiative.

In this submission, we have demonstrated the severe deleterious effects that a statutory fiduciary duty would inflict on the marketplace: it would increase costs by inviting nuisance litigation and by creating tremendous additional overhead in the form of compliance obligations. It would put the business model that is wilfully *chosen* by the majority of Canadians, the embedded compensation model, at risk. It would put securities advisors on different footing from their insurance counterparts, and would cause considerable confusion amongst clients who work with dual-licensed advisors to put together a comprehensive financial plan that draws on both industry sectors.

It would also present an incredible, if not impossible, challenge for regulators to codify into statute the elements of a fiduciary duty. This issue is complex and contentious, with disagreement even amongst an expert panel assembled to discuss the topic:

> "There appeared to be a lack of consensus on many of the important issues surrounding the possible imposition of a fiduciary duty. For example, the panellists did not agree on what a fiduciary duty encompasses, when it should apply and whether the current regulatory regime for advisers and dealers is functionally equivalent to such a standard, in any event. Regardless, most of the experts agreed that if a fiduciary duty is imposed, it is important to clearly address the expectations around the standard of conduct expected of advisers and dealers in providing advice."[79]

This daunting challenge is evident throughout the Consultation Paper. We demonstrated how the CSA's attempt to refine the duty to apply only to retail clients is sensible at a conceptual level, but there are critical logistical challenges when boiling down that concept into text. Similar problems would apply to the various carve-outs that the CSA proposes could be included in a statutory articulation to accommodate various business models. As an example, we pointed to the perversion of holding advisors to a fiduciary standard, the highest standard of care in law, even when they are not permitted to exercise their skill or judgment. These ambiguities would only exacerbate the expectation gap that the CSA is attempting to address, leading to years of costly litigation as parties attempt to understand their rights and obligations under a new framework.

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[78] (2012) 35 OSCB 9559.
[79] Megan Harman, "Opinions divided over whether fiduciary standard should apply to Canadian advisors" *Investment Executive* (March 28, 2010), online: http://www.investmentexecutive.com/-/news-52967.

Ultimately, a statutory fiduciary duty would cause many advisors to leave the industry, and those that remain would gravitate to the high net worth segment of the market. Independent advisors in smaller communities would be disproportionately hit, and lower- and middle-income Canadians would struggle to access advice. Given the significant benefits of advice to consumers across the wealth spectrum, this unfortunate result would harm the welfare of millions of consumers and leave them less financially prepared for life's events. The loss of advice would also demonstrably harm Canadians' financial literacy, as advisors are the best and primary source of financial information for millions of consumers.

While other jurisdictions may be considering their own statutory fiduciary duty, we have demonstrated why it would be a mistake for Canada to import their initiatives into our domestic sphere. The U.K., Australia and the U.S. each have their own unique systemic problems that are not applicable to Canada. For better or for worse, their regulators have reacted to enormous political pressure, and their solutions will cause significant disruption in their markets. To follow these jurisdictions down the road of a statutory fiduciary duty would be to suffer their side effects when we do not have their underlying maladies.

All of this is not to say that Canada's system is perfect. There are serious problems involving fraudulent misrepresentation, forum hopping and the questionable proficiency of certain purported advisors. However, none of these problems would be solved by a statutory fiduciary duty. Instead, we attach our proposal, based on raising the professionalism of all advisors in the industry, as a better solution that would serve consumers, advisors, regulators and product distributors. We believe that our proposal, with its focus on the *relationship* between the advisor and client, is the best way to achieve our mutual objective of protecting consumers and bolstering confidence in the marketplace.

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Advocis appreciates this opportunity to provide our comments and we look forward to working with the CSA. Should you have any questions, please do not hesitate to contact the undersigned, or contact Ed Skwarek, Vice President, Regulatory and Public Affairs at 416-342-9837 or via email at eskwarek@advocis.ca.

Sincerely,

Greg Pollock, M.Ed., LL.M., C.Dir., CFP
President and CEO

Harley Lockhart, CLU, CH.F.C.
Chair, National Board of Directors

APPENDIX "A"

ADVOCIS' PROPOSAL TO
ENHANCE THE PROFESSIONALISM OF FINANCIAL ADVISORS

Please see attached.

Raising The Professional Bar

Greater Consumer Protection Through Higher Professional Standards.

A New Way Forward

Advocis®
The Financial Advisors Association of Canada

Table of Contents

Introduction and Executive Summary

Millions of Canadians rely upon financial advisors to provide them with financial planning and investment advice, including access to financial products and services to help achieve those plans. Given the advisor's central role in securing their financial futures, Canadians should be able to trust that their advisor satisfies high industry-wide standards of professionalism, proficiency and accountability. Unfortunately, this is not always the case: currently, in nearly every province, anyone can hold themselves out as a financial advisor, regardless of training or licensing, and standards for important consumer safeguards such as continuing education or errors and omissions insurance vary widely by province and sector. The current system leaves consumers exposed.

Advocis believes the current situation can be greatly improved with a straightforward new requirement: all persons who hold themselves out to the public as financial advisors, regardless of whether they sell particular financial products, should be required to maintain membership in a recognized professional association.

This requirement will significantly enhance consumer protection by raising the professional bar for all financial advisors. Advisors will be required to comply with the association's high proficiency and conduct standards that are enforced with an effective complaints and disciplinary process. Consumers will be able to easily verify their advisor's credentials and disciplinary history across industry sectors. Advisors themselves will benefit from enhanced public trust, status and confidence in them as true professionals, while seeing unethical colleagues who tarnish the industry removed in an efficient manner. Product providers will enjoy enhanced professionalism from the individuals who represent their firms to the public and a stronger platform from which to recruit new advisors.

This proposal is designed to complement the existing regulatory framework, which is largely focused on the sales of specific insurance and securities products. Rather than duplicate the efforts of existing regulators, the proposal fills in critical regulatory gaps that arise from this product focus and better reflects the comprehensive approach to financial planning and investment advice that most Canadians receive. The proposal can only be implemented with the cooperation of provincial governments, through legislative or regulatory action that makes membership mandatory and accredits those associations that have the ability to deliver the proposal's benefits.

Given the tremendous gains to regulators, advisors, product providers, and most importantly, consumers, it is time to raise the professional bar by requiring that all financial advisors be members of a professional association and abide by high industry-wide standards of proficiency and conduct.

Problems with the Current Regulatory Framework

Financial advisors play a critically important role for millions of Canadians. Through the provision of financial planning and investment advice, retirement and estate planning, disability coverage, long-term care and critical illness insurance, advisors help the public prepare for life's events and secure their financial futures. This is ever more important in an economic climate where governments, facing their own fiscal challenges, are expecting Canadians to be increasingly self-reliant.

Given their critical role, Canadians should be able to trust that financial advisors are proficient, up-to-date in their knowledge and in compliance with the highest standards of conduct and ethics. While this aptly describes the majority of advisors, there are inevitably some who do not meet these standards, and due to gaps in the current regulatory framework, consumers are exposed.

Problem #1: Anyone can call themselves a financial advisor, which means consumers face significant – and unnecessary – risk exposure.

Anyone, regardless of their training, experience or education, can hold themselves out to the public as a financial advisor – which means that anyone can provide the public with what is purported to be "financial advice", even with little or no financial acumen. This regulatory gap is exploited by fraudsters such as Earl Jones, who represented himself as a financial advisor despite not being registered with securities authorities. This is an extreme example, but it highlights the significant harm consumers could suffer when they place their trust in a title that they believe is regulated, but which does not actually guarantee any expertise.

Problem #2: Existing regulation is focused on the sales of products, not the ongoing relationship of trust between financial advisors and their clients.

Financial advisors help clients develop comprehensive financial plans and provide advice on investments that can help achieve those plans. This is often a multi-year relationship built on the client's trust in the advisor's expertise. Advocis believes that all professionals in such positions of trust should subscribe to a code of conduct and ethics that establishes an overriding duty to their clients. They should also maintain errors and omissions insurance to protect clients in the event that the advisor fails to live up to that code.

But rather than focusing on this important relationship, existing regulation is based on the sales and distribution of financial products, and is further fragmented based on the type of product, whether it be life insurance, mutual funds or other securities. There is no industry-wide requirement that advisors subscribe to codes of conduct or maintain responsible levels of errors and omissions insurance. The result of this is that, depending on the type of product purchased, consumers could be receiving substandard levels of protection. Advocis believes that consumers should enjoy high degrees of protection governing their entire advisory relationship, and this should not vary with the type of financial product that is needed to fulfill the consumer's financial plan.

Problem #3: There is no firm and clear requirement for advisors to keep their knowledge current.

Before obtaining their license to sell life insurance, mutual funds or other securities, financial advisors must demonstrate their initial proficiency in the product. Life insurance advisors are required to meet provincial licensing standards and to pass the Life License Qualification Program. The Mutual Fund Dealers Association of Canada (MFDA) designates as Approved Persons those individuals who meet the MFDA's registration standards and pass a designated mutual funds licensing exam. The Investment Industry Regulatory Organization of Canada (IIROC) designates as Registered Representatives those individuals who meet IIROC's registration standards and pass the Canadian Securities Course.

While these measures ensure the advisor's understanding of the product at the time of licensing, the industry is constantly evolving and static knowledge quickly becomes obsolete. But under the current framework, regulators' requirements for continuing education (CE) vary by product sector and even by province. In the life insurance sector, some provinces require advisors to complete several CE credit hours each year, some permit holders of educational designations to satisfy reduced requirements, and other provinces have no CE requirements whatsoever. For mutual funds, MFDA Rules speak only vaguely to CE, stating that it "should be provided". IIROC takes a clearer stance and specifies its expectation that advisors complete CE on both compliance and professional development matters.

Advocis believes that, regardless of product sector or province, advisors should be required to complete CE to maintain their license in good standing. Current regulations could allow advisors to become seriously deficient in their knowledge, posing a risk to consumers.

Problem #4: There is no effective, industry-wide disciplinary process.

Individual insurance or securities regulators are empowered to impose a variety of sanctions on advisors found guilty of misconduct, including stripping those advisors of their license or registration. However, a regulator's enforcement powers are limited to its respective sector – which does not reflect the business reality that the majority of advisors operate across sectors, and in assembling a client's financial plan, the advisor will likely recommend a combination of products that span those sectors.

This sectoral approach leaves consumers exposed. The types of serious misconduct that warrants an advisor's outright expulsion from one sector, such as fraud or gross negligence, speak to that advisor's conduct and ethics and are not sector-specific concerns. But currently, if an advisor is expelled from the mutual fund sector, for example, that advisor can continue to sell segregated funds in the insurance sector. Advocis believes this type of "sector hopping" must be eliminated.

Also currently lacking is an easy mechanism for the public to verify their advisor's registration credentials. Regulators maintain their own individual websites where the public can verify their advisor's registration, but the information is valid just for that sector. Generally, the public does not understand the product-centred approach to regulation and the need to verify their advisor's status with each individual regulator. In the example above, if the advisor's client had only reviewed the advisor's standing with the provincial insurance regulator, the client would not have become aware of the serious sanction in the mutual funds sector.

The Solution: Require that Financial Advisors belong to an Accredited Professional Association.

Fortunately, the solution to the problems identified above is simple, straightforward, and does not require significant government action or resources: anyone using the professional title of "financial advisor" should be required to maintain ongoing membership in an accredited professional association.

To be accredited, the professional association would be required to have the following characteristics:

- a code of conduct and ethics requiring, inter alia, the prioritization of the client's best interests;
- a requirement that members maintain errors and omissions insurance;
- elevated minimum initial proficiency standards, including addressing the proficiency standards of fee-only planners who do not sell financial products;
- continuing education requirements that address both substantive and professionalism matters;
- a best practices manual or practice handbook and information resources for members;
- a governance structure that includes representation from both financial advisors and the public;
- a complaints and disciplinary process that empowers the association to suspend or cancel the advisor's membership; and
- a public-facing database whereby clients can conduct a "one-stop" check of their advisor's credentials and disciplinary history.

Today, many financial advisors voluntarily choose to belong to professional associations such as Advocis that feature many of the characteristics listed above. These associations help advisors maintain high professional standards in serving their clients. This proposal seeks to codify that commitment to professionalism to encompass all advisors, and builds on the current sales-focused regulatory framework.

In essence, the proposed solution emphasizes proficiency, ethical standards, and accountability in the client–advisor relationship.

Membership in a professional association would mean that sellers of financial products and services put the interests of consumers first and provide them with proficient professional service. In particular, consumers would benefit through:

- the ability to review the credentials and disciplinary history across product sectors of a prospective financial advisor in an easily-accessible format;
- greater assurance that the financial advisor they select will meet a consistently high level of professionalism and accountability;
- greater protection from unqualified and unethical financial advisors, due to both higher licensing standards and the presence of errors and omissions insurance; and
- a responsive and robust complaints and disciplinary process that can remove unscrupulous actors from the industry and prevent further harm.

Regulating usage of "financial advisor" is timely, appropriate and necessary

Financial advisors are one of the last groups of specialized practitioners whose professional title is not regulated by law. While other professions such as medicine, law and engineering have had their professional titles regulated for over a century or more, in recent years many other areas of professionalized activity have become similarly regulated. For example, in Ontario, the title of Social Worker is restricted to registrants of the Ontario College of Social Workers and Social Service Workers, and in Alberta, the Alberta Boilers Safety Association, and the Petroleum Tank Management Association of Alberta is restricted to registrants of these associations.

With so many people struggling to meet their retirement goals, with new families starting out without proper financial planning in place, and with government policies increasingly shifting the responsibility for Canadians' future financial needs onto individuals, now is the time to regulate the use of the professional title of "financial advisor."

II. Understanding The Professional Membership Association

This paper now turns to a more detailed look at the characteristics of proposed professional associations. (For an overview of the current regulatory framework, its shortcomings, and the virtues of the proposed professional association model, please see Appendix A, attached hereto.)

a. Who will belong?

Subject to several narrow and easily identifiable exceptions listed below, everyone who sells financial products to consumers, and everyone who offers financial advice and planning to the public, should be required to maintain membership in a recognized professional association. This would include:

- individuals who are licensed to deal with the public with regard to life and health insurance under insurance legislation;
- individuals who are registered by a securities regulator in any advisor category under National Instrument 31-103 and are licensed to sell or provide advice to the public with respect to financial products;
- individuals who hold themselves out by titles or claimed credentials that suggest financial advice-giving expertise, such as "financial advisor," "investment advisor," "wealth planner," "wealth advisor," "financial planner," "estate planner," and "retirement planner" or such other titles as may be designated by regulation, regardless of whether they are required to be licensed or registered to sell or provide advice regarding financial products; and
- individuals who hold themselves out as pensions or group benefits consultants who are not otherwise captured by the criteria above.

b. Who will be excluded?

It is important to note that the professional association requirement will not capture these clearly identifiable classes of financial services practitioners whose activities may be characterized as a form of "financial advice," such as:

- mortgage brokers and real estate agents;
- bank tellers who offer advice about deposit products;
- licensed accountants (CAs, CGAs, and CMAs) who provide financial advice ancillary to their provision of accounting and tax advice; and
- lawyers who offer financial and tax advice ancillary to providing legal advice.

c. Membership in a professional association as a condition of continued licensing

Individuals who hold themselves out as financial advisors would be required to belong to a professional association. Proof of membership would be a condition of the individual's registration or licensing (including license renewals) in the securities or insurance sectors. If an individual ceases to be a member of a professional association, his or her licensing or registration would also contemporaneously be in abeyance.

d. Regulators will designate associations

The relevant regulator would publicly designate as an approved professional association any membership association which it recognizes as fulfilling the necessary criteria (as described in Section 1 of this document). This would require regulators to draft the conditions of recognition necessary for accreditation as an approved professional association, to identify existing organizations as plausible candidates for recognition, and to invite candidate organizations to apply for recognition.

To be successful in their application for accreditation, candidate associations would have to agree to the following conditions:

- a commitment to meet specific criteria, which could include guidelines for the management and governance of all aspects of the operation of the association;
- execution of a memorandum of understanding with the regulatory body whereby the candidate association agrees to meet the aforementioned criteria while maintaining its accreditation;
- a commitment to pay for periodic audits, commencing with an audit within 12 to 18 months following recognition; and
- an acknowledgment that the regulatory body may revoke recognition of the candidate association.

It is likely that more than one association would be recognized by the regulator at the outset of implementing the proposed professional association model. Recognized associations would register financial advisors as members while building the systems and infrastructure required to meet their commitments to the regulator. If a professional association was found to have failed to meet its obligations and is unable to correct such deficiencies within a reasonable period, its recognition could be terminated. At that point, the defunct organization's members would be required to transfer to another professional association, and be directed to meet the new association's registration requirements within a specified period of time.

e. Proficiency standards for all financial advisors

All recognized professional associations would publish their proficiency standards. All financial advisors would be required to file an annual Certificate of Professional Standing issued by their association, as a condition of ongoing licensing or registration in the industry. In addition, all financial advisors would be required to meet a proficiency standard that encompasses the knowledge and competencies that their recognized professional association considers to be appropriate.

Initial proficiency standards for membership would be premised on the assumption that everyone who is licensed or registered to sell financial products meets the initial requirements for membership in a recognized professional association. However, all members would be required to fulfill ongoing continuing education requirements, which would have a structured component.

Accordingly, all recognized professional associations would accept, for the purposes of admitting individuals to membership, certain approved evidence of initial proficiency. For individuals who are life agents or securities representatives, sufficient evidence would lie in the fact that they currently meet the respective licensing or registration requirements for life agents or securities representatives. In the case of the individual who is a fee-only financial planner and receives no compensation directly or indirectly from the sale of financial products, the evidence of initial proficiency would lie in the fact that he or she currently holds a recognized financial planning designation. However, associations could, upon application, designate an individual as proficient, based on relevant education and industry experience.

The following designations would be granted initial proficiency recognition, provided that the fee-only advisor is in good standing with one of the designation-granting bodies:

- Certified Financial Planner™ (CFP™), sponsored by the Financial Planning Standards Council;
- Personal Financial Planner (PFP™), offered by Canadian Securities Institute;
- Certificate in Financial Planning (Planificateur financier [Pl. fin.] designation), sponsored by the Institut québécois de planification financière (IQPF);
- Registered Financial Planner (R.F.P.), sponsored by the Institute of Advanced Financial Planners;
- Chartered Financial Consultant (CHFC), sponsored by Advocis, the Financial Advisors Association of Canada;
- Certified Health Insurance Specialist (CHS™), sponsored by Advocis, the Financial Advisors Association of Canada;
- Chartered Life Underwriter (CLU®), sponsored by Advocis, the Financial Advisors Association of Canada; and
- Chartered Financial Analyst (CFA), sponsored by the CFA Institute.

Under the proposed model, all financial advisors who hold themselves out as financial planners would be required to hold in good standing one of the above-noted financial planning designations.

f. Continuing education requirements

All financial advisors would be subject to ongoing continuing education requirements. These would include course requirements established by professional associations in consultation with industry regulators and firms. Individuals would be given credit by their association for mandatory continuing education taken in compliance with the requirements of regulators, but could be subject to additional requirements set by their professional association of choice. For example, all financial advisors could be required by their association to take courses on professional ethics and their association's code of conduct within a specified time after becoming members.

The main features of the proposed membership model with regard to continuing education include:

- all financial advisors would be required to fulfill competency-based continuing education requirements established by their association;
- professional associations would complement the proficiency standards and continuing education requirements of regulators and coordinate their continuing education programs with the requirements of regulators;
- professional associations would be required to credit their members for all continuing education completed in compliance with the requirements of a securities or insurance regulator or licensing body;
- professional associations would develop systems that facilitate the tracking of continuing education course requirements and course completions, with such systems being readily accessible to members and regulators; and
- professional associations would require all members to take continuing education courses related to professional ethics and to the association's professional standards and code of conduct, within a prescribed period of time after an individual becomes a member of the association.

g. A code of professional conduct

All financial advisors would be required to subscribe to their professional association's code of professional conduct, and abide by their association's rules of professional conduct in all of their dealings with third parties (i.e., the application of the code and rules would not be limited to the financial advisor-client relationship). Any code of professional conduct would of necessity establish and explicate:

- the priority of the client's interest;
- issues of misconduct (including criminal convictions and regulatory infractions);
- the duties surrounding conflicts of interest;
- the duty to provide competent service;
- the duty to act with honesty and integrity;
- the duty to preserve and protect client confidentiality; and
- the duty to cooperate with the association and regulators.

h. An errors and omissions insurance requirement

All financial advisors, and their corporations and/or agencies, would be required to carry professional liability insurance relating to the activities they ordinarily engage in as financial advisors.

i. A public registry of financial advisors

Professional associations would participate in a public registry of financial advisors which would be accessible on the Internet and through other appropriate modes of public inquiry. The public registry would enable any member of the public to conveniently access information about an individual’s qualifications and registration/licensing status and professional conduct as a financial advisor.

j. A best practices manual and information resources for members

Professional associations would be required to compile and make available online a best practices manual/practice handbook. They would also be required to prepare and circulate information materials, such as online and e-mail bulletins concerning regulatory requirements and developments, and membership disciplinary proceedings.

For reasons of Canadian constitutional law, the proposal for financial advisors to belong to a professional association would need to be implemented at the provincial level. Securities and insurance regulators would require individuals who are licensed to sell financial products, or who otherwise hold themselves out to the public as financial advisors, to belong to an association. Fee-only financial planners who do not sell financial products and are outside the scope of securities and insurance legislation would still be required to be members of an association.

a. Models of self-governance: self-regulatory organization vs. delegated administrative authority

The professional association must be recognized as an official regulatory body of financial advisors by provincial governments. This recognition can be accomplished in two primary ways: (i) as a full-fledged self-regulatory organization; or (ii) as a delegated administrative authority.

(i) self-regulatory organization

The self-regulatory organization model is the traditional approach to professional self-regulation. Examples of organizations constituted under this model include the Law Society of Upper Canada, the College of Physicians and Surgeons of Ontario, the Mutual Fund Dealers Association of Canada and the Investment Industry Regulatory Organization of Canada.

Regulatory power is vested in these organizations through provincial legislation (such as the Law Society Act) or official recognition by a government agency (such as a CSA recognition order of the MFDA). Obtaining this recognition is relatively challenging; the vetting process is rigorous, the standards to be met are high and the process can take several years.

Once approved, though, this model grants the organization a relatively large degree of autonomy – the organization is empowered to make rules governing a wide array of matters (including newly emerging areas) without having to go back to the province for approval. They are not subject to continuous government oversight; they are largely trusted to govern their own affairs, with only occasional reporting to, and reviews by, the government. To maintain the public's confidence as being a true professional regulator, they generally do not engage in any public-facing advocacy efforts that promote the profession or the organization's members.

(ii) delegated administrative authority

The delegated administrative authority (DAA) model is a relatively new way of obtaining recognition as a professional regulator. DAAs are not-for-profit corporations that assume the day-to-day operational responsibility for licensing, education, complaints handling, inspection and enforcement matters as described in government legislation. DAAs reduce the government's footprint: the association's employees are not public servants and they are self-financing, largely through fees paid by the association's members. This model has gained acceptance in several provinces: notable examples include Ontario's Travel Industry Council, Alberta's Boilers Safety Association, and the British Columbia Safety Authority.

While the process of obtaining DAA recognition is less cumbersome than obtaining recognition as a self-regulatory organization, the powers granted to the DAA are more limited in scope. The province retains overall accountability and control of relevant enabling legislation; it monitors and remains accountable for the overall performance of each authority. DAAs have certain reporting obligations to the government, such as annual reports and audited financial statements, and they can be subject to operational reviews.

b. What organizations are likely to qualify for accreditation as a professional association?

The answer will largely depend on the accreditation standards that are set by the regulator. Also relevant will be the estimate, on the part of potential applicant organizations for accreditation, of the potential benefits and costs of meeting the accreditation standards and of operating as a professional association.

The requirement as outlined is not premised on onerous accreditation standards. It should be assumed that the standards would not be so burdensome that they would not be satisfied by a number of existing organizations, including associations that currently provide professional resources to financial advisors.

c. Requiring membership in a professional association in the securities sector

Most Securities Acts across the country allow that province's securities commission to prescribe rules, including criteria that an applicant must satisfy prior to registration: see, for example, sections 143 (1) and (2) of the Securities Act (Ontario) or 223 and 224 of the Securities Act (Alberta). Using this discretion, securities commissions could make membership in an association one of these criteria. Alternatively, National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations could be amended to require membership in an association as a condition of registration.

d. Requiring membership in a professional association in the insurance sector

Most Insurance Acts across the country do not provide the province's Superintendent of Insurance with the explicit authority to prescribe licensing conditions. However, most of these acts do provide broad latitude for the Superintendent to set the standards for determining whether a candidate is "suitable" for licensing.

Using this broad latitude, the Superintendent could deem that membership in a professional association speaks to the candidate's suitability to obtain and maintain an insurance license in the province. In provinces where the Superintendent is not granted this discretion regarding suitability, the province's Insurance Act could be amended to either give the Superintendent such discretion, or the membership requirement could directly be prescribed in the Insurance Act.

e. Governance, discipline, and enforcement

(i) promoting the public interest

It is essential that any approved professional association represents the interests of consumers and the broader public interest, as well as the interests of its member financial advisors. Approved professional associations should be not-for-profit entities dedicated to financial advisor professionalism in the public interest. It is essential that professional associations be entirely independent from financial institutions, as well as product manufacturers and distributors.

The governance arrangements of all recognized professional associations, which would be set out in their charters, would include provisions for effective public representation. In particular:

- every recognized professional association would have public directors on its governing body, and also on any board committee responsible for professional conduct, discipline, advocacy, and policy and regulatory affairs; and
- public directors would be appointed in accordance with a suitable process that is appropriately independent in nature and designed to recruit qualified individuals.

(ii) governance issues

Initial membership application. With regard to applying for membership in a professional association, financial advisors would be permitted to apply for membership in an association of their choice. This would be the case even if they are already affiliated with a professional association at the time when they are required to apply to a recognized association for the purpose of membership. For example, the fact that an advisor holds a financial planning designation and is affiliated with the professional association that issued the designation will not make him or her a member of that association for the purposes of the professional association proposal.

Membership suspension or termination. An individual whose membership in a professional association is suspended or terminated as a consequence of his or her association's disciplinary proceedings, or whose membership is suspended as a consequence of the suspension of his or her license or registration by a regulator, would not be able to be employed in the industry as a financial advisor until he or she is again a member in good standing.

An individual who has had his or her license or registration suspended, cancelled or made subject to ongoing conditions, or who has had his or her membership in an association suspended, cancelled or made subject to ongoing conditions, would be required to disclose his or her current status when applying for membership with a recognized association.

Show cause. An association would be entitled to require an individual who has had his or her license or registration suspended, cancelled or made subject to ongoing conditions, or who has had his or her membership in any association suspended, cancelled or made subject to ongoing conditions, to show cause why he or she is fit to be accepted as a member or to continue as a member.

Sharing of membership information. Professional associations and regulators would inform each other in a timely manner with regard to any changes in the membership and licensing or registration status of individuals. Upon being informed that the licensing or registration status of a member has been suspended, revoked, or made subject to conditions, or that the member is the subject of disciplinary proceedings, an association would take appropriate steps. Similarly, regulators would initiate a review of the licensing or registration of an individual upon being informed that his or her association membership has been suspended, revoked or made subject to conditions, or that his or her license or registration has been revoked, suspended or made subject to conditions by another regulator.

It would be necessary to carefully consider how to design a system where licensing and registration and association membership are inter-dependent, so that suspension or termination of any one (licensing, registration, association membership) could result in suspension or termination of the other(s). Fairness and due process implications would need to be studied, and a process would need to be designed to ensure fair treatment for the individual.

(iii) the complaints and disciplinary process

No duplication. Professional associations would complement but not duplicate the enforcement and disciplinary functions of regulators. In particular:

- a professional association's complaints and disciplinary process would enforce the association's rules and standards;
- a professional association's complaints and disciplinary process would not replace or supplant the disciplinary process of securities and insurance regulators;
- a professional association would have considerable discretion with regard to the investigation of complaints and the initiation of professional discipline, in order to ensure that association resources are used effectively to protect the public and complement the efforts of regulators; and
- a professional association, in considering whether to investigate complaints or initiate a disciplinary proceeding, would seek to conserve association resources and avoid duplicating the complaints and disciplinary processes of regulators.

Priority to public protection. As well, a professional association, in its complaints and disciplinary processes, would give priority to protecting the public by:

- ensuring that individuals who violate industry requirements in any one sector are not permitted to continue to be employed in the industry without further review; and
- exercising its authority to suspend or revoke an individual's membership in the association in specified circumstances that, while outside the scope of the regulatory jurisdiction of industry regulators, demonstrably indicates a lack of professional integrity or unsuitability to offer financial services to the public (i.e., convictions for criminal and regulatory offences, which indicate a lack of professional or personal integrity).

Initiation of proceedings. A professional association would be entitled to initiate disciplinary proceedings where there is reason to believe that a member has violated the code of professional conduct. Public directors of the association would participate in directing the investigation of complaints and the initiation of disciplinary proceedings. The association would be entitled to initiate disciplinary proceedings whenever it considers it appropriate to do so, and would be empowered, in the course of its disciplinary process, to suspend or terminate membership, and to impose conditions on membership.

Power to delegate. Investigations and the prosecution of disciplinary proceedings could be delegated by a professional association to a third party accountable to the association, which could establish its own hearing panel. Alternatively, two or more professional associations could jointly establish a tribunal to hear and determine matters for any associations willing to participate in a joint fashion. The members of such a tribunal would be drawn from the participating associations.

(iv) advisor competence and incapacity

A professional association could investigate a member's competence and capacity to provide services to the public, and initiate proceedings and suspend or revoke membership or impose other conditions.

(v) administrative sanctions

A professional association would have the authority to suspend or terminate membership, and to impose conditions on membership for administrative reasons, including for non-payment of fees, for failure to fulfill continuing education requirements, and for suspension or termination of licensing or registration by a regulator.

(vi) cooperation with all industry regulators

Professional associations would cooperate with financial industry regulators with regard to complaints and disciplinary matters. Individual members would be required to consent to the sharing of information with financial industry regulators in regard to complaints and disciplinary matters. In general, a professional association would not proceed with any complaints or disciplinary proceedings in the event other proceedings, initiated by a regulator and based on the same impugned conduct or circumstances, are already underway. As well, professional associations would cooperate with financial industry regulators with regard to continuing education programs and, when possible, participate in their policy development processes. Finally, the relevant regulators would establish a process for accrediting professional associations and monitoring their compliance with standards.

a. Promoting the interests of clients and consumers

The proposed membership model would promote the consumer interest in a number of areas.

(i) a mandated code of professional conduct and ethics

As noted above, all financial advisors would be required to comply with the code of professional conduct of their association of choice. Such a document would explicitly codify the following:

- recognition of the priority of the client's interests over those of the advisor;
- duties respecting conflicts of interest, including disclosure to the client of all real and apparent conflicts;
- the duty to provide competent service, performed with honesty and integrity;
- the duty to respect client confidentiality; and
- an accessible enforcement mechanism for disciplining and punishing members for misconduct, including criminal convictions and regulatory infractions.

(ii) proficiency standards and continuing education – the cornerstone of professionalism

Professional associations would establish initial proficiency standards for financial advisors, and would administer continuing education requirements designed to ensure that all financial advisors maintain a high standard of proficiency.

Such associations would be required to actively administer their codes of conduct, so the public is assured that member advisors understand and fulfill the ethical obligations they owe to their clients. Moreover, all financial advisors would be required to file an annual "Certificate of Professional Standing" issued by their association. This would be a condition for maintaining a provincial license or registration to sell financial products – and to ensure that the high standards to provide ongoing financial advice are met.

Individuals who want to hold themselves out as competent practitioners in areas of professional specialization, such as financial planning, would be required to hold in good standing the necessary recognized designations.

Professional associations' annual continuing education requirements would focus on the financial advisor's duties to clients. These CE requirements would complement and build on the practice proficiency standards and CE requirements of regulators.

(iii) best practices and member information resources

Professional associations would publish information resources for members, such as a best practices manual, and periodic bulletins updating members on important regulatory requirements and developments, further ensuring client protection.

(iv) professional accountability — integrated across sectors

Professional associations would be empowered to suspend or revoke membership, or impose various conditions on membership for unprofessional conduct, including violations of regulatory requirements, failure to cooperate with regulators, and criminal and regulatory offences. Actions or omissions which impugn or bring into disrepute the advisor's professional integrity or competence, or that of the profession as a whole, and their suitability to offer financial advice to the public, would be reviewable.

An association's disciplinary action would have consequences for a member's ability to sell financial products as a provincial licensee or registrant. If a member of the association is expelled, that individual would be prevented from selling financial products. As well, if any regulator revoked or imposed conditions on a member's ability to sell financial products, that member's association would take appropriate action to suspend, revoke or impose conditions on his or her membership. Such measures would further buttress the actions of the particular regulator by imposing conditions on selling products or providing advice.

As noted above, a regulatory requirement that advisors must be in good standing with a professional association would prevent unscrupulous individuals from simply moving to a different financial sector and seeking licensing or registration.

The resulting regulatory umbrella created by professional associations would close current gaps in the enforcement and disciplinary reach of regulators, by ensuring that individuals who violate industry requirements in any one sector would not be permitted to continue activity in the industry without proper review.

Membership associations would have considerable discretion with regard to the investigation of complaints and the initiation of professional discipline, in order to ensure that association resources are used effectively to protect the public and complement the efforts of regulators. Associations would publish disciplinary proceedings and would follow a process of natural justice regarding procedural rights (hearing, tribunal, appeal process, etc.).

(v) ease of public access to information on financial advisors

Professional associations would be required to make information about their members conveniently accessible in a single public database. This would enable the public to easily determine if an individual is a member of a professional association and review his or her credentials.

b. Benefits to other key actors in the securities and insurance sectors

The proposed membership model would work to promote the interests of financial advisors, governments and regulators, and product providers and distributors.

(i) financial advisors would benefit from:

- enhanced public trust, status and confidence in advisors as professionals,
- access to resources that complement and facilitate standards and compliance with regulatory requirements, and
- a raised professional bar, through improved education and standards and the ready removal – in a public and effective manner – of unethical colleagues who tarnish the industry as a whole.

(ii) government and regulators would benefit from:

- the delivery of enhanced consumer protection and the “reining in” of unethical advisors who move from sector to sector;
- additional protection of the wider public from unqualified or unaccountable financial advisors;
- additional professional support for the government policy objective of increased individual financial responsibility for future financial needs;
- a reduced regulatory burden created by the various professional associations proactively complementing the current regulatory requirements and enforcement; and
- the combined expertise of the various professional associations, all of whom will contribute to the development of policy and implementation of effective regulation.

(iii) product providers and distributors would benefit from:

- the reliable professionalism of financial advisors representing their firms and products;
- the prevention of unethical advisors moving from one company to the next; and
- the development of a stronger platform to support the recruitment of new advisors into the industry through enhanced professional standing.

The following table indicates the limitations and drawbacks of the status quo and the benefits to consumers, advisors, and other stakeholders.

Advantages of professional membership over the status quo

Issue	Insurance	MFDA	IIROC	Proposed professional association membership
Who is covered?	Insurance agents	Mutual fund salespersons	Securities salespersons	**Everyone** who holds out as a financial advisor
Public represented in governance?	**Yes**	**Yes**	**Yes**	**Yes**
Financial advisors are "at the table" when regulators make policy?	Only to a limited extent.	Dealer members of the MFDA are the main stakeholder consulted.	Dealer members of IIROC are the main stakeholder consulted.	**All associations** will advocate with regulators on behalf of member financial advisors and consumers
Standards focus on consumer interest or on distributor / dealer interest?	Insurance focus	Mutual fund dealer focus	Securities dealer focus	**Consumer / client relationship focus**
Establishes proficiency requirements for all financial advisors to meet?	Licensing requirements focus on insurance only	Registration requirements focus on mutual funds only	Registration requirements focus on broader securities only	**Builds on standards of insurance, MFDA and IIROC with structured continuing education requirements**
Mandatory competency-based Continuing Education?	No mandatory client-focused content	No specific continuing education requirement	No mandatory client-focused content	**Yes.** Mandatory courses on ethics, conflicts of interest, duty to client, leveraging, regulatory / compliance developments
Use of a Code of Professional Conduct outlining duties and obligations to clients and public?	No enforceable dedicated Code of Professional Conduct articulating duty to clients, as such, but Insurance Councils in Western Canada have codified conduct rules in their by-laws	No dedicated Code of Professional Conduct articulating duty to clients, as such	No dedicated Code of Professional Conduct articulating duty to clients, as such	**Yes**

Advantages of professional membership over the status quo (continued)

Issue	Insurance	MFDA	IIROC	Proposed professional association membership
Participation in a public registry that covers all financial advisors?	No	No	No (IIROC Advisor Report is limited to advisors with IIROC members)	**Yes**
Can curtail ability of unethical or unregulated individuals to hold themselves out to the public as financial advisors?	No. Only able to suspend or cancel insurance license.	No. Only able to suspend or cancel status as MFDA advisor.	No. Only able to suspend of cancel status as IIROC advisor.	**Yes.** Including remedies against individuals who do not belong to an association (the "Earl Jones" problem)
Ability to prevent employment as a financial advisor of individuals who do not meet standards?	No. Loss of insurance license does not prevent employment as MFDA or IIROC advisor	No. Loss of MFDA status does not prevent employment as IIROC or insurance advisor	No. Loss of IIROC status does not prevent employment as MFDA or insurance advisor	**Yes.** While an individual's professional association membership is suspended or cancelled, they are barred from acting as an insurance, MFDA or IIROC advisor.
Ability to deal with misconduct relevant to integrity and suitability that is not within the regulator or SROs scope?	No	No	No	**Yes**

About Advocis

Advocis, The Financial Advisors Association of Canada, is the oldest and largest voluntary professional membership association of financial advisors in Canada. Advocis is the home and the voice of Canada's financial advisors. Through its predecessor associations, Advocis proudly continues a century of uninterrupted history of serving Canadian financial advisors, their clients, and the nation.

With over 11,000 members organized in 40 chapters across Canada, Advocis serves the financial interests of millions of Canadians.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members are professional financial advisors who adhere to an established professional Code of Conduct, uphold standards of best practice, participate in ongoing continuing education programs, maintain appropriate levels of professional liability insurance, and put their clients' interests first.

Across Canada, no organization has members who spend more time working one-on-one on financial matters with individual Canadians than us. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future.

Questions?

If you have questions or comments, please contact:

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