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

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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 (the Consultation Paper)

We are pleased to provide the members of the Canadian Securities Administrators (CSA) with comments on the Consultation Paper. Our comments are those of individual lawyers in Borden Ladner Gervais LLP's Investment Management and Securities Litigation practice groups and do not necessarily represent the views of BLG, other BLG lawyers or our clients. We note that we have not responded to the specific questions posed by the CSA, rather we have chosen to respond more generally on the concepts proposed in the Consultation Paper.

The Current Registrant Regulatory Regime Works Well

We support CSA initiatives directed at providing investors with significant protections when dealing with investment industry professionals. We also support and promote compliance by registrants with the current robust securities registration regime in Canada which includes:

(i) a duty on registered firms and individuals to act fairly, honestly and in good faith with all clients,

(ii) extensive prescriptive requirements with respect to the integrity, proficiency, capital adequacy and ongoing conduct of registrants,

(iii) a "know-your-client" and suitability assessment process that is aimed at ensuring advice is appropriate for the client's personal and financial circumstances,

(iv) disclosure obligations and related requirements pertaining to the registrant-client relationship (referred to generally as the client relationship model or CRM) that are aimed at ensuring clients receive the information that is reasonably necessary for them to understand the services being provided to them by a registrant and the investments they are making, and

(v) requirements to provide investors with prospectus-level disclosure for publicly issued securities, for example, mutual funds.

We note that the securities regulation in some provinces (Alberta, Manitoba, New Brunswick and Newfoundland and Labrador) already provide for a fiduciary duty standard of care for registered advisers, given the discretionary nature of the advice provided by this group of registrants. We consider that this would be the case at common law (generally) in any event, and therefore we do not have any issue in expanding the above-noted regulatory requirements to registered advisers acting in a discretionary capacity to be consistent across Canada.

We believe that the current Canadian registration regime sets out the appropriate elements for investor protection, and it is these elements that the CSA should continue to focus on and enhance (as illustrated by the continuing evolution of the CRM by the CSA and by the self-regulatory organizations). In this way, the CSA will continue to ensure the high level of investor protection that Canadian investors enjoy – while at the same time fostering fair and efficient capital markets and confidence in the capital markets which are also important mandates of Canadian securities laws.

In our view, the Consultation Paper fails to adequately capture and define the perceived failure in the current regulatory regime, particularly as it relates to dealers, which warrants further intervention. We encourage the CSA to allow the current registration regulation regime to continue to evolve along the well-thought out path it is proceeding, and not introduce a new (and unknown) element such as a statutory best interest standard which is not defined, will be open to interpretation by courts and the various securities commissions, and may result in unintended consequences for capital market participants.

In our view the current Canadian registration regime adequately addresses the circumstances in which a fiduciary duty should exist between a registrant and a client (i.e. where the registrant has discretionary authority), and the circumstances in which a duty of care and robust registrant conduct requirements should exist (i.e. where the client has a decision-making role in the registrant-client relationship).

The duty under Canadian securities laws to act fairly, honestly and in good faith is one of the major cornerstones of investor protection. The other cornerstones of investor protection when read and applied in conjunction with this duty, establish a framework for ensuring appropriate and reasonable investor protection particularly in circumstances where the registrant does not have discretionary authority. These other cornerstones of investor protection include:

(i) The collection of know-your-client (KYC) information and the suitability assessment

The collection of KYC information is fundamental to ensuring an appropriate recommendation is made to a client by a registrant. The client's KYC information establishes the "circumstances" of the client and the registrant then assesses those "circumstances" in relation to proposed investments to make suitable recommendations to the client. A client's KYC information includes details about the client's:

- personal and financial circumstances,
- investment knowledge and experience,
- risk tolerance, and
- investment objectives and time horizon.

Cost alone will not be the only factor that both the registrant and the client consider when selecting a suitable product.

(ii) Registrant Disclosure Obligations

Current registrant disclosure obligations are aimed at ensuring that a client has the information necessary to understand the services being received from a registrant, the investments being considered, and the avenues available to address issues with the registrant.

Conflicts of interest are required to be managed by registrants which generally involves either avoiding the conflict altogether or minimizing the conflict through management and/or full disclosure to clients. Through this process a client is equipped to make an informed decision about whether or not to proceed with an investment in the face of the conflict. Just because there is a conflict present in a particular situation, does not necessarily mean a client is being exploited or being given bad advice.

Conflicts of interest requirements are being refined as part of the evolution of CRM and therefore we find the CSA's comments about the effectiveness of conflicts of interest requirements somewhat premature given that these requirements have yet to be fully implemented. We encourage the CSA to allow CRM to come to fruition before concluding that it isn't working as intended.

(iii) Fit and proper – integrity, proficiency, capital adequacy and conduct

Fit and proper requirements are aimed at ensuring that registrants have the integrity and skills to meet their duty to act fairly, honestly and in good faith with clients, to discharge their suitability obligations to clients, and to be in a stable financial position in order to provide service to their clients on an ongoing basis.

We encourage the CSA to continue to monitor and review the investor protection elements of the current regulatory regime and address any areas that need augmenting or enhancement. We believe this would be a more effective route to filling any real investor protection gaps that may exist than the introduction of an undefined statutory fiduciary duty, particularly in the case of dealers.

Practical implications of a statutory best interest standard on dealers

Notwithstanding our primary comment about the concept of imposing a fiduciary duty at this time (as set out above), we have considered the practical implications that an imposition of a statutory best interest standard would have on registered dealers, as well as certain of the statements made in the Consultation Paper about a best interest standard. For the most part our comments are directed at what a statutory best interest standard would mean for registered dealers and their dealing representatives who today, generally act in accordance with suitability standards – and would not generally be considered to be fiduciaries under common law except in specific circumstances, which would be dependent on the facts of each case.

As noted above, the discussion of this issue has less impact on registered advisers, given the nature of that business and the nature of the relationship between clients of registered advisers and those advisers.

While we provide some comments (below) about the practical implications of a statutory best interest standard on dealers, as is evident from the many very technical and legalistic questions posed in the Consultation Paper, we recommend that considerable additional legal analysis and review be conducted by the CSA if they decide to move forward with this principle in the context of registered dealers.

The Consultation Paper states that a fiduciary duty does not require the fiduciary to act as a guarantor or insurer of his/her advice. While this is technically true, the practical effect that the imposition of a statutory best interest standard would have on dealers and their dealing representatives may be quite the opposite. Under the current regulatory regime, dealers and dealing representatives are subject to, amongst other requirements, suitability assessment obligations and know-your-product obligations when making recommendations to clients, and a firm must have a system of controls and supervision in place to ensure that the firm and its registered individuals are meeting these obligations and otherwise operating in compliance with securities laws. If a dealer or a dealing representative is required to defend an investment recommendation they would normally do so by establishing that supervision was properly conducted at the appropriate times and by calling a credible expert to testify that the investments were suitable for the client with reference to the industry standard. Other issues that would be brought into the discussion could include whether the registrant properly recorded the client's KYC information and/or whether the risks of an investment were properly explained. Often times these issues can be resolved if the registrant kept complete records of his or her advice.

However, if a dealer or adviser's obligation is fiduciary in nature – the standard is not clear. At common law, acting in a client's best interest means that a registered firm must ensure that:

- the client's interests are paramount,

- conflicts of interest are avoided,
- the client is not exploited,
- the client is provided with full disclosure, and
- services to the client are performed reasonably prudently.

In our view, the ambiguity of these principles will lead to courts (and the securities commissions) resolving them in favour of the client with the practical effect being that registrants will be put in the position of being guarantors of market losses as discussed below.

The CSA raise the following issues in the Consultation Paper:

(i) *Suitability assessment isn't enough*. The Consultation Paper makes it clear that suitability of investments would no longer be the standard, which also raises the question as to what would happen to the "suitability" obligation under a best interest standard. The new standard would be whether the registrant acted in the best interest of the client which, though not defined, is an acknowledged tighter standard. Therefore, even a suitable recommendation could result in liability. The mere fact that the registrant conducted supervision properly and an expert holds that the investment was suitable for the client would not be enough.

(ii) *The relative commission rates charged for the investment and comparable investments will be scrutinized*. Should registrants simply recommend the least expensive options from a commission perspective in order to avoid being accused of having a conflict of interest? It should be acknowledged that the least expensive option isn't necessarily the "best" option for a client based on their circumstances.

(iii) *Assumption of risk by client no longer relevant*. The Consultation Paper suggests that the vast majority of clients are financially illiterate and therefore can't possibly be expected to understand the disclosure provided to them. This assumption leads to the inevitable conclusion that no matter what the registrant provides the client by way of disclosure, the client will not absorb this information and accordingly cannot make decisions based on this disclosure alone and accordingly cannot take responsibility for their own decisions. Something more is needed – which the Consultation Paper suggests is a best interest standard for registrants.

(iv) *Contributory negligence is likely not going to apply*. The Supreme Court of Canada has concluded that except in rare circumstances, where there is a breach of fiduciary duty, damages should not be reduced to account for contributory negligence - in other words, the client should not bear responsibility for his/her choices.

In addition, in a regular investment loss case where there is no fiduciary relationship, disgorgement of commissions as a separate head of damages is generally not available to a client unlike in situations where there is a fiduciary relationship. Finally, it will likely be easier for plaintiffs to secure an award of punitive damages, given the enhanced nature of the duty imposed on dealers and dealing representatives.

Fiduciary duties are extremely onerous at common law, and in light of the issues raised above, it is easy to see how Court decisions may result in dealers being put into the position of guarantors of market losses.

If a statutory best interest standard was adopted for dealers, it is important to note that instead of the Courts determining on a case by case basis whether or not a client is sufficiently vulnerable that a fiduciary relationship exists, this duty will apply to every retail client. This would include sophisticated retail clients who are well versed in investing and use their dealer/dealing representatives as a sounding board for advice but are ultimately making their own investment decisions. Query whether this will lead to an elimination of the traditional retail dealer – instead, will we have a situation where retail clients are limited to either having a discount brokerage account (where a fiduciary duty would not apply) or having a discretionary managed account with a portfolio manager (to whom a fiduciary duty already applies)?

Difficulties in Defining What "Best Interest" Means

It is difficult to comment on a hypothetical best interest standard in a securities rule or regulation without first establishing what is meant by "best". Does "best" equate to only recommending the "best of the best" – is there only one "best" investment for a client? Does "best" mean "least expensive" as the Consultation Paper alludes to?

It is important to remember that the common law elements of best interest are found primarily in situations where the adviser or dealer had discretionary authority, or the functional equivalent of discretionary authority. However, the courts will consider on a case-by-case basis whether the imposition of a fiduciary duty is necessary – in doing so, it will consider the vulnerability of the client, whether the client has reposed trust in the registrant, the level of reliance on the registrant, whether the registrant had any discretion in managing the account, and in addition will consider the applicable professional rules of conduct (the Consultation Paper notes this, but more so in the context of there being uncertainty as to the standard that will be applied, rather than for the proposition that it will only be applied where appropriate).

As discussed below, there are many factors that go into determining what, under the circumstances, are the "best" investments for a client, and the current registration regime establishes a framework in which the relevant and appropriate factors are considered by registrants when making recommendations to clients.

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We thank you for allowing us the opportunity to comment on the Consultation Paper. Please contact any of us at the contact details provided below if the CSA members would like further elaboration of our comments. We, together with other BLG lawyers who have considered the Consultation Paper, would be pleased to meet with you at your convenience.

Yours truly,

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