BY E-MAIL

February 22, 2013

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
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Attention:

John Stevenson Secretary
Ontario Securities Commission
20 Queen Street West, Suite 1900, Box 55
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jstevenson@osc.gov.on.ca

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Montréal (Québec) H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Dear Sirs / Madames:

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)

The Exempt Market Dealers Association of Canada (the **EMDA**) is pleased to provide the members of the Canadian Securities Administrators' (**CSA**) with comments on the Consultation Paper.

The EMDA is a not-for-profit association founded in 2002 to be the national voice of exempt market issuers, exempt market dealers (**EMD**s), and participants in the exempt market across Canada. The EMDA plays a critical role in the exempt market by:

- assisting its hundreds of dealer and issuer member firms/individuals to understand and implement their regulatory responsibilities;
- providing high quality and in-depth educational opportunities to exempt market participants;
- encouraging the highest standards of business conduct amongst its membership across Canada;
- increasing public and industry awareness of the exempt market and its role in the capital markets;
- being the voice of the exempt market to securities regulators, government agencies, other industry associations and the capital markets
- providing valuable services and cost-saving opportunities to its member firms and individual dealing representatives; and
- connecting its members across Canada for business and professional networking.

Additional information about the EMDA is located on our web site at: www.emdacanada.com.

EMDs may act in two primary capacities in the capital markets: (a) as a dealer or underwriter for any securities which are prospectus exempt; or (b) as a dealer for any securities, including investment funds which are prospectus qualified (mutual funds) or prospectus exempt (pooled funds), provided they are sold to clients who qualify for the purchase of exempt securities. The qualification criteria for exempt purchasers and exempt securities are found primarily in National Instrument 45-106 *Prospectus and Registration Exemptions* (**NI 45-106**).

EMDs are fully registered dealers who engage in the business of trading in exempt securities, or any securities to qualified exempt market clients. EMDs are subject to full dealer registration and compliance requirements, and are directly regulated by the provincial and territorial securities commissions. The regulatory framework for EMDs is set out in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**NI 31-103**) which applies in every jurisdiction across Canada.

EMDs must satisfy the same "Know Your Client" (**KYC**), "Know Your Product" (**KYP**) and trade suitability obligations as other registered dealers which are IIROC or MFDA members. NI 31-103 sets out a comprehensive dealer regulatory framework (substantially similar for all categories of dealer, including investment dealers) which requires EMDs to satisfy a number of regulatory obligations including:

- educational proficiency;
- capital and solvency standards;
- insurance;
- audited financial statements;

- know your client;
- know your product;
- trade suitability;
- compliance policies and procedures;
- books and records;
- client statements;
- trade confirmations;
- disclosure of conflicts of interest and referral arrangements;
- complaint handling;
- dispute resolution;
- maintenance of internal controls and supervision sufficient to manage risks associated with its business;
- prudent business practices requirements;
- registration obligations; and
- submission to regulatory oversight and dealer compliance reviews.

EMDs may focus on certain market sectors (*e.g.*, oil and gas, real estate, mining or minerals, technology, venture financing, etc.) or may have a broad cross-sector business model. EMD clients may be companies, institutional investors, accredited investors, or eligible investors who are qualified to purchase exempt securities pursuant to an offering memorandum.

EMDs provide many valuable services to small, medium and large businesses, investment funds, merchant banks, financiers, entrepreneurs, and individual investors, through their ability to participate in the promotion, distribution and trading of securities, as either a principal or agent.

The Consultation Paper poses a number of questions many of which we will respond to through our general comments. In our general comments we will also address those questions that specifically reference the exempt market community.

General Comments

The EMDA is very supportive of securities regulatory initiatives directed towards providing clients with significant protections when dealing with investment industry professionals. The EMDA supports and promotes compliance by the exempt market community with the current robust securities regulatory environment in Canada, the cornerstones of which include:

(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) the suitability assessment process that is aimed at ensuring advice is appropriate for a client's circumstances, and

(iv) disclosure obligations and related requirements around the registrant-client relationship (referred to 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 the registrant and the investments they are making.

The EMDA believes that these elements of the current Canadian regulatory regime are appropriate and are the elements the Canadian securities regulators should continue to review and enhance (as illustrated by the continuing evolution of CRM by the CSA and the self-regulatory organizations) and by doing so 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. The Consultation Paper fails to adequately capture and define the perceived failure in the current regulatory regime which warrants further intervention. We encourage the CSA to allow the current registration regime to continue to evolve along the well-thought out path it is proceeding, and not introduce an element such as a statutory best interest standard which is not defined, open to interpretation and may result in unintended consequences for capital market participants.

What does "best interest" mean?

It is difficult to comment on a hypothetical "best interest" requirement in a securities rule or regulation without first establishing what is meant by "best interest". Does the "best interest" 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 at times?

At common law, acting in a client's best interest means that the registered firm must ensure that

- the clients' interests are paramount;
- conflicts of interest are avoided;
- clients are not exploited;
- clients are provided with full disclosure; and
- services are performed reasonably prudently.

It is important to remember that these elements were developed at common law primarily in circumstances where the "adviser" had discretionary authority, or what appeared to be the 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 CSA paper noted 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).

By imposing a statutory fiduciary duty, this duty will not only apply in circumstances where the court would have found one in any event. It will also apply in circumstances where sophisticated clients, well versed in investing, use their registrant as a sounding board for advice but ultimately make their own investment decisions (basically, any time any "advice" is given).

Query whether this will lead to an elimination of the traditional retail dealer – instead, will we have a situation where the industry goes to two extremes? Discount brokerages (where a fiduciary duty would not apply) on one end of the scale and portfolio managers (to whom a fiduciary duty already applies) on the other end?

We believe that many factors go into determining what the "best" investment for a client is – including reasonableness in the circumstances – and that the current regulatory regime establishes a framework in which the relevant and appropriate factors are considered by registrants when providing advice.

Current Regulatory Regime and Investor Protection Concerns

In our view the current Canadian regulatory 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 are appropriate and a fiduciary duty shouldn't exist (i.e. where the client has a decision-making role in the registrant-client relationship).

We do not believe there is a "buyer beware" situation for investors in Canada as the CSA stated in the Consultation Paper that some commentators believe. The duty under Canadian securities laws to act fairly, honestly and in good faith is one of the major cornerstones of investor protection, and 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 under the current regulatory regime 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 a proposed investment to determine suitable recommendations for the client. A client's KYC information includes details about the client's:

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

Impact on Certain Business Models and Capital Raising

Without a definition of "best interest" that includes qualifications a best interest standard would in our view, negatively impact certain business models - for example, registrants who engage in the development and distribution of proprietary products, or those who promote small and medium size enterprises. Under an unqualified best interest standard these business models would violate the standard because of the potential for conflicts of interest. If registered firms could not both develop and sell proprietary products to clients, the cost of capital will undoubtedly go up as the distribution of these securities would require more entities to be involved.

Exempt market dealers play a valuable role in Canada's capital markets by assisting, amongst others, small, medium and large businesses, investment funds, entrepreneurs and individual investors, to access capital or to make investments in situations where the services of a traditional full service dealer are not warranted or perhaps available (e.g. the cost of using a traditional full service dealer may be too high for a start-up company).

A fiduciary standard increases a registrant's potential liability for each recommendation made to a client and therefore it is reasonable to conclude that this would result in reduced access to financial products by investors and ultimately limit the ability of investors to find investments that have the potential for larger returns. Retail investors who want to have an active role in their investment portfolio, and are willing to incur higher levels of risk for the opportunity to make higher returns may find that registrants who had

access to these types of investment opportunities are no longer in business because the business model was no longer financially viable, or these registrants are not willing to take on retail investors as clients in light of the uncertainty of the practical implications of a "statutory best interest duty". And likewise, capital raising by start-up companies and small-to-medium size enterprises will be particularly negatively impacted if access to the pool of retail investors decreases because of the lack of dealers, and particularly dealers in the exempt market, who are willing to take on retail investors as clients.

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We thank you for the opportunity to provide you with our comments on the Consultation Paper. If you have any questions or concerns, we ask that you direct them to Brian Koscak, Chair of the EMDA at bkoscak@emdacanada.com or 416-860-2955.

Yours very truly,

The Exempt Market Dealers Association of Canada

Per: "*Marsha Gerhart*"
Director

This letter does not represent the comments of the employer or firm of any director and/or officer of the EMDA and is submitted without prejudice to any position taken or that may be taken by that individual's employer or firm on its own behalf or on behalf of any client.