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

John Stevenson, Secretary
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Me Anne-Marie Beaudoin
Corporate Secretary
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Dear Sirs/Mesdames:

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* ("Consultation Paper 33-403")

We appreciate the opportunity to provide our comments in regard to Consultation Paper 33-403, and fully support the CSA's mission "to give Canada a securities regulatory system that protects investors from unfair, improper or fraudulent practices and fosters fair, efficient and vibrant capital markets, by developing a

national system of harmonized securities regulation, policy and practice."[1] For the purposes of our response to Consultation Paper 33-403, we have divided our comments into four parts: (1) General Comments; (2) Fiduciary Standards and Financial Services; (3) Consumer Choice; and, (4) Principal Trading and Capital Raising.

(1) General Comments

As a long-standing participant in Canada's capital markets, Scotiabank and its securities registrants have considerable experience in providing Canadians with wealth management services and have participated for many years in the securities rule-making process with respect to numerous regulatory initiatives, including NI 31-103, the Client Relationship Model project, and the Point of Sale project. In this regard, recent and significant enhancements to suitability assessments, conflicts of interest management and disclosure rules, driven in large part by the Client Relationship Model ("CRM"), have added to an already comprehensive and robust investor protection framework. CRM has been over ten years in the making and will soon be fully implemented, with many of its core elements due to be implemented in March 2013.

One only need refer to publications like the Ontario Securities Commission ("OSC") 2012 Annual Report to obtain insight as to the vitality of Canada's investor protection framework. Of the 5,100 calls received by the OSC's Contact Centre, five percent related to registrant misconduct and five percent to how and where to complain.[2] Based on approximately 1.5 million investors in the province of Ontario[3], this would suggest a failure rate of .03%. Similarly, the Investment Industry Regulatory Organization of Canada ("IIROC") receives an average of approximately 1,000 complaints per year (this includes complaints sent to firms and reported to IIROC via the Complaints and Settlement Reporting System).[4] Given the approximate 10.3 million non-advisory (discount) and full-service brokerage accounts with IIROC-regulated firms,[5] this suggests a failure rate of .01%. In addition, the World Bank 2012 *Doing Business Guide* ranks Canada as having the fourth strongest investor protection regime in the world.[6]

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[1] Canadian Securities Administrators, *About CSA – Our Mission*, online: http://www.securities-administrators.ca/our-mission.aspx

[2] Ontario Securities Commission, *2012 OSC Annual Report – Strong Investor Protection*, online: http://www.osc.gov.on.ca/static/_/AnnualReports/2012/investor_protection/index-all.html

[3] Statistics Canada, *CANSIM Table 111-0037 Canadian investors, by investors' characteristics (Ontario, 2011)*, online: http://www5.statcan.gc.ca/cansim/pick-choisir;jsessionid=D1BB1E416E617E2842791756B6245160

[4] IIROC, *Statistics – Case Assessment*, online: http://www.iiroc.ca/industry/enforcement/Pages/Statistics.aspx

[5] Investor Economics, *Retail Brokerage Report* (Fall 2012) at pages 26 and 58.

[6] The World Bank, *Doing Business – Measuring Business Regulations*, online: http://www.doingbusiness.org/rankings. In contrast, it is worth noting that Australia, where in the recent wake of several high profile collapses of securities firms the government has enacted significant regulatory reforms (including a qualified best interest standard), was ranked 70th on investor protection by the World Bank.

It is against this backdrop—Canada's highly-developed and successful investor protection regime—that we consider the advisability of a statutory best interest standard when advice is provided to retail clients. And so, at this conceptual stage of the rule-making process, one could easily argue that there is no evidence of a systemic issue or regulatory gap involving the provision of advice to retail clients that need be addressed by the imposition of a fiduciary standard as that described in Consultation Paper 33-403.

If, for the sake of argument, one were to assume that a systemic issue or regulatory gap exists, the confusion with respect to the difference between the suitability standard and a best interest standard is noteworthy and must be addressed. The failure to adequately describe what "best interest" means or encompasses must first be remedied before one can determine the context in which to "qualify" that standard. The spectrum of possibilities that exists as between an *absolute* fiduciary duty and a *qualified* fiduciary duty are wide-ranging, so much so that it would be virtually impossible to estimate at this stage the costs and/or benefits to retail clients and other capital markets participants. The adoption of a fiduciary standard could bring fundamental changes, perhaps even a complete overhaul, of the most recent enhancements to Canada's securities regulatory regime.

In addition, it would have been helpful if Consultation Paper 33-403 provided examples of suitable investments that were *not* in the client's best interest. Although Canadian courts have been clear that a fiduciary duty does not require the fiduciary to act as a "guarantor" when providing financial advice, the practical impact could be quite different, such as in the case of advice given in relation to higher-risk securities and financial instruments, such as small and mid-cap equities and derivatives. While higher-risk investments can offer the potential of higher returns and can be an appropriate part of a balanced portfolio, the legal uncertainty and potential liability for providing advice to speculative and/or knowledgeable investors with respect to such products could result in fewer advisers offering advice and fewer retail clients receiving advice.

With respect to the sale of proprietary products, e.g. mutual funds and certain structured products, their distribution should be permitted to continue subject to the suitability standard. It is important to note that many dealers and advisers offer only proprietary products or an otherwise 'limited shelf' of products. Mutual funds in particular provide retail investors with the opportunity to participate in the capital market and receive affordable investment advice. If a best interest standard were to be interpreted as requiring dealers to offer an expansive range of products, it could have a significant negative impact both on retail clients and dealers whose business model is predicated on providing a limited product offering to this investor segment.

The CSA should also consider whether a fiduciary standard would create an un-level playing field with respect to the regulation and sale of insurance products versus securities. It may be the case that certain market or product 'dislocations' could

occur if one group or market abides by a different standard of conduct than the other.

(2) Fiduciary Standards and Financial Services

In his book, *Fiduciary Law*, referenced in Consultation Paper 33-403, Professor Leonard Rotman writes, "[…] a cursory examination of fiduciary jurisprudence reveals that the [fiduciary] concept is not well understood or properly implemented,"[7] and uses the term "fiduciary paradox" to describe the phenomenon of the widespread use of a concept that is in fact poorly understood.[8] Although the range of relationships sanctioned as fiduciary by Canadian courts have grown at a faster rate than any other jurisdiction, leading an Australian jurist to describe Canada as a "fiduciary relationship industry,"[9] Canadian courts have consistently declined to impose a uniform fiduciary standard on all financial advisers. Speaking on behalf of the majority in a seminal Supreme Court of Canada decision, Justice La Forest writes,

> The relationship of broker and client is not *per se* a fiduciary relationship. Where the elements of trust and confidence and reliance on skill and knowledge and advice are present, the relationship is fiduciary and the obligations that attach are fiduciary. On the other hand, if those elements are not present, the fiduciary relationship does not exist. The circumstances can cover the whole spectrum from total reliance to total independence. Where a fiduciary duty is claimed in the context of a financial advisory relationship, 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.[10]

Where there is vulnerability, trust, reliance, discretion and/or professional rules of conduct in an advisory relationship, Canadian courts have not been shy to find a fiduciary duty.[11] However, as Rotman cautions, the fiduciary concept should not be regarded as the panacea for all claims.[12] The fiduciary concept is elusive and complex, and Canadian courts have spent years fine-tuning its appropriate application in the context of the provision of investment advice. When one considers the complexity of the fiduciary concept (and the carve-outs and qualifications), any perceived benefit should be carefully balanced against the uncertainty and potential for an inordinate number of meritless lawsuits based upon an inappropriately applied standard.

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[7] Leonard I. Rotman, *Fiduciary Law* (Toronto: Thomson-Carswell, 2005) at preface.
[8] *Ibid* at 17.
[9] *Ibid* at 48. Rotman also remarks, "[t]he fervour with which some Canadian jurists have embraced the fiduciary principle has bemused their Commonwealth colleagues." *Ibid* at 49.
[10] *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 at 381.
[11] Consultation Paper 33-403 at 7. See also, *Hunt v. TD Securities Inc.* (2003), 2003 CarswellOnt 3141 (O.C.A.). Even sophisticated parties may be owed a fiduciary duty in an investment advisory situation. See *Hodgkinson v. Simms*, *supra* note 10.
[12] *Supra* note 7 at 49.

The confusion associated with a qualified fiduciary duty is evident in an example raised in Consultation Paper 33-403 relating to the Australian reforms, wherein it is suggested that the best interest standard could be designed so as to permit "scaled advice," which is defined as "advice that only considers a specific issue (for example, single issue advice on retirement planning),"[13] such that:

> The client might prefer to receive more targeted advice on a matter that is particularly concerning them rather than comprehensive advice. As long as […] the decision to narrow the subject matter of the advice [is based] on the interests of the client, the provider will not be in breach of their obligation to act in their client's best interests. *The scaling of advice by the provider must itself be in the client's best interests*, especially since the client's instructions may at times be unclear or not appropriate for his or her circumstances. (Emphasis Added)[14]

This passage suggests that even a qualified fiduciary duty leaves little room for the input and agency of the investor. As such, it is unclear as to how placing the onus on advisers to not only bear responsibility for the appropriateness of the advice, but also the breadth of the advice, constitutes a *qualified* best interest standard or a "safe harbor." The range of possibilities, even within a qualified standard, is so broad that identifying potential implications is an exceedingly challenging task.

(3) Consumer Choice

We believe that the adoption of a statutory best interest duty could unintentionally harm retail clients by creating uncertainty, reducing access to products and services, and raising the costs of investing. If the interests of retail clients are to remain paramount, then there should be assurance that the suitability standard remains in effect so as to allow advisers and dealers to continue to offer a broad range of products and services, which means providing retail clients with the opportunity to choose from among the various business models and distribution channels that currently exist. And, for businesses offering a somewhat limited selection of products, it is worth noting that in the United States the *Dodd-Frank Act* specifically provides that "the sale of only proprietary or other limited range of products," or the receipt of commission-based compensation, shall not, in and of themselves, violate the uniform fiduciary standard of conduct.[15]

Consultation Paper 33-403 considers two leading U.S. studies that were designed to determine the likely impact of a statutory fiduciary duty on broker-dealers. The first study, commissioned by the Securities Industry and Financial Markets Association ("SIFMA") and conducted by Oliver Wyman (the "Oliver Wyman Study"),

[13] Consultation Paper 33-403 at 31.
[14] *Ibid.*
[15] *Dodd-Frank Act*, H.R. 4173, 111th Cong. (2010) s. 913 at page 453.

published in 2010, concludes that the application of the fiduciary concept outlined in the Investment Advisers Act of 1940 on brokerage activities would harm investors by reducing product and service availability and increasing their costs.[16] In contrast, the second study published in March 2012 by professors Michael Finke and Thomas Langdon (the "Academic Study") reaches a different conclusion, finding "no statistical difference between [states where broker-dealers are subject to a fiduciary duty and those where they are not] in the percentage of lower-income and high-wealth clients, the ability to provide a broad range of products including those that provide commission compensation, the ability to provide tailored advice, and the cost of compliance."[17]

Both studies provide helpful insights. A potential limitation of the Academic Study, however, is in its design to measure, at least in part, "perceived" as opposed to objective differences in business conduct. A study of advisers' perceptions about whether they are meeting their clients' needs and acting in their best interests, although of some use, does not objectively establish whether there is in fact a statistical difference in the range of products offered in states that are subject to a statutory fiduciary standard of care and those that are not.[18]

As noted above, the *Dodd-Frank Act* states that the receipt of compensation based on commission shall not, in and of itself, be considered a violation of the standard of conduct applied to brokers and dealers. Similarly, Mary Schapiro, former Chairman of the Securities and Exchange Commission ("SEC"), has stated that if the SEC adopts a fiduciary rule, it would be business model neutral and would allow brokers working with retail customers to charge commissions.[19] Notwithstanding the U.S. example, we are concerned that a fiduciary duty could limit the use of commission-based brokerage accounts. We believe middle-class and less affluent investors would be most disadvantaged by a shift away from this type of account, especially for those who trade infrequently and/or maintain small accounts.

According to the Oliver Wyman Study, fee-based advisory services are 23-37 bps more expensive than commission-based services.[20] The Oliver Wyman Study also found that the indirect costs of additional compliance, disclosure and surveillance

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[16] Oliver Wyman, *Standard of Care Harmonization – Impact Assessment for SEC* (October 2010), online: http://www.sifma.org/issues/item.aspx?id=21999

[17] Michael S. Finke and Thomas Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice* (March 9, 2012), online: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2019090. The Academic Study is based on a survey of twelve questions given to advisers in fiduciary and non-fiduciary states. Although the design of certain questions are objective in nature (for example, "what percentage of your clients have incomes of less than $75,000" and "are you able to recommend products that provide a commission?"), other questions are inherently subjective. These questions include, for example, "do you offer your clients a choice of financial products that meet their financial needs and objectives?" and "do you feel that you make product recommendations that are in the best interest of your client?"

[18] *Ibid* at 18.

[19] See Melanie Waddell, "Reaction to Schapiro Comments on Fiduciary Rule Are Quick and Varied" (December 9, 2011), AdvisorOne, online: http://www.advisorone.com/2011/12/09/reaction-to-schapiro-comments-on-fiduciary-rule-ar

[20] *Supra* note 16 at 4.

associated with an enhanced standard may have the greatest impact on consumers, as an "[estimated twelve to seventeen million] small investors 'at the margin' could lose access to current levels of advisory service if even two additional hours of coverage and support is required per client."[21] Given the high regulatory and compliance costs associated with the current regulatory environment, dealers must seek efficiencies and achieve economies of scale to remain profitable, particularly in relation to small accounts.

Also, it is worth noting that uncertainties with respect to the legal interpretation of a statutory best interest duty could result in errors and omissions insurance becoming prohibitively expensive or simply unavailable. As a consequence, it may be the case that advisers would be reluctant to accept new or less affluent clients, pushing into non-advisory channels those investors who would benefit from and could have otherwise afforded professional advice.

(4) Principal Trading and Capital Raising

Because a fiduciary duty is the highest standard of care recognized by law and equity, it may well require the complete avoidance of, as opposed to the disclosure and management of, conflicts of interest. As such, any new or amended standard of conduct would have to be crafted so as to allow dealers to continue to provide market liquidity, such as in the case of principal trading.

The participation of retail investors in the fixed-income market is significant. In 2012, approximately $174 billion dollars of fixed income products were held in full-service accounts across the retail brokerage industry,[22] and recent statistics show that in Canada approximately a quarter of retail client assets entrusted with investment dealers are invested in fixed-income securities.[23] Dealers anticipate retail demand for these securities and hold them in inventory in order to efficiently and cost effectively meet investor needs in the secondary market. In this regard, dealers take on risk by holding these securities in inventory and are compensated *via* the spread between purchase and sale prices. Any restrictions on principal trading could negatively impact investor access to fixed income products by increasing the cost of debt offerings due to less or limited liquidity in the secondary market.

The capital raising process is vital to the growth and development of the Canadian economy and retail investors play a very important role in this process. A statutory best interest duty could adversely affect capital raising in the equity, quasi-equity and public debt markets. The Canadian market is concentrated, with a relatively

[21] *Ibid*.
[22] Investor Economics, *Retail Brokerage Report* (Fall 2012) at 24.
[23] IIROC, *IIROC News Release: IIROC announces rule changes on fair pricing for fixed-income and other OTC securities* (September 1, 2011), online: http://docs.iiroc.ca/DisplayDocument.aspx?DocumentID=C1151595F307420EBB13596938D8382B&Language=en

small number of leading underwriters in the debt and equity markets. In most cases, full-service dealers that engage in underwriting activities provide access to new issues to their respective retail clients—something that is desired by both issuers and retail clients. The current prospectus regime and suitability requirements provide investors with effective protection, and any attendant conflicts of interest are well-managed. We fail to see how the imposition of a statutory best interest duty will benefit investors when all costs (both direct and indirect) are considered; in addition, limiting retail participation in the capital raising process would have the unintended consequence of increasing financing costs for governments and corporations. If the best interest standard obliges firms to avoid rather than disclose these conflicts, or were it to have a chilling effect on the distribution of securities generally, then the impact for clients, issuers, and the economy could be significant.

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In summary, we feel that the current regulatory framework strikes an appropriate balance between investor protection and capital markets efficiency. As such, we strongly disagree with any characterization of Canadian advisory services as "buyer beware" transactions, which, according to Consultation Paper 33-403, serves as one of the investor protection concerns fueling the standard of conduct debate. We are unaware of any regulatory or market failure that would lead one to conclude that Canada has fallen behind other jurisdictions and we suggest that the CSA carefully monitor the impact of the new standards coming into force in other jurisdictions. Finally, we encourage the CSA to allow CRM and other recent regulatory changes to be fully implemented and evaluated before any conclusions are drawn as to whether a statutory best interest duty is necessary.

We would also like to add that Scotiabank representatives participated in working groups formed by the Investment Industry Association of Canada and The Investment Funds Institute of Canada to study Consultation Paper 33-403.

Thank you for considering our comments.

Yours truly,

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