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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

John Stevenson, Secretary

Ontario Securities Commission
20 Queen Street West, Suite 1900, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin, Corporate Secretary

Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, Tour de la Bourse
Montréal, Québec H4Z 1G3

Re: CSA Consultation Paper 33-403

We are writing to provide comments with respect to the CSA 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.*

Quadrus Investment Services Ltd. ("Quadrus") is one of the largest mutual fund dealers in Canada with more than 3770 registered investment representatives. It is the exclusive mutual fund dealer for London Life Insurance Company and preferred mutual fund dealer for the Gold Key investment representatives of The Great-West Life Assurance Company.

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We thank the CSA for providing an opportunity to give feedback on the desirability and feasibility of introducing a statutory best interest duty to address perceived investor protection concerns regarding the current standard of conduct that advisers and dealers in Canada owe to their clients.

In our submission we have chosen to focus on the following three areas which help summarize what we believe to be in the best interest of all Canadians.

1) Investor Protection Concerns
2) The Statutory Best Interest Standard Described in the CSA Paper
3) The Question of Functional Equivalency

1) Concern over Investor Protection

We commend the CSA for their attention to the protection of investors within Canada. Quadrus is aligned with the CSA's desire of ensuring that Canadians can expect an honest, fair and transparent standard of conduct from their advisers and dealers. We feel answering the following question posed by the CSA is most pertinent in addressing this shared desire.

Do you believe that some or all of these concerns are inapplicable (or less significant) in any CSA jurisdiction as a result of its current standard of conduct for advisers and dealers?

As a national dealer conducting business in each of Canada's provinces and territories, we have significant experience working with clients under a number of different Securities regulatory environments. As the Paper notes, unlike other provinces Quebec currently imposes a statutory duty on investment representatives to act in the best interest of their clients. Our experience leads us to believe that clients are no better protected under the Quebec regime than they are in any other province. We see no evidence that the imposition of a statutory best interest standard improves outcomes for clients.

The CSA is encouraged to be certain that each of the five investor protection concerns it has identified are mitigated in actuality versus in concept by testing the experience of Quebec investors versus the experience of investors from the rest of the country.

We have given consideration to the five *Concerns at a Glance* included in your paper. With respect to **Concern 1: Principled foundation,** some commentators may believe that a statutory best interest standard would result in a higher level of conduct for advisers and dealers in respect of their clients. We suggest that the current regulatory structure in common law provinces has similar results as the existing statutory best interest standard in Quebec - we view the Quebec model as one of a number of appropriate regulatory frameworks.

Similarly, with respect to **Concern 2: Information and financial literacy asymmetry,** we have not seen any evidence that would suggest that Quebec residents are more knowledgeable and better informed than the rest of Canada.

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Concern 3: Standard of conduct expectation gap: may suggest that investors and investment representatives need to better understand their relationship and the expectations they should reasonably have of each other, but we have not observed lesser client satisfaction in jurisdictions outside of Quebec than within Quebec.

On **Concern 4: Recommendation of suitable investments versus investments in the client's best interests:** this suggests that Quebec investors should have better investment results than investors in the rest of the country. We have seen no evidence to support such a conclusion. In addition, this concern seems more focused on obtaining the lowest priced alternative for a client, without acknowledging that the lowest cost does not guarantee that the product is in the client's best interest.

Finally on **Concern 5: The application in practice of the current conflicts of interest rules might be less effective than intended**: conflicts of interest arise within all regulatory frameworks and in fact are external to regulation, as they are inevitable when people deal with one another. There is nothing inherent in a statutory best interest framework or any other framework that can eliminate conflicts of interest. Although, the actual conflicts of interest will vary depending on the regulatory framework in place, conflicts of interest themselves can never be removed. We believe that the best safeguard against the negative implications of conflicts of interest is full and meaningful disclosure of such interests to the client.

In summary, we are very concerned that the imposition of a statutory best interest standard will result in an alternative "suitable" regulatory environment, but one that comes with increased regulatory costs without evidence of resulting value. As is correctly noted by the CSA, even slightly higher costs (whether as a result of increased compliance costs or otherwise) when compounded over the long term can have a significant negative impact on the value of an investment portfolio. A change to a province's securities regulatory foundation is not without cost and may be counterproductive if the outcome it provides to investors is effectively unchanged. We strongly recommend that the CSA engage in a detailed cost/benefit analysis before implementing change of any kind.

2) <u>The Statutory Best Interest Standard as Described in the CSA Paper</u>

Should securities regulators impose a best interest standard applicable to advisers and dealers that give advice to retail clients? Why or why not?

Quadrus is not opposed to investment representatives and dealers being subject to a best interest standard if that standard is clear and unambiguous and allows clients and investment representatives to understand exactly what is expected of them in any given situation. We are opposed to the imposition of a vague and general best interest standard without evidence that doing so will actually improve the investor's situation. The two American research studies cited by the CSA provide no such indication that a best interest standard provides better investor outcomes.

The Oliver Wyman *Standard of Care Harmonization: Impact Assessment for SEC* study indicates retail investors would experience "reduced product and service availability and higher costs" as a result of a change to a statutory best interest type model for investment advisors and broker-dealers within the United States. We are apprehensive of any potential regulatory change that would have an unintended negative impact on consumers in Canada similar to the risks outlined for the US by Oliver Wyman. The impact of regulatory changes predicted within the U.S. market by the Oliver Wyman Study are reduced access to:

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- An investor's preferred investment and advisory model;
- Investment products distributed primarily through broker-dealers; and
- The most affordable investment options.

These conclusions are concerning to Quadrus. The March 2012 study entitled *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice* does not demonstrate that each consumer will be better with the imposition of a fiduciary best standard. It doesn't even suggest that each consumer will be no worse off within a new standard. Rather, it suggests that, in the aggregate, society will be better off when the new standard is introduced. We feel it is incumbent upon the CSA to ensure that no single investor is "left behind." Clearly no Canadian investor should be worse off as a result of a change in the securities rules within his/her province. If Canadians have reduced access to investments or investment advice as a result of a new regulatory model, is that really in the clients best interest?

We do not feel this is mere semantics. Many have a mistaken understanding that a "best interest standard" as proposed within the CSA paper is a standard which creates better investment outcomes for all investors, or at a minimum better investment outcomes for some and outcomes no worse off for the remainder. We have serious concerns that the imposition of such a standard could create a "chilling effect", inadvertently and unintentionally making large segments of the investing public unable to obtain the services of an experienced investment representative. Our experience is that a large segment of the Canadian public needs and desires assistance with their investments. Increased compliance costs and potential liability to clients who, in retrospect, decide that their portfolio isn't "best" for them, could push investment advisors to narrow their range of potential clients.

We recognize that the CSA paper has not attempted to define the limits of a "best interest standard", but we are concerned that many stakeholders create their own definition. For the sake of clarity, as the CSA goes forward in its deliberations on this topic, it may be helpful to rename the standard as simply a "statutory clients interest standard". The word "best" will inevitably lead to retroactive assessments of recommendations. What is "best" for a given client is very difficult to determine in advance. Very narrow parameters will have to be established if both parties are to be able to fairly assess whether the standard has been met. Stakeholders would then be less likely to misconstrue the outcome to be expected as a result of a change to such a regulatory framework.

If such a duty is imposed, are the terms of the best interest duty described above appropriate (for example, should there also be an on-going obligation regarding the suitability of advice previously given or investments held by a client)? What changes, if any, would you suggest to the terms of the best interest duty described above?

The terms as described by the CSA are incomplete in some very important areas.

The terms impose no corresponding responsibilities upon Canadian investors. Certainly, Canadian investors have a duty to understand and choose their investments wisely and then to monitor and rebalance their investments. As a society it would not be prudent to allow Canadian investors to abdicate their responsibility to be financially educated.

We feel that any imposition of duties upon advisers and dealers should correspond to the imposition of fundamental duties upon Canadian investors. Without such a balanced approach, the system will reward

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investors for failing to educate themselves and take personal responsibility for their investment decisions. By staying uneducated Canadians can comfortably accept any advice from an investment representative knowing full well that if the outcome is favourable they are in a better position, and if the outcome is not favourable they can simply lodge a complaint against, or sue the investment representative and dealer.

Such an environment creates a moral hazard as investors have an incentive to act in a way that is inconsistent with their risk tolerance, investment objective and time horizon. For instance, a low risk investor may have an incentive to inform his investment representative that he understands markets and can tolerate high levels of risk. After a few years with an investment portfolio of this nature if the investor is significantly ahead then all is well. However, if the portfolio is reduced in value they can seek redress arguing they were in fact a conservative low risk investor. It should not be the responsibility of the investment representative or dealer to second guess whether an investor is attempting to present themselves as someone they are not. If the investment advice provided is fairly based on the information given by the client, at the very least a "safe harbor" rule should apply to avoid such situations.

We feel that the current Quebec standards do a reasonable job of addressing the corresponding responsibility of an investor. As quoted in the CSA paper "The extent of these obligations under the Civil Code varies depending on the legal context and nature of the investment advisory relationship (e.g. discretionary account or non-discretionary account, executing broker only), the degree of trust, dependence and vulnerability of the client". We see no similar language in the proposed CSA definition or terms that would imply a shared responsibility between investors and investment representatives or dealers. We suggest that the CSA definition and terms could be improved by utilizing the Quebec approach.

If the CSA concludes that current suitability obligations imposed on advice provided by investment representatives and dealers provide too large a range of appropriate products, then we recommend that they revise them so that the industry has clear rules as to what makes up the smaller range of products which meet such requirements.

Are there other general issues related to imposing the best interest standard described above that should be addressed?

Any best interest standard, if determined to be appropriate, should be applied on a very *qualified* basis. This is how such a standard was adopted in the UK, EU, Australia and in proposed form in the US.

Specifically, from Australia the introduction of the qualified best interest standard provided a statutory safe harbour that clarifies that the investment representative does not need to provide perfect advice and does not need to canvass the whole universe of products. As noted earlier, we feel strongly that the language of the proposed standard may encourage investors to abdicate personal responsibility for their investment decisions. A balance needs to be restored or proper protection needs to be provided for the investment representative and dealer. The Australian regulators seem to have recognized this by providing clear steps, which if followed, will provide a safe harbour for investment representatives and dealers.

From the U.S., it seems there is the desire is to ensure the duty does not constitute an on-going duty with respect to advice previously given. This appears to differ from the CSA terms which impose an ongoing duty which ends only upon the termination of the client relationship. It is conceivable that under such a requirement an investor could follow the advice of an investment representative once and then not engage with that same investment representative over the next 20 years. During that period of time, the personal situation of the

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investor may have changed considerably to say nothing of the changes in products, investment markets, etc. The terms proposed by the CSA would allow the investor to hold a continuous claim against the investment representative and dealer that the advice given 20 years ago was not in their best interests. The fact that the investor chose to ignore contact from the investment representative appears to be irrelevant under the standard. The fact that the investor hadn't terminated the relationship seems to impose an unreasonable standard upon investment representatives and dealers. The U.S. approach appears to adjust for the issues with providing an on-going duty requirement.

3) The Question of Functional Equivalency

Does the duty of an adviser or dealer to act fairly, honestly and in good faith when dealing with clients, coupled with the existing rules related to suitability and conflicts of interest, already impose a standard of conduct that is functionally equivalent to a fiduciary duty?

Provinces with a common law foundation have the benefit of years of precedents, and a general understanding of the duties and obligations of each party. Such an approach provides historical equity in assessing which situations create a fiduciary duty between an investment representative and client. A decision to move from a well developed common law framework where the obligations of each party are well understood to an untested statutory framework is very concerning. The existing common law and the current standards of care are sufficiently flexible to address client concerns generally. A more rigid approach is likely to have significant unintended consequences, which may be more harmful to the investing public than the issue it is attempting to cure. The unforeseen consequences of such a dramatic shift to the securities regulatory framework of Canada causes us to recommend a cautious approach to the CSA.

We feel that the regulatory frameworks that exist within Quebec and the other 9 provinces and territories, though different from each other, provide outcomes that are functionally equivalent and have stood the test of time. These regulatory frameworks are appropriate for all client situations as they currently stand. These regulations include the following:

- A requirement to deal fairly, honestly and in good faith with clients
- A requirement to observe high standards of ethics and conduct in the transaction of business with clients
- Proper disclosure and handling of conflicts of interest
- Supervisions of activity in client accounts
- Background checks (such as police, credit, employment, education and proficiency course completion)
- Industry specific education requirements
- Compensation disclosure
- Insurance and bonding

We commend the CSA for creating an environment where dealers and investment representatives owe their clients such a high standard of conduct. The CSA should pause before replacing of these regulations with an untested and vague Statutory Best Interest Standard. We are not convinced that it will create an environment which provides any better protection to Canadian investors.

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We thank the CSA for the forum to provide our comments on their Consultation Paper.

Yours truly,

Michael Stanley
President and Chief Executive Officer
Quadrus Investment Services Ltd.