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February 22, 2013

To:
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:
Me Anne-Marie Beaudoin
Corporate Secretary
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Submitted by E-mail

Dear Sirs/Mesdames:

Subject: **Comments on Consultation Paper 33-403: Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is Provided to Retail Clients**

Independent Financial Brokers of Canada welcomes the opportunity to provide our comments on the above-referenced consultation paper.

We wish to compliment the CSA on the thoroughness of this paper in articulating the various issues and policy positions related to the standard of conduct for financial advisers and dealers, as well as the comprehensive review of approaches adopted or being considered in other countries. In addition, we are pleased that the CSA has undertaken to solicit comments from interested parties at an early stage of the discussion, allowing a fulsome debate and consideration of the issues well ahead of any specific proposal to consider any regulatory change.

Independent Financial Brokers of Canada (IFB)

IFB is a voluntary, professional trade association representing some 4,000 licensed, financial professionals across Canada who operate as self-employed business people. Our members have chosen to be independent so they may provide clients with financial advice and access to investment choices from a range of companies and products. For more information on IFB, please see our website, www.ifbc.ca.

IFB was established nearly 30 years ago to support those who wanted to operate under an independent business model, rather than under an employer-employee or single company agent model. Today, our members still choose to belong to this Association and support what it stands for. One condition of membership is that members agree to adhere to the IFB code of ethics. IFB's code of ethics (see www.ifbc.ca/principles_ethics.asp) was remodelled over 10 years ago to reflect the Joint Forum of Financial Regulator's recommended code of conduct for financial intermediaries. It remains a high and current standard today and notably begins with a requirement to always put the interests of the client first. Because of this, IFB members voluntarily agree to be held to a higher standard than is prescribed by the industry.

In addition, IFB supports the professional standards of its members by offering compliance tools, a comprehensive errors and omissions program (an important element in protecting investors, various continuing education events, and ongoing communication of industry issues which may impact their business practices. In return, the IFB E&O plan has experienced a low frequency of claims arising from improper business conduct or poor suitability.

The majority of our members are dual licensed – operating under both securities regulation as mutual fund salespersons and under insurance regulation as life insurance brokers, although many hold other complementary licenses such as for general insurance, securities, deposit instruments, mortgages and professional designations such as financial planning, etc.

Unlike many others who will provide comment, we do not represent the views of a singularly regulated group, but rather one whose members must answer to a variety of financial regulators and self-regulators, including securities regulators, and often in more than one provincial/territorial jurisdiction.

We are particularly concerned about the potential impact of a statutory best interest standard being applied to our members in circumstances where they are dual licensed and their clients have portfolios holding both life insurance and securities products. The life insurance industry has principle-based regulations that require advisors to exercise "utmost good faith" in any dealings with a client or potential client. Furthermore, after considerable scrutiny of the life insurance industry practices in Canada (in response to events related to wrong doings in the U.S. which uncovered no such wrong-doing here) the Canadian Council of Insurance Regulators endorsed three principles for managing conflicts of interest for dealing with clients. These principles have been in place since 2006 and require life insurance agents to place the interests of the client first, to disclose any actual or potential conflicts of interest and to recommend suitable products and services based on the needs of the client.

To assist life insurance advisors to comply with appropriate disclosure about themselves and their business relationships, industry stakeholders (including IFB) developed a disclosure protocol. This disclosure requires advisors to identify to clients the companies the advisor represents, the nature of the relationship with those companies, how the advisor is compensated, if the advisor is or may be eligible for additional compensation (e.g. a travel incentive or bonus), additional conflict of interests (if any), an undertaking to provide the client with more information on request and how to access information on industry complaint mechanisms. In addition, some of this information is replicated in the Fund Facts documents, endorsed by both securities and insurance regulators, when clients are considering the purchase of a mutual fund or segregated fund. While this is not intended to be a comprehensive account of life insurance standards of practice it does point to the fact that both insurance and securities regulators have recognized that transparency and disclosure are central to improving investor protection.

Today, clients have access to a great deal of disclosure which they can use to evaluate whether or not they wish to proceed with a particular purchase or to deal with that particular advisor. In addition, they have access to an advisor's errors and omissions insurance to seek remedy for financial loss arising from an error, fraud (in many provinces) or misleading sales practice, quickly and inexpensively. For more serious offences, clients can seek legal remedy through the courts where a fiduciary duty may well be found to exist based on the specifics of the case.

We believe the Canadian regulatory structure is sound, but no degree of additional regulation will provide investors with a bullet-proof solution for protection from criminals. This is where better enforcement, higher levels of financial literacy/education and other investor protection tools can help the public become more astute at discerning the legitimacy of the advisor and investment being recommended. As CSA Chair Bill Rice says in his "Message from the Chair" released February 21, 2013: *"The CSA 2012 Investor Index provides context around the investment climate in Canada and the factors that can enable fraud to occur. While the study demonstrates some encouraging trends – more Canadians are saving for retirement and more are using financial advisors than in previous years – the results also show that most Canadians have unrealistically high expectations of the returns they should expect on their investments. When interest rates are as low as they are today, investors naturally seek higher returns. A promise of high, risk-free returns is one of the clearest warning signs of a fraudulent scheme."*[1]

[1] About Enforcement, *Message from the Chair*, Canadian Securities Administrators website, http://www.securities-administrators.ca/aboutcsa.aspx?id=1120

Below are some general comments, followed by more specific ones aimed at addressing some of the issues identified in this paper.

General comments

i) Cost-benefit analysis

At this stage, the CSA has not undertaken a cost-benefit analysis of the potential options and impacts. If the CSA moves forward on this initiative, we believe that it is essential to undertake a cost-benefit analysis as part of its review of alternatives. Such an analysis will serve to provide all stakeholders with concrete input into the potential effects of a particular strategy and contribute to a better understanding and acceptance by all.

ii) Concurrent CSA consultation on mutual fund fees

The CSA issued the discussion paper on introducing a statutory best interest duty, which was followed in December 2012, with a subsequent consultation paper intended to examine the current mutual fund fee structure. The CSA said that the reason for issuing the discussion paper on mutual fund fees is "*to see whether there are investor protection or fairness issues, and to determine whether any regulatory responses are needed to address any issues we find*". In addition, it says, "*While the focus of this paper is on mutual funds, we recognize that there are other investment fund products whose fee structure may raise similar investor protection and fairness issues for investors. Accordingly, we anticipate that any regulatory initiative we might ultimately undertake would assess whether the same initiative should also apply to other investment funds and comparable securities products*." [2]

While the mutual fund fees paper appears to anticipate an earlier implementation than the best interest paper, some of the issues identified in the mutual fund fees paper concerning the current compensation structure will undoubtedly be affected by any future move to implement a statutory best interest duty. This may well result in dealers/advisors having to incur additional cost to undo or redo changes already paid for and in place by then.

The industry has incurred significant costs to-date to incorporate the technological changes required to meet the enhanced requirements under NI31-103 related to the Client Relationship Model (CRM). These include, among others, relationship disclosure, enhanced reporting and conflict of interest disclosure to clients and incorporating a 'plain language' approach. The implementation date of the latest phase of the CRM is not until March 1, 2013 and, therefore, not yet rolled out or experience-tested with clients. These enhancements, along with the many that have already been put into place, provide clients with greater transparency which, in turn, will provide them with information to question more freely anything in the trade or in their account that they do not understand.

Despite this, the CSA is asking that stakeholders consider these consultations independent of each other, when in practice they are inevitably intertwined. Taken together, they will not only layer on more costs but potentially fundamentally change how mutual funds, investment funds and similar types of securities operate their businesses today. We believe it would be preferable and more cost-effective to view these policy initiatives in tandem, rather than as separate and distinct.

[2] Canadian Securities Administrators Discussion Paper and Request for Comment 81-407 *Mutual Fund Fees*, December 13, 2012, part 1. Introduction

Further, we submit that these changes will have an unequal impact within the securities sector. Mutual fund and securities dealers and advisors will bear a greater burden of this impact than portfolio managers. Portfolio managers, due to their discretionary powers, already are held to a fiduciary standard and are not compensated by commissions. Clients of portfolio managers are generally more affluent, who meet the investment standards required to access this type of account and pay for the services on a fee-based basis. Clients of mutual fund and securities dealers generally have smaller retail accounts, and use a commission structure. This structure helps to make the services provided by these dealers-advisors more affordable to smaller retail clients and, therefore, more accessible. These different compensation standards are in place so that all segments of the retail investor are served. We would not want to see regulatory policy limit the ability of small investors to save, other than through traditional interest bearing accounts, like GICs or bank accounts, for example.

iii) The current situation

As mentioned at the outset of our response, it is important to draw a distinction between those cases of investor loss attributable to perpetrators of financial fraud and the everyday business conducted by the many thousands of licensed advisors who provide good advice to ordinary Canadians. While investor fraud gains much public interest and scrutiny, these cases often involve individuals who are unlicensed and/or who misrepresent themselves and the investment to potential investors. It is unlikely that unscrupulous individuals will be deterred by the imposition of a fiduciary standard. Adding regulatory burden to a system which is largely compliant will do little to curb those who are intent on achieving personal gain through unethical or illegal means. However, it will increase the cost of compliance and time spent on compliance activities to oversee legitimate investment transactions, which are the vast majority. Again, the effect of these costs will not be equal for all market participants. Large, integrated financial organizations will be better able to adjust and absorb those costs. Small and mid-market players will be at greater risk of not being able to withstand these increased costs which will lead to their further decline. It is important to recognize that these are today the dealers and advisors which still provide individualized service to smaller retail clients, albeit in shrinking numbers.

iv) Fiduciary duty can exist today

Much of the discussion in support of implementing a best interest duty has revolved around protecting investors who are more vulnerable because they are dependent on the advice received. In today's environment, these might well be situations where the advisor is seen to have a fiduciary duty and, indeed, case law supports this. The courts have not been loath to apply a fiduciary standard in cases where it has been warranted. Imposing a single standard on all accounts does not recognize the many other types of relationships that can exist between dealers/advisers and their clients. Therefore, we prefer the approach taken by Canadian regulators to-date that has bolstered investor protection, (most recently through the CRM); thereby providing, in practice, many of the benefits of a best interest requirement, while not mandating a single standard.

Better enforcement of existing requirements, with recourse for clients to complain and seek restitution, seems a less burdensome approach while achieving similar outcomes. There already exist a number of options for clients to resolve complaints, outside of expensive litigation, today. In addition, most advisors are required to have errors and omissions insurance or do so voluntarily for their (and their client's) protection. E&O insurance provides a first line of defence for investors to recoup losses without the expense and inconvenience of pursuing restitution through the courts (where sometimes there are no assets to satisfy the judgement). Changing to a uniform best interest standard may well increase the

cost of E&O for advisors and dealers and reduce the ability of retail investors, particularly those with small claims, to recover damages for careless or unsuitable investment advice in a timely manner.

v) Significant improvements to investor protection are in place

As mentioned above, we consider E&O to be the first line of defence for clients who seek restitution. As an important consumer protection tool, we believe all advisors and dealers should have E&O insurance coverage. While it is a licensing requirement for life insurance advisors, this is not the case for mutual fund advisors. In practice, many do purchase E&O for their and their clients' protection; however, we believe that investors would benefit from it being a mandatory licensing requirement.

In recent years, securities regulators and self-regulators have mandated increased levels of disclosure and transparency for clients and in client documentation, which has been reworked to a plain language standard. An excellent example of this is the "Fund Facts". This stemmed in part from the view that lack of disclosure and poor transparency were at the root of much of the confusion that exists in advisor-client relationships. Clients did not always understand the investment, its costs/fees, advisor compensation and how the fund had performed in the past. However, much of this has now been addressed with the implementation of NI31-103, as well as changes implemented by the MFDA and IIROC.

NI 31-103, and its companion policy, provides guidance on how to comply with the greater level of disclosure, including a recommendation to avoid conflicts of interest where possible. In addition, there are more events now which trigger updated suitability reviews and have affected procedures for both IIROC and MFDA dealers and advisors. In our view, the implementation of these requirements (i.e. disclosing potential conflicts of interest, fees, complaint mechanisms, etc.) have in effect moved the relationship away from a lower suitability standard, and much closer to a fiduciary one. While we understand that recommending a 'suitable' investment can be different than recommending the 'best' product for the client, we would argue that the higher suitability standards in place today significantly narrow this gap without adding the cost of a statutory best interest standard across all business models. Having said this, the CSA seems prepared to carve-out certain types of advisor channels, such as those in the exempt market and scholarship plans, which seems inconsistent.

Imposition of a uniform best interest standard is particularly disadvantageous to those advisors who are not permitted to engage in discretionary trading. While the CSA suggests an outright exemption for execution-only, exempt market and scholarship plan dealers and advisors, it has no intention to do so for mutual fund dealers and advisors. This despite the fact that a mutual fund license restricts the scope of products, does not allow discretionary trading and is characterized by more limited advice to clients. We believe this should be revisited and that regulators should strive to find options that are business neutral so as to not disadvantage some models over others.

vi) Option to address different levels of advice

According to the paper, there is client confusion over the client-advisor relationship, in that clients often do not understand the difference between the suitability standard and a best interest standard. We think this could be addressed through a disclosure document while still allowing for a modified best interest standard to recognize instances where there is a reduced dependence on the advice provided. Any such arrangement would be endorsed and agreed to by the client. For example, where the relationship is more discretionary, the advisor could identify that s/he is held to a best interest standard. Whereas, for relationships less dependent on advice, the disclosure would reflect this and indicate that the advisor's advice is incidental and/or limited to the transaction.

This type of approach would provide clients with choice and yet be business model neutral. Clients who choose to work with an advisor held to a suitability standard would know this up front through full disclosure, as would those who choose to work with an advisor held to a fiduciary standard. Clients would retain the type of professional they are most comfortable with. This would allow for a more flexible approach and better recognize the range of options and types of accounts that clients have today.

Other situations to be addressed

A uniform standard raises questions related to situations where less "personalized" advice is provided. For example, how would a single standard address more impersonal situations, like recommendations or endorsements in the newspaper or on social media? Such recommendations can send investors off on their own perhaps without sufficient knowledge and without the advice of an advisor and result in financial loss with no restitution. How will discussions held with prospective clients versus existing clients be impacted?

Key investor protection concerns with the current standard of conduct

CSA staff has identified 5 key concerns in this paper. We will comment on each one below:

1. **Inadequate principled foundation.**
   A key element that seems to be missing in this discussion paper is acknowledgement that advisors value their clients. In practical terms, without them they have no business. Clients are free to vote with their feet at any time if they do not value the services or advice provided to them. In addition, advisors are fundamental to helping Canadians save for the future – whether that is for unexpected expenses or eventual retirement.

   Today's economic reality is that fewer and fewer Canadians can rely on government retirement plans and employer sponsored pensions to finance their retirement. In addition, there is frequent media coverage of Canadians' high level of personal debt and low savings. In fact, as recently as February 15th an article in the Globe and Mail, entitled "Unthrifty boomers as emerging seniors", cited research that found that those over age 65 increased their debt levels by 15 percent last year. The article quotes TD chief economist Craig Alexander as saying "Canadians are entering retirement more indebted than ever".

   Given these facts, we think regulators should be encouraging Canadians to seek out investment advice, from legitimate advisors and dealers, so that they can implement and adhere to a regular savings platform. We find it disconcerting that part of the message in this paper seems to be that regulators view the current system as not serving investors well and needs to be fixed. If this is not the case, it appears to be the media's perception of it, which is just as problematic. Ultimately, it is the regulators' job to regulate those under its purview in a fair and transparent manner. These actions should contribute to a positive public perception, not to an atmosphere of mistrust.

2. **Information and financial literacy asymmetry.**
   We concur that those who are licensed and have the specialized training of a financial professional will – and should – have a higher degree of knowledge than the average investor. Indeed, insufficient knowledge, lack of access to the market and lack of time are all reasons that consumers of all levels of sophistication and financial means seek out professional advice.

Having said this, the key to reducing this asymmetry is to improve the level of financial literacy and access to informational and educational tools for the general public. While advisors, like our members, assist in this process everyday with their clients, it is reflective of a much broader public policy issue that rests with government, regulators and their investor education initiatives. In our view, it is unreasonable to place this burden on the shoulders of individual advisors.

Furthermore, we reference our earlier observations that a great deal of disclosure is available to clients now. In today's information age, access to information is far more readily available than in the past for those clients to access independently. However, the difficulty with more and more mandated disclosure is that it becomes ineffective due to information overload. Clients do not want to read pages and pages of disclosure. Despite the cost to industry for firms to generate prospectuses, simplified prospectuses, offering memorandums, etc., most end up unread. While advisors cannot force clients to read lengthy legal documents and/or take the time to understand them, there are few advisors who would not welcome the opportunity to explain in greater detail any products being suggested or to answer client questions.

3. Standard of conduct expectation gap.

The CSA cites information gathered from the Investor Education Fund study that most investors believe that their advisor or dealer has a legal duty to act in their best interests and that this creates a problem because it does not accurately reflect today's suitability standard. Having said this, the study goes on to say that 76% of investors said that they trust their advisor or dealer to give them the best possible advice and would identify the best investment choice for them. Another 62% said they believed their advisor or dealer would recommend the best product for them regardless of whether it resulted in less compensation.

While the CSA says these findings are of concern, we suggest this demonstrates that a large majority of investors are satisfied with their advisor or dealer and trust their recommendation. We don't see these numbers as negative. If the CSA believes investors are being misled by a large number of advisors-dealers in their investment choices or misrepresenting themselves, then this points to the need for better enforcement and disciplinary action. However, we do not believe this to be the case.

Previously, we referred to the importance of supporting financial education to assist investors. However, it is equally important for the general public – not just investors – to be educated as to how they can determine whether the advisor they are considering engaging or investing with is properly licensed. This knowledge would help to combat the number of egregious situations where investors are taken in by con artists – situations which, ultimately, reduce the public's trust in the industry as a whole.

We see education as a valuable role the CSA and/or investor education organizations could play and suggest it undertake an extensive media campaign aimed at raising public awareness about issues such as:

a) why consumers should only deal with a licensed financial professional ;
b) how to determine if an advisor-dealer is licensed, and
c) how to check an advisor's disciplinary history.

Despite the industry's best efforts to-date, to provide educational tools and resources, a media campaign undertaken by regulators would have a tone of impartiality that it is difficult for industry stakeholders to replicate.

4. **Recommendation of suitable investment which is not necessarily in the client's best interests.** This argument is premised on the current compensation practices in the industry and that these practices create an undesirable conflict of interest for advisors and dealers. As identified in our earlier remarks, a greater level of written disclosure has been implemented to help clients understand the costs, fees and compensation affecting their purchase. This information provides triggers and opportunities for clients to question the costs and compare them to similar products, for example through the Fund Facts.

   It is also important to point out that advisors serve their clients but must execute trades through their dealer. Their dealer controls the shelf of approved products the advisor can make available to the investor and can influence the products recommended or sold. Such situations could place the advisor in a conflict over which s/he may have little control. Any best interest standard would have to recognize this and free the advisor from this dealer influence.

5. **The application of current conflicts of interest rules may be less effective than intended.** The CSA has identified 3 concerns. The first concern (a) says the current principles-based rules relating to disclosing conflicts of interest are not resulting in full and complete client disclosure by all advisors and dealers. One solution would be for regulators to provide more education and guidance so that advisors and dealers better understand the expectation of regulators in this regard.

   The second concern (b) suggests that current compensation practices represent a fundamental conflict of interest in that they can provide an incentive to sell certain products. The CSA notes it has a separate policy initiative to consider these practices for mutual fund products. IFB will comment on this separate consultation paper. However, as per our earlier observation, these two consultations need to be viewed together so that policy positions are not adopted that may have to be reversed at a later date.

   There are sound reasons why the industry has both a commission-based compensation structure and a fee-based structure. Such structures serve different segments of investors and we do not believe that regulators should interfere with these options unless there is an over-riding need to do so. At this time, we do not see that the need has been proven or is generally harmful to consumers. On the other hand, some countries have recently introduced bans on commissions, which give Canadian regulators a real opportunity to observe the effect of these changes, thereby learning from others' experiences and gaining valuable insight in advance of taking a particular policy position.

   The third concern c) is whether more prescriptive rules need to be developed to deal with recommendations to buy, hold or sell securities in related or connected issuers. We have no comment on this as it is more appropriately addressed by other commenters, specifically those in the exempt market.

This concludes our comments. We have chosen not to directly address the 52 questions posed in this paper individually. However, we hope that collectively we have answered many of these questions from the perspective of our members. We look forward to participating further in these discussions as they evolve.

Should you have any questions on our response, please contact either myself or our regulatory affairs contact, Susan Allemang (email: sallemang@ifbc.ca).

Yours truly,

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