INVESTMENT DEALERS ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DES COURTIERS EN VALEURS MOBILIÈRES

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PRESIDENT AND CHIEF EXECUTIVE OFFICER

April 27, 2004

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
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Fair Dealing Model Concept Paper Comments

I am pleased to provide, on behalf of the Investment Dealers Association of Canada (IDA), our comments on the Fair Dealing Model (FDM) Concept Paper. These comments are in line with those set out in our previous submissions on the FDM.

We support the Core Principles of the FDM. Indeed, we could hardly do otherwise. The FDM is based on relationships, self-managed, advisory and managed for you, which are described in our rules. In addition it is based on principles: a clear allocation of responsibilities, all dealings with retail investors should be transparent, and conflicts should be managed to avoid self serving outcomes, with which we agree.

The FDM supports a continuing important role for self-regulatory organizations like the IDA. In fact, it notes that many existing IDA rules are already consistent with aspects of the FDM, while others may need to be adapted, extended and otherwise improved.

However, we would like to raise the following general concerns:

Harmonization

A primary concern is the lack of harmonization between the FDM and existing regulatory systems and current regulatory proposals, specifically The BC Model's Draft Legislation and Guides, published by the British Columbia Securities Commission and the Uniform Securities Legislation, proposed by the Canadian Securities Administrators, including the OSC. We are concerned that the FDM, an ambitious and far reaching initiative, has been published without the endorsement of the Canadian Securities Administrators. In Canada, the need for harmonization is a central theme in regulatory reform and must apply particularly to any proposed regulations in the financial services industry. We ask that any further considerations of the FDM focus first on

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how the FDM would harmonize with existing regulatory structures and other proposals for regulatory reform.

Co-ordination with Self-Regulatory Organizations

We want to underscore the importance of ongoing co-ordination with SROs, like the IDA, in the implementation of the FDM. As the FDM correctly states, any rules developed would have to consider existing IDA rules that regulate the client-advisor relationship. As the SROs are responsible for regulating the advisory and sales activities of registrants dealing with the investing public, it is important that these organizations play an integral role in the development of the FDM.

The IDA is assisting in co-ordination through the participation of IDA Member firm and staff representatives in the Implementation Working Groups. These individuals will be exceptionally helpful in identifying those IDA rules that are consistent with the FDM and those rules that may need to be adapted, extended or otherwise improved. This will ensure that the likelihood of duplicative and potentially inconsistent rules relating to fair dealing is minimized, that the new policy is balanced, that it reflects market realities and that it is practical.

Fair Dealing Model Structure

The rules that will implement the FDM concepts should permit flexibility and individual customization of relationships between advisors and clients. Excessive rigidity will tie innovation and competitiveness to the slow and inflexible process of regulatory rule change.

We hope that in formulating the FDM, the Ontario Securities Commission will bear in mind that more rules will not necessarily result in increased investor protection. We suggest that implementation of the FDM should be accompanied by an emphasis on the enforcement of existing regulations and enhanced investor education and protection.

Costs

Considering all of the above, one of our major concerns is that it would be extremely costly to fully implement the FDM, costs that would be passed on to the investing public. The FDM states that the OSC has not yet completed its cost-benefit analysis because many of the specific requirements have not yet been finalized. We believe the performance of a rigorous cost benefit analysis is critical for two reasons; first, the cost benefit analysis will have an important influence on the specific requirements and secondly it will address the growing concern among market participants, especially the smaller dealers, with respect to the increasing burden of regulation.

In addition to the above general concerns, Attachment I to this letter provides our current views on the specific recommendations contained in Parts IV - Practical Details: How the Model Will Work. Our views fall into four categories:

(1) recommendations that we support and are already the subject of an IDA rule,

(2) recommendations that we support and that will require a new or amended IDA rule,

(3) recommendations we do not support because we disagree with them in principle or because we believe they are impractical and

(4) recommendations that we cannot decide if we support or not without further information on what is intended.

These views are of necessity preliminary because it is impossible to fully support or reject a proposed rule until a draft of the actual rule is reviewed.

As noted above, the IDA appreciates the opportunity to work with and to share its comments with the Commission on the FDM. Although it is our view that many of the issues addressed by the FDM are dealt with in IDA regulations, there remain many good ideas and suggestions in the document. We believe that, together with industry participants, we can work towards creating improvements in the relationships between clients and their financial services providers. Throughout the process, however, it will be necessary to be cognizant of those areas where a great deal of additional work is required, particularly in developing a relevant and useable Fair Dealing Document, analyzing and disclosing portfolio risk and performance and disclosing aggregate compensation.

We believe that most if not all of what the FDM intends to achieve can be implemented, for IDA Members, through IDA rules. Therefore we recommend that the OSC work with the IDA and other SROs to implement the FDM through self-regulatory rules. We believe this process will have three immediate benefits:

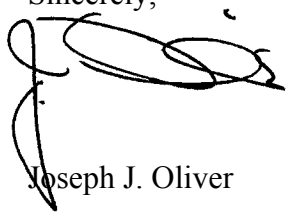
(1) changes to IDA rules to implement the FDM can be made expeditiously, probably within 6 months, i.e. years ahead of the schedule set for implementation of the FDM,

(2) harmonization will be greatly facilitated and

(3) it will help to ensure that resulting rules will reflect the dynamics of the industry, including technical and cost constraints and the practical application of requirements by industry personnel.

We would welcome the opportunity to provide further explanation on any of our comments that may be unclear and to meet with Commission staff at your convenience.

Sincerely,



Joseph J. Oliver

Parts IV - Practical Details: How the Model Will Work — Attachment I

(1) RECOMMENDATIONS THAT WE SUPPORT AND ARE ALREADY THE SUBJECT OF AN IDA RULE

REF #	OSC RECOMMENDATIONS FROM FDM CONCEPT PAPER	COMMENTS / IDEAS	PAGE
1.	**Representatives' duty of care** Having undertaken to advise someone, a representative has a general duty to advise carefully, fully, honestly, and in good faith.	▪ *The IDA supports this recommendation. This requirement is currently incorporated in By-law No. 29.1.*	53
2.	**Choice of investments** The appropriateness of individual transactions will be evaluated in the context of the investor's overall portfolio.	▪ *The IDA supports this recommendation. This requirement is currently contained in Regulation 1300.1(c)*	54
3.	**Best execution** Where a financial services provider executes a trade on a client's behalf, fair dealing requires best execution, regardless of whether the provider trades as agent or principle.	▪ *The IDA supports this recommendation. This requirement can be found in By-law 29.3A; Regulation 1300.17 and it is also a UMIR requirement.* ▪ *It may be necessary in the context of this review for the industry to review certain managed account trading practices such as the use of soft dollars.* ▪ *It may also be necessary to consider the impact and use by investment dealers of alternative trading systems, where better execution might be possible, but where there may be regulatory barriers to participation.* ▪ *It should also be noted that there has been some discussion about the definition of "best execution" in the concept paper and elsewhere. The focus is whether factors other than price can or should be considered in the context of "best execution".* ▪ *Clarification of this issue is required.*	55
4.	**Account monitoring responsibilities** The relationship type would determine who is responsible for monitoring an account, and the nature of the responsibilities.	▪ *The IDA supports this recommendation. This is our current requirement - Policy No. 9 for self-managed accounts; Regulation 1300 and Policy No. 2 for advisory accounts; Regulation 1300 and Policy No. 2 for managed-for-you accounts.*	76

(2) RECOMMENDATIONS THAT WE SUPPORT AND THAT WILL REQUIRE A NEW OR AMENDED RULE

REF #	OSC RECOMMENDATIONS FROM FDM CONCEPT PAPER	COMMENTS / IDEAS	PAGE
5.	**Creating a Fair Dealing Document** For every account opened, the investor and the representative must sign a Fair Dealing Document that documents the relationship type, investment objectives, and services they have agreed upon.	▪ *The IDA is generally supportive of this recommendation and agrees that every account should be opened with a signed document that describes the items noted.* ▪ *There is general agreement that the IDA standard New Account Application Form (IDA Form 2) is outdated. A working group of the Compliance and Legal Section is currently reviewing the IDA Form 2 and will make recommendations for its improvement.* ▪ *Collection of this information without storing it in an electronic database with online reference tools and exception reports that are useful to investment advisors will limit the ability to use this information. This will be an issue for firms not intending/unable to pursue this technological strategy.* ▪ *Further, to fully utilize this information electronically, key concepts such as "risk" and "speculation" must be made more quantifiable* ▪ *Should every account be opened with a **signed** document? (The Paper notes that if the Fair Dealing Document (FDD) is completed online, electronic confirmation is sufficient)* ▪ *Does this recommendation apply to all existing accounts? If so, a multi-year phase-in period would be required.*	44
6.	**Choice of Investments** In an Advisory or Managed-For-You relationship, advice may not be influenced by compensation. Recommendations or discretionary decisions must be based on the representative's expert judgment and the objectives agreed upon in the Fair Dealing Document.	▪ *The IDA supports this recommendation but recommends it read "In an Advisory or Managed-For-You relationship, advice must put clients' interests first rather than compensation.* ▪ *Existing By-law No. 29.1 addresses this issue generally.*	54

(2) RECOMMENDATIONS THAT WE SUPPORT AND THAT WILL REQUIRE A NEW OR AMENDED RULE

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7.	**Benchmarks** Reporting external benchmarks would not be mandatory, but if an account statement includes them, the regulations would set minimum standards to require that the benchmarks chosen are appropriate to the investor's portfolio.	▪ *The IDA supports this recommendation.*	71

(3) RECOMMENDATIONS WE DO NOT SUPPORT BECAUSE WE DISAGREE WITH THEM IN PRINCIPLE OR WE BELIEVE THAT THEY ARE IMPRACTICAL

REF #	OSC RECOMMENDATIONS FROM FDM CONCEPT PAPER	COMMENTS / IDEAS	PAGE
8.	**Information provided to investors** Prior to the execution of any transaction, financial services providers would be required to present a summary of the essential features of the transaction to all Advisory investors and certain Self-Managed investors.	▪ *This recommendation raises a concern of liability or exposure for the registrant/firm. Should the registrant not provide the client a written Transaction Summary, the registrant must keep notes detailing the oral summary. There is an issue should the notes not be kept and/or should the notes kept not include the same information as provided in the Transaction Summary templates as set out in Appendix C.* ▪ *Whether written or oral, the implementation of a requirement to present a Transaction Summary that requires specified information is probably not appropriate, as it reduces the ability of advisors to tailor the information provided to clients in accordance with their needs. For example, an inexperienced investor will require a more detailed summary of a transaction than a more experienced, sophisticated investor who may, in any event find this information to be of little use.* ▪ *Shouldn't it instead be the responsibility of the advisor, exercising his or her professional judgment, to determine the appropriate information to be provided to the client?* ▪ *This recommendation is likely unworkable in practice due to advisor time constraints.* ▪ *It is reasonable to suggest that a transaction summary, particularly a verbal summary, be a "best practice", the use of which is to be determined by the Advisor in light of the needs of the client and the nature of the relationship they have established. Inclusion of the elements of a complete transaction summary should be included in the Conduct and Practices Handbook as a best practice.*	57

(4) RECOMMENDATIONS THAT WE CANNOT DECIDE IF WE SUPPORT OR NOT WITHOUT FURTHER INFORMATION ON WHAT IS INTENDED

REF #	OSC RECOMMENDATIONS FROM FDM CONCEPT PAPER	COMMENTS / IDEAS	PAGE
9.	**Choosing the relationship type** At the account opening stage, all investors must choose one of the three relationship types: Self-Managed, Advisory, or Managed-For-You. The consequences of the choice must be made clear to the investor.	▪ *Generally, it is agreed that the consequences of this choice must be made clear.* ▪ *Regulation 1300 and Policy No. 9 currently provide a regulatory structure for these three relationships. A fourth type of relationship – a discretionary account – is also accommodated in the IDA rules. For this relationship the investment advisor is given discretionary authority over a client's account and regular commissions, rather than an account management fee, are applied.* ▪ *There is an opportunity to clarify the rules to insure that accounts are effectively categorized and the effects of categorization are clear to the members. Members would also be required to advise their clients of the implications of different account categories, both ongoing and retroactively. As in respect of all rule changes involving disclosure and documentation, retroactive steps involving existing accounts must be carefully considered to avoid punishing costs and other fallout.* ▪ *The proposed treatment of non-solicited transactions in Advisory accounts raises a concern because it would effectively repeal IDA Policy No. 9B.*	40
10.	**Education video of interactive demonstration** Prior to completing the Fair Dealing Document, every investor must have an opportunity to view a brief educational video (or equivalent) about the basics of securities investing and the choices available to them under the Fair Dealing Model.	▪ *It is important that the paper indicates that merely the "opportunity" be given to the client to review the video, as many clients would resent the enforcement of a requirement to view a video or equivalent* ▪ *The IDA is willing to develop a cost-effective standard CD or videotape to be distributed with new account documentation.*	49

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11.	**Information sheets** An Information Sheet is a standardized description of a particular type of security, or of investing in general, that would be distributed to an investor prior to his first transaction	▪ *This recommendation should be reviewed in the context of all other currently mandated client disclosure material, particularly those that are long and complex, such as the strip bond disclosure statement and the arbitration brochure. These various forms of disclosure should be made client (and firm) friendly.*	49
12.	**Obligations governing transaction advice and execution** Representatives in Advisory relationships would take on greater responsibility at the point of sale for educating investors and filtering information received from third parties.	▪ *Is this a cost effective channel for delivering investor education?* ▪ *This recommendation is quite vague apart from a sub-point requiring that mutual fund companies produce disclosure packages that are more "concise" and "relevant" than current prospectuses, for distribution by investment advisors to their clients.* ▪ *Is it appropriate to write a rule for "filtering information" received from third parties? Is it intended that the advisor would be held responsible for improper filtering?* ▪ *As part of the filtering of third party information, to what extent is it intended that an advisor would be held responsible for the interpretation of the third party information? For example, the reserve information provided by mining or oil and gas companies is highly technical and subject to ongoing revision by the companies themselves. Why make the advisor responsible/liable for the interpretation of this information?* ▪ *What would an enforceable standard for filtering and interpreting look like?* ▪ *Advisors are currently responsible for ensuring that the investments made in advisory accounts are suitable. This will not change. It may be regulatory overkill to suggest that it is necessary to also regulate or mandate the form*	51

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		and types of communication that are provided by an advisor in respect of general investment services, beyond specially prepared communications relating to specific investments, such as strip bonds or mutual funds. In fact, such regulation might have a chilling effect on advisors and their employers, leading them to avoid providing third party investment information that might otherwise be of interest and helpful to investors.	
13.	**Information provided to investors – mutual funds** Confirmations for mutual fund purchases would show the specific amount of compensation (fees and commissions) the investor has paid or is potentially committed to pay to the dealer and the representative.	▪ *In principle, the IDA supports the concept of compensation transparency.*	59
14.	**Transparency of compensation received** Financial services providers must disclose the total incremental cost of each transaction to clients, including all amounts of compensation received.	▪ *See comments in **Item # 13** above. Current systems and methodologies do not support such disclosure.*	62
15.	**Transparency of compensation received - bonds** On all bond transactions, financial services providers acting as principle would be required to provide quotes or information respectively at the point of sale on both a buy price and a sell price.	▪ *The IDA generally supports this recommendation.. However, currently, it is difficult for registrants to determine the representative price in over-the-counter fixed income markets because prices can differ across dealer marketplaces and in terms of transaction size.* ▪ *A further consideration is whether the amount paid directly to the Advisor should also be disclosed. At full-service dealers there is generally "transfer" pricing provided by the bond desk to the Advisor. The difference between the transfer price to Advisor and the price to the client is the Advisor's "commission". The Bond Desk may also makes a profit on the transaction based on the mark-up or markdown in the price to the Advisor from wholesale*	64

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		markets. The Bond Desk's profit is also influenced by its' cost of holding the bond in inventory. Any discussion of disclosing transaction costs for bond trades should include advice from experts in this area. Where there is an Advisor on the trade, the amount paid to the Advisor is the most relevant. Disclosure is more problematic with self-managed or managed for you accounts. ▪ *Again, it is suggested that this issue be referred to a Working Group in connection with this recommendation.*	
16.	**Transparency of compensation received – mutual funds** A firm executing trades in mutual funds must provide investors with specific information about the nature and amount of compensation the firm would receive from a transaction, including any benefits received from a third party.	▪ *Same comments as those for **Item #14**, above.*	65
17.	**Transparency of compensation received – wrap accounts** At the point an investor first commits to a wrap account, the financial services provider must disclose if a transfer of the account to another firm will require the sale of some or all of the investments in the account and the payment of tax on any capital gains.	▪ *The IDA supports this recommendation.*	66
18.	**Communicating the risk levels of individual securities** Before any transaction is completed, the financial services provider in an Advisory relationship should provide the investor with meaningful information about the riskiness of the security, and how it would affect the investor's portfolio.	▪ *There are concerns regarding the level of precision required in explaining the risk level to clients and how this relates to the explanation of risk recommended in **Items #19(c)** and #**22**.* ▪ *Quantitative measures of securities risk are complex, may be difficult for clients to understand and can be costly to implement. Accordingly, consideration of this recommendation should be referred to an appropriate Working Group.* ▪ *The paper suggests that the OSC does not intend to*	67

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		prescribe a method for determining risk levels, but that the method used must be one "generally accepted by experts". It seems troublesome, at best, if different firms use different methods of assessing risk, especially where they result in different conclusions. The current practice of Advisors in assessing risk for the purpose of assessing suitability is primarily subjective, with some reliance on the firm's research analysis where available. It is arguably different to evaluate a security for the purpose of assessing suitability than for the purpose of assigning a risk rating to it. Most Advisors would be required to rely upon a third party's rating system. ▪ *There are few, if any, compliance systems that measure risk in client portfolios.*	

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19.	**Content of account statements** Reports to clients must include the following components:		69
	(a) personalized performance information	▪ *The IDA supports this recommendation, generally. However, it was stressed that current systems within the investment industry do not support the provision of this information. In most instances, investment firm data does not include the cost base or "book value" of securities. Even if it were possible to maintain book value records for securities purchased at the firm, in many instances accounts include securities delivered to the account from elsewhere, with no book value data.* ▪ *The Working Group assigned to address these issues should therefore include significant information technology resources, including representation from ADP, ISM and the major clearing firms.* ▪ *See also comments made at **Item #22**.* ▪ *Should this information be provided on a quarterly rather than monthly basis?*	
	(b) the aggregated costs of compensation incurred by the investor	▪ *The IDA has asked for clarity as to what is included in "aggregated costs of compensation incurred by the investor"?*	
	(c) an analysis of the portfolio's risk level	▪ *The IDA supports this recommendation in principle, subject to addressing the comments in **Item #18** and the performance of a cost/ benefit analysis*	
20.	**Personalized performance information** Statements must provide personalized performance information – defined as the percentage change in value, over a specified time period, of all the funds the investor has contributed to her account.	▪ *The type and frequency of portfolio performance measures should be considered by a Working Group, given the complexity of performance measures, the need for consistent measures across the industry and the costs of implementing those measures* ▪ *Same comments as those for **Item #19(a)**.*	69

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21.	**Aggregating costs of compensation over a period** Annual account statements would be required to disclose the aggregate compensation paid to the financial services provider over the past year.	▪ *Same comments as those for **Item #19(b)**.*	72
22.	**Analysis of risks** Account statements must provide some form of information about risk. Possible methods of presenting risk include: 1) an overall risk rating for the investment portfolio as a whole 2) a risk rating for each security in the portfolio 3) a graph showing the percentage of the account's holdings that fall within each level of risk used by the financial services provider 4) a risk-adjusted return for the overall portfolio.	▪ *Presumably the risk assessment of the portfolio must be consistent with the investment objectives of the client. This, again, raises the difficulty of comparing the analysis of an account with the client's investment objectives unless all of the information is in electronic form and appropriate supervisory programs written.* ▪ *The IDA had noted that a monthly snapshot is impractical. Month to month, risk may well exceed agreed-upon performance standards for perfectly appropriate reasons. Will the advisor be liable when this happens?* ▪ *Will AIMR standards be adopted as the basis for preparing this information?* ▪ *Same comments as those for **Item #19(c)**.*	75

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23.	**Updating the Fair Dealing Document** The Fair Dealing Document must be updated to reflect any significant changes in investment objectives, service level, or the relationship itself.	▪ *The IDA supports this recommendation, in principle. However, the requirement to sign each change is impractical - an alternative means of affirming each change such as a negative confirmation process, is preferable.* ▪ *Some care should also be given to determining what constitutes a material change. If, for example, a client indicates in their Fair Dealing Document that a mid-term investment objective is to purchase a home or automobile and that objective is met, does the document have to be changed?* ▪ *It is also important from a supervisory perspective that the investment objectives expressed in the Fair Dealing Document be capable of translation into electronic form. It is realistic to expect effective supervision of an account where the investment objective is 50 percent income securities. It is unrealistic to expect effective supervision of an account where the investment objective expressed by the client is to "buy a car".*	77