447 PORTAGE AVENUE, WINNIPEG, MANITOBA R3C 3B6 TELEPHONE: (204) 956-8470 FAX: (204) 956-1446

W. TERRENCE WRIGHT, Q.C.
Senior Vice-President
General Counsel & Secretary

April 29, 2004

DELIVERED VIA E-MAIL

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
19th Floor, Box 55
Toronto, ON

Dear Sirs:

Re: Fair Dealing Model

Introduction

We are responding to your request for comments regarding your Concept Proposal of January, 2004 on the proposed Fair Dealing Model.

Investors Group has long been supportive of initiatives to enhance investor protection within a dynamic and strong industry. As a general comment, we believe that the Fair Dealing proposal does a good job of highlighting some of the major concerns with the existing regulatory system, particularly regarding:

- the limited usefulness of current mandated disclosure (particularly prospectuses)
- the lack of key information for investors (such as bond price transparency and rates of return on investments)
- the duplicative nature of much of the existing regulatory model

On the other hand, in our view the Fair Dealing proposal overreaches in proposing a fundamental restructuring of a large portion of the Canadian securities industry instead of focusing on specific deficiencies that are the underlying source of concern. Implemented as currently contemplated, the Fair Dealing proposal would not represent a step forward for the securities industry and, accordingly, the proposal should be reformulated to scale back its scope to deal instead with certain key issues relating to (i) the nature and content of point of sale disclosure (ii) improving the content and quality of the ongoing disclosure provided to clients and (iii) simplifying and harmonizing the existing registration system in Canada.

We have a number of comments on the proposal organized under several broad headings: concerns with the process used, concerns with certain underlying assumptions and comments on specific items set out in the proposal, as follows:

Concerns with Process

We have a number of concerns with the process that has been used in developing the Fair Dealing proposal to this point. These include:

- **CSA involvement**- no proposal should come forward on a unilateral basis. It must be fully canvassed within the Canadian Securities Administrators (CSA) and have received CSA's support and should be advanced and managed through the CSA Secretariat, which recently became operational. It is only in this way that meaningful dialogue can take place across the country and resources utilized most efficiently.

- **scope of initiative**- again, as commented earlier, whatever the form of the final model, it should go forward only if it is adopted on a national basis. The suggestion that an arrangement between jurisdictions that would accept compliance with the fair dealing requirements in Ontario as constituting compliance with the other jurisdictions' rules is not an acceptable alternative. Different- even if better (which is far from clear in this case)- is always a problem for the national firms that dominate the financial services industry in Canada.

- **comprehensiveness**- although the proposal is generally very broad, in one respect it is not comprehensive at all, namely the exclusion of segregated funds from its scope. Segregated funds are, of course, economically very similar to mutual funds and limiting the reach of the Fair Dealing model only to the latter makes no sense. As a result, the final form of the proposal should deal with the distribution and sale of segregated funds in the same way that it treats mutual funds. If this is not possible- and our understanding is that insurance regulators are unwilling to endorse the Fair Dealing proposal- then it is doubly important that the initiative be scaled back to focus on the key issues identified above.

- **participation**- although the Fair Dealing proposal, if implemented, will affect the adviser community enormously, key industry associations- such as ADVOCIS, the Financial Planning Standards Council of Canada and the Investment Funds Institute of Canada- do not appear to have been consulted. A proposal this broad should have formal representation from all affected parties and this does not seem to have been the case to date.

- **industry involvement**- although the initial group consulted by the OSC in developing the Fair Dealing proposal published in January included representatives from various areas, relatively few representatives were from the financial services industry itself. We recognize that, to a certain extent, some of the industry input was drawn from self regulatory organizations. However, we do not view this as effective or necessarily representative of the realities of running a business in the financial services industry in Canada. In our view some of the deficiencies we have identified in the current draft of the proposal seem the product of the relatively limited consultative process that has been used to bring the draft to this point.

- **specificity of proposal**- although the current version of the Fair Dealing proposal is stated to be in the conceptual phase, in fact it contains very specific provisions for the complete recasting of significant aspects of the Canadian financial services industry. This reflects a fundamental problem with the process that has been used. The proposal purports to address problems without actually establishing that those problems exist. Put another way, instead of engaging in a meaningful discussion of the nature and extent of problems within the financial industry and proceeding on from there, the proposal simply states that certain issues are problems that must be addressed. In our view this is not an effective process.

Concerns with Underlying Assumptions

A number of the assumptions underlying the Fair Dealing proposal are problematic and should be reconsidered. These include:

- **restrictions on compensation**- the proposal to restrict or even prohibit certain types of compensation (for example, banning third party compensation from mutual fund manufacturers) is inappropriate. The regulatory focus should remain, as it traditionally has, on requiring meaningful disclosure of compensation arrangements and should not regulate, negotiate or disallow certain types.

- **conflicts of interest**- conflicts of interest should continue to be dealt with primarily on a disclosure basis as opposed to introducing prohibitions as the Fair Dealing proposal currently contemplates. The proposal states that a guiding principle is to "manage conflicts of interest to avoid self serving outcomes". Again in our view this focus is inappropriate and instead it should be on ensuring that any conflicts are fully disclosed to clients in a meaningful manner to enable them to provide their informed consent to them.

- **"unbundling" of fees**- a key principle underlying the proposal is that fees should be unbundled. The (untested) assumption this reflects is that this is what investors want or is in their best interests, which is far from clear. Instead of mandating unbundling, the focus of reform in this area should be on better, more meaningful disclosure.

Comments on Fair Dealing Model

We have a number of specific concerns with elements of the current version of the Fair Dealing proposal. These include the following:

- **mandated forms of relationship**- the proposal to require that clients choose among one of three distinct forms of relationships- self managed, advisory or managed ("managed for you")- with a securities firm should not be adopted, for several reasons:

- regulation should not be prescriptive in this way. The marketplace should determine what relationships are available to clients. Instead regulation should focus on

  (i) the required disclosure that should flow from such relationships;

  (ii) the duties and obligations that should arise from that relationship;

(iii) the proficiency that should be required for representatives.

- the use of three (and only three) categories is artificial and unduly limiting and does not reflect the wide variety of relationships that have evolved in the marketplace. Shoehorning these diverse relationships into one of three alternatives may seem attractive in the abstract but are too restrictive from a commercial perspective.

- making each category of relationship mutually exclusive from the others does not reflect the way that the securities industry actually works nor, more importantly, the services clients actually want from a firm. For example, a client who relies on an adviser for most investment decisions may choose to "self manage" some aspects of the relationship (ie. by choosing certain trades on his or her own). The proposal would not allow this and instead would require that the client open up a second, separate relationship instead of allowing a single one which would accommodate the range of services the client seeks.

- **legal position of adviser**- the proposal comments that the role of a representative in an advisory relationship is to act "as an investor's agent on behalf of the firm". In fact in law the representative is the agent *of the firm* who nonetheless owes duties to the client, which may include a fiduciary obligation depending on the facts. As a matter of agency law an individual cannot be the agent of two principals at the same time as the proposal currently suggests. Regulation should not arbitrarily change the legal nature of the firm/representative/client relationship, particularly if the standards are, as here, impossible or impractical to meet.

- **manufacturer responsibility**- as an alternative to disallowing certain types of compensation such as "trailer fees", the Fair Dealing proposal suggests that manufacturers who pay such compensation could be made liable for the acts of the representatives who receive it. This proposal should not be implemented and responsibility should remain where it is, namely with the dealer and its representative, even if the source of particular types of compensation is a fund manufacturer.

- **point of sale/pretrade disclosure**- the existing prospectus based disclosure model is largely ineffective and the recommendation that this be replaced with a simpler and more meaningful point of sale document makes sense. At the same time, the proposal goes too far in requiring the pretrade disclosure it proposes, which would mandate disclosure of the dollar amount of all compensation in advance as opposed to the general disclosure now provided. General disclosure at the outset coupled with disclosure of the actual amount in the confirmation remains the better approach.

- **duty to educate**- the proposal would require dealers and their representatives to provide educational information at the outset of the relationship. In our view this is not an appropriate role for them. Instead regulators and, more fittingly, others (such as industry groups like IFIC and the Canadian Securities Institute) should make this information available but it should be up to investors to decide whether or not they wish to make use of it. One of the defining features of the current environment is the breadth and depth of information that is readily available to everyone, particularly through the Internet. One of the

other characteristics is the unwillingness of many investors to actually access it, but surely this is their choice. Already different firms provide different levels of information on investing generally to clients as a point of competitive distinction with other dealers.

- **documentation of relationship**- one of the curious tensions within the Fair Dealing proposal is its approach to documentation. On the one hand it decries the "sheer volume and complexity" of certain kinds of paperwork at one point while at the same time in another place it nonetheless contemplates a significant increase in the level of documentation that would be required in connection with the client's relationship with the firm. This documentation would have to be completed not only at the outset but would also have to be updated on a continuous basis to reflect changes throughout. This would greatly expand the existing obligations of dealers and representatives which, generally speaking, requires them to update know your client information where there have been material changes and to canvas clients periodically to determine whether there have been any. While the proposal suggests that the length and complexity of the documentation could be reduced to eliminate the "boilerplate legal language not specifically driven by regulatory requirements", in our view this is unrealistic. Instead the fundamental changes being suggested to the distribution models and the significant reallocation of responsibility between the client on the one hand and the adviser and firm on the other can only lead to increased complexity as dealers and representatives seek to define and indeed limit their respective liability.

- **account statement disclosure**- the proposal would require significant additional information on account statements, including rates of return, a risk assessment of the portfolio and total compensation. While we agree that improved rate of return disclosure would be an important advance, there are significant challenges in developing a single method of calculation and presentation. In turn, the proposed new disclosure of compensation and risk level raise other concerns outlined elsewhere in this response.

- **compensation disclosure**- we have two concerns with this issue:

    - the proposal focuses on compensation throughout and calls for it to be potentially repeated in one form or another: (i) before the trade (ii) in the trade confirmation and (iii) on the account statements. As to presentation, in different places the proposal contemplates that it be provided: (i) on a transaction basis (ii) on an incremental basis and/or (iii) on a cumulative basis. We agree that meaningful disclosure of compensation is important and improvements can be made in this regard, for example, when a fee (such as a deferred sales charge on a mutual fund) has expired and an adviser recommends that the client switch into another product such as a different mutual fund or segregated fund with a new fee schedule. Having said this, endless and duplicative repetition of this information does not further this goal;

    - there is a lack of clarity in the proposal as to at what level the disclosure should occur. In our view it should be at the dealer level only. Product related costs should be set out in the prospectus (in the case of mutual funds) or the information folder (in the case of a segregated fund).

- **nature of "advice"**- the proposal assumes a very open ended obligation on the part of an adviser regarding "advice", which would be defined in a much broader way than is currently the case. While this is consistent with the shift contemplated by the Fair Dealing proposal from a product based model of regulation to one that is based on the nature of the relationship, this creates one major difficulty: the potential liability on the part of the adviser that may be very difficult to define. An adviser, for example, who recommends that a client invest in mutual funds as opposed to, say, paying down debt may trigger a breach of the restated suitability obligation contemplated by the Fair Dealing model. This is not an appropriate change.

- **recasting of suitability obligation**- currently the suitability obligation relates to individual trades. The Fair Dealing proposal would amend this obligation to one that applies to the ongoing portfolio of a client. This is a massive, and unwelcome, transfer of risk to the representative. Clients in an advisory relationship (other than a fully managed one) should remain primarily responsible for ensuring that their portfolio remains consistent with their personal situation, needs and investment objectives and the role of the representative should remain one of providing advice. Also, it must be recognized that clients have more than one adviser and it is unfair to impose such a high standard on the adviser for this reason. If, of course, clients decide to rebalance their portfolios (whether on their own initiative or on the recommendation of their representative (the representative would remain fully responsible for ensuring that any resulting trades are suitable).

- **disclosure of risk**- improved disclosure of risk is a recurring theme in the Fair Dealing proposal and this is a goal that should be pursued. Having said this, the proposal understates the challenges involved in this given there is no single measure that is generally accepted.

- **underlying technology**- the technological challenges (both in cost and effort) involved in implementing elements of the Fair Dealing proposal (including the new disclosure on account statements and trade confirmations) are not recognized in the proposal. Instead they are dismissed with the comment that industry is intending to invest shortly in "broad technology upgrades" and it is assumed these changes can be implemented with minimal effort, an assumption that is simply incorrect.

- **missing elements**- key parts of the proposal- such as the revised proficiency and registration model- are missing at this point. As a result it is unclear to assess the comment that a single service provider licence will "reduce cost and red tape". This should be a central objective of any reform in this area.

- **accreditation**- one of the gaps in the Fair Dealing proposal is the fact that it does not build on the existing industry groups that have done extensive work on ethics, conflicts of interest and disclosure. The result is at best needless duplication and at worst conflicting and inconsistent requirements.

- **SRO involvement**- although the Fair Dealing proposal alludes to integrating with the requirements of self regulatory organizations, its actual approach fails to do so. Many of its proposed provisions would overlap with SRO rules and policies but the concept of integration that the proposal implicitly sets forth is that the role of the SRO would be to

implement and police compliance with the Fair Dealing proposal as opposed to having the SROs take the lead in developing the rules that would apply. In our view, it is more appropriate for the SROs to take the initiative in developing these rules regarding market conduct and proficiency since they have the expertise and the credibility to do so, as organizations driven by their members with a strong voice from a public director constituency.

- **costs**- given the major costs faced by the industry if the Fair Dealing proposal, or even elements of it, are put into place, a meaningful and objective study of the costs and benefits involved is crucial before adoption. Our expectation is that costs would far outweigh the benefits as the Fair Dealing proposal is currently structured which is a key reason why we believe it must be scaled back.

Process

While no one can argue against a policy of "fair dealing" we are very concerned with the appropriateness of both the process used to bring the Fair Dealing proposal to this point and that which is apparently being employed to bring it to a conclusion. There is a real question as to the representativeness of the original committee and there is no clarity around how they were chosen. Similarly, we are concerned about the mandate given to the working groups that have been established and the process they are using. There is a growing perception in the industry that the working groups are being asked to focus solely on the *implementation* of the Fair Dealing proposal as currently contemplated when, in our view, its mandate should be broader and extend to reviewing the basic principles of the model with a view to recommending which elements should be kept, changed or rejected. To do otherwise may lead to the perception that there is no real commitment to an open process nor to seek meaningful input from the financial services industry or the public. This is an essential starting point towards achieving a broad consensus: the perception of an open and transparent consultative process that reviews the existing regime in a forthright and open way for the purpose of ultimately achieving appropriate changes to the existing system that has broad support across the financial services industry, an industry that has, generally speaking, served the Canadian investing public well over the course of decades in providing Canadian investors with an opportunity to achieve their stated goals and objectives. Any process that, while purporting to be open, leaves any impression that the outcomes have been pre-determined by the proponents does a disservice to those proposing meaningful change that balances the principle of enhanced investor protection with the goal of a strong and vibrant financial services industry.

Please do not hesitate to contact me if you would like to discuss any of these matters.

Yours truly,

INVESTORS GROUP INC.

W.T. WRIGHT, Q.C.

WTW/lad