



May 27, 2004

Mr. John Stevenson.
Secretary
Ontario Securities Commission
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Via email: jstevenson@osc.gov.on.ca

Subject: Fair Dealing Model Concept Paper Comments

Dear Mr. Stevenson,

On behalf of the Canadian Securities Institute, I would like to thank you for giving us the opportunity to comment on the OSC's Fair Dealing Model initiative.

CSI is one of Canada's largest, most experienced and respected providers of financial education. In our capacity, we realize the importance of both professional and public education in contributing to a well-functioning financial marketplace. CSI provides licensing courses, financial sector management training and professional designation programs in financial planning/wealth management and portfolio management. We work closely with the IDA and the Securities Commissions in setting and raising proficiency standards for registrants. Furthermore, CSI, through the activities of the Investor Learning Center (ILC), has over the past 10 years gained extensive experience in developing and disseminating investor-level education via publications, seminars and high-school programs.

While CSI supports the principles and objectives of the FDM, we are concerned about the practicality of its implementation and question the need for what we perceive as a significant re-working of the present regulatory framework.

As a subsidiary of the IDA and a member of the Joint-Industry Group, CSI has been involved in discussing the various elements of the FDM. However we will focus our comments on issues relating to our particular area of concern and expertise: proficiency and investor education.

Harmonization

An overall concern is how unilateral provincial initiatives such as the OSC's Fair Dealing Model and the BCSC's BC Model might undermine and potentially weaken the national registrant proficiency standards in place today.

Regardless of the reforms adopted, it is essential that individual registrants have the appropriate level of proficiency across Canada. Given that these individuals are the "face" of the industry to the investing public, maintaining high standards of proficiency will help in protecting the Canadian investor.

While there are many areas of securities regulation where the lack of harmonization across Canada has created a less than efficient capital market, the proficiency of individual registrants has over the years been an area where CSA members have had similar positions which has benefited the securities industry and its customers nationally.

The present proficiency system is based on key principals set by the Securities Commissions which are in turn implemented through SRO (i.e. IDA, MFDA) regulations and by-laws. In the area of registrant proficiency, there has been a strong collaborative effort between regulators and industry. SROs have set the detailed requirements and Commissions generally recognize SRO bylaws. The benefit is that the proficiency standards and requirements have been applied and maintained consistently by SROs across the country. This also allows proficiency requirements to be upgraded and adapted rapidly to the changes in the industry and the introduction of new financial products.

Increased role of advisors in investor education

As an educator, CSI is, of course, a strong supporter of increased investor education. However, the FDM's proposal that advisors be the primary information and education provider for investors seems misguided for the following reasons.

- Liability issues

The FDM states that:

“investors are more likely to rely on advice given to them personally and directly, so we would hold representatives accountable for it. For example, representatives would be expected to filter and independently assess issuer-generated information or third-party research to support investment representatives.” (FDM p. 52)

Advisors are currently responsible for ensuring that investments are suitable and to provide guidance and information to investors. But the FDM seems to be shifting much of the burden of education/information and interpretation of all types of investment products to the advisor. How would this be enforced? What standards of filtering and interpretation could be set? If this increased responsibility were to be put upon advisors, it is possible that it could limit the range of investments offered to an investor not due to their suitability but due to the riskiness of the investments and the advisor's unwillingness to interpret third-party information.

- Investors' capability and willingness to be educated/informed

There is no doubt that during advisor-investor meetings/conversations to open an account, to discuss transactions or to do an annual review, there are opportunities to educate/inform investors. Some would call these "teaching moments". As demonstrated by the UK experience with the Key Facts Document mentioned in the Concept Paper, and from practical experience of Canadian advisors, if investors are not interested and/or capable of learning, the teaching moment becomes more theoretical than practical. Will an advisor need to assess the true capability of investors to absorb and comprehend various types of financial information? Is the FDM proposing a test? Unfortunately without a test there is no way to ensure that an investor is fully informed and qualified. Thus, if things go wrong, investors can still plead ignorance or misunderstanding in a court of law.

Our experience in investor education is that you cannot make someone learn unless there is clear motivation and interest. We have found that when their financial interest is at stake, investors don't always want to learn and that some would genuinely prefer to allow their advisors to think for them. While this is not a good thing, it should not be the responsibility of the advisor to change people. Furthermore, as educators we know that passive media such as videos and publications are limited in their ability to teach. Learning requires the active involvement of the student. Therefore to be effective an advisor would have to have pedagogical skills and that seems to be an unrealistic expectation. What happens if an investor refuses to participate? How much time and effort must an advisor spend on this aspect of his or her role? All these factors make these new FDM requirements unworkable.

It is clear that advisors are part of the investor education process, as are the firms, regulators, educators and the media. Numerous studies and surveys indicate that investors have a wide range of interest, need and capability to become informed about financial issues. The OSC, the IDA, educators and firms should continue to expand investor education initiatives but putting the primary onus on advisors as front-line educators is neither practical nor effective.

Licensing and Proficiency Standards

With regards to licensing and proficiency standards of financial services representatives, the OSC has stated that they will be addressed in the second concept paper. Thus our comments at this point are directional only.

We support the concept that all firms offering financial services that deal with the retail investor should adhere to a common code of conduct (similar to the IDA's Code of Ethics and Standards of Conduct) as they are all "gatekeepers" for the investor. However, with regards to the proficiency of individual representatives, the FDM proposes conflicting initiatives.

- Basic licensing requirements

"...all individuals would obtain a basic financial services provider license, based on integrity...Licenses would not be based on particular products and services"
(FDM p. 27)

What criteria regarding proficiency would be used to grant the license since the FDM states that it does not intend to require a single entry-level exam? While we agree that a common exam is not the solution, it is unclear how the OSC would grant licenses to representatives.

- Ticket system and proficiency requirements

"A ticket system would assign proficiency and capital adequacy requirements appropriate for services and activities carried out by the business, and by individuals delivering those services on its behalf. (FDM p. 84)

" Both the firm and the representatives are responsible for ensuring the representative is competent to perform the service contracted for. (FDM p. 53)"

It is unclear who will set and monitor the proficiency requirements for each type of service and then monitor what services each representative is qualified for. Will it be the OSC, the SROs, the firms or the representatives?

The FDM indicates that proficiency requirements will be linked not to product licenses but to the service provided using a ticket system. This ticket system is said to be similar to what SRO's presently use where the appropriate proficiency requirement is dependant on the product and relationship. If this is the case we fail to see the advantage of revamping the SRO registration categories and proficiency requirements.

- Proficiency requirements based on services rather than products

“Individuals would have the flexibility to provide a range of services without obtaining licenses... with representatives providing this new layer of reliable investor protection, we can stop restricting investors’ access to entire categories of financial instruments” (FDM p. 84)

Despite what is implied by a “ticket system”, the overall intent of the FDM seems to be that proficiency would not be determined by traditional product categories but by services offered. Our overarching concern is that for advice to properly address the client needs and financial plan, it must be based on a solid understanding of the substance of a recommendation – the product. We agree that “know your client”, transparency and codes of conduct should apply to all representatives regardless of the product transacted. However key issues relating to suitability, risk/return tradeoffs and diversification are attributes of the financial instrument, and therefore, proficiency requirements must be linked to products upon which the advice is based. Ultimately advice without proven product knowledge is limited and potentially risky.

These comments are preliminary until the second concept paper is released. CSI would be interested and available to participate on the committee that is developing the second concept paper. We believe CSI’s expertise in proficiency standard setting and education would be useful as the OSC looks into this critical area of reform.

Yours truly



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