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May 29, 2008

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
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  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territories  
Registrar of Securities, Nunavut

**Re: CSA Proposed National Instrument 31-103 Registration Requirements**

Thank you for the opportunity to comment on the second version of the Canadian Securities Administrators' (CSA) Proposed National Instrument 31-103 Registration Requirements (the "Proposed Rule") released earlier this year.

Advocis is a national professional association that is committed to preparing, promoting and protecting financial advisors in the public interest. We do this by providing a professional platform including career support, designations, best practices direction, education, timely information and professional liability insurance. This strengthens the relationship of trust and respect between financial advisors and their clients, the public, and government. Advocis is Canada's largest association of financial advisors, representing life and health insurance licensees, and mutual fund and securities registrants across the country for over a century. Our members are individuals, the majority of whom carry on business as either sole proprietors or independent, small businesses. A smaller proportion of Advocis members operate under employee-employer arrangements of financial services firms. We represent advisors at all stages of the business cycle, ranging from new entrants to the industry to mature practices led by leaders in the industry serving a significant client base.

A significant portion of Advocis members are regulated under provincial securities commissions. As the CSA's Proposed Rule directly impacts our members, we attach our comments for your consideration. Advocis looks forward to working with the CSA to ensure the final Rule reflects our mutual objectives.

Yours sincerely,

Teresa Black Hughes CFP, CLU, RFP, FMA, CIM  
Chair, National Board of Directors



# Proposed National Instrument 31-103 Registration Requirements

Advocis' Submission to the  
Canadian Securities Administrators (CSA)

*May 29, 2008*

## Executive Summary

### **Advocis:**

- supports the CSA's objective of ensuring that harmonized registration requirements provide protection to investors from unfair, improper or fraudulent practices and would like the CSA to reflect our unique perspective on the objectives of this reform initiative in the final Rule.
- would support the CSA in its efforts to begin recognizing business structures outside of the traditional employee-employer relationship by recognizing principal-agent relationships in the definition of sales representative.
- would like to work with the CSA to find workable registration categories within the Proposed Rule that addresses the concerns of *non-traditional business structures* such as independent owner-operators who are typically dual-licensed financial advisors who sell life and health insurance and mutual fund products. We are exploring various models and would appreciate the CSA's confirmation that it is willing to consider including a placeholder in its final Rule to allow for this possibility.
- supports the CSA in implementing a principles-based approach in some areas of the Proposed Rule. We continue to have some concerns that the Self Regulatory Organizations' (IDA and MFDA) interpretation and final implementation of such principles may in fact be overly prescriptive in nature, thus defeating the purpose of introducing principles. A rules-based approach to regulation and the layering-on of additional rules and regulations will not prevent misconduct in the financial markets nor will it ensure consumer protection, which needs to be recognized by the IDA and MFDA. Expanding the scope of principles-based regulations should be seriously considered by all regulators at this juncture.
- is concerned with the CSA's policy development process, in particular that the CSA would draft a Proposed Rule:
  - without broadly consulting with industry stakeholders during the early stages of the policy development process, particularly organizations like Advocis whose members represent a significant segment of the financial services industry;
  - that is broad in scope and captures all market participants, including those who, for the most part, do not participate directly in the Canadian capital markets (raising of capital function) and are already regulated by provincial insurance regulators; and
  - that provides no robust cost/benefit analysis of bringing non-direct capital market participants and financial planners under the ambit of the Proposed Rule.
- believes that the Conduct Rules, which describe the way in which professional financial advisors interact with their clients, is imposing an external framework on the client-advisor relationship that for the most part is not principles-based.
- strongly supports consumer protection, and believes that it can be more effectively achieved through broad principles, an approach currently being adopted by the UK's Financial Services Authority and Canada's provincial insurance regulators.
- believes that there are significant opportunities for regulatory cross-pillar harmonization (between the securities and insurance sectors), particularly in the area of market conduct, and would like to explore possible exemptions from the application of the proposed conduct rules to the extent that insurance-regulated financial advisors are already in compliance in order to achieve regulatory efficiencies for small, independent financial advisors.

## **Introduction**

### ***Regulatory Perspective***

A number of our comments are similar to those made in our submission in respect of the 2007 draft Proposed Rule. We would like to take this opportunity to reiterate some of these points as the CSA moves towards finalizing its Proposed Rule.

Advocis supports the CSA's objective of ensuring that registration requirements provide protection to investors from unfair, improper or fraudulent practices, as well as the CSA's intent to harmonize, streamline and modernize the registration regime across Canada. Moreover, Advocis is a strong supporter of consumer protection and believes that consumers are generally best served in competitive market environments that provide consumers with the most choice.

Advocis believes that one of the most effective ways to protect consumers is to ensure that they receive professional financial services advice. Advocis takes the view that professional financial advice is delivered by an accredited financial advisor who has a professional designation, adheres to a professional code of conduct, maintains membership in a recognized professional body, subscribes to practice standards, acquires competency-based continuing education and maintains adequate errors and omissions (E&O) insurance coverage to protect both the consumer and the financial advisor.

From a regulatory perspective, we understand the appeal of a comprehensive rule that i) captures all market participants who engage in the business of dealing in securities, ii) provides prescriptive rules that outline the obligations and expectations of market participants, and iii) can be administered relatively easily by ensuring that it applies to all participants (with a few exceptions), and puts the onus of compliance on market participants to ensure that they conduct themselves in a fit and proper manner. Notwithstanding, this must be balanced with the needs of the various market participants that operate under vastly different delivery channels, so that they can continue to offer valuable services and advice to Canadians on their financial needs.

### ***Advocis Members and Their Objectives***

In order for regulators and policy makers to gain a thorough understanding of our positions regarding the Proposed Rule, we wish to further articulate the nature and business structures of financial advisors who Advocis represents.

Advocis members are in many instances owner-operators of small and medium-sized businesses who provide professional financial advice to millions of Canadians. Their goal is to assist individuals, families, and businesses in achieving their financial objectives. Advocis members adhere to the principle of the priority of the client's interest, which has formed part of our Professional Code of Conduct for over a century.

Many of our members have become securities registrants after they have established an advisory practice in other financial activities, such as life and health insurance agents. In addition, our membership includes financial advisors who have developed similar practices based on investment funds alone. In addition, a significant number of financial advisors hold financial planning designations and provide objective and comprehensive financial planning advice to their clients.

Advocis' core activities include providing generally accepted professional designations, high standards of professionalism through the enforcement of a Code of Professional Conduct, and

participating in the development of public policy and regulation affecting financial advisors and their clients before the federal and provincial governments across Canada.

## **General Comments**

### ***Policy Development Process***

Effective public policy requires identifying the problem or issue correctly and then using appropriate methods to address or resolve it. In some cases, there may not be a problem or issue that needs to be addressed. Moreover, regulators who initiate policy responses without input from market participants during the early development stages risk incorrectly defining problems and hence implementing ineffective policies. While we recognize the benefits of a proactive regulatory approach to prevent, detect, and deter harm to investors and the overall market, we believe each regulatory initiative needs to be weighed against the risks of over-regulation and the imposition of unnecessary administrative burdens and compliance costs on market participants and ultimately investors. The overall cost of regulation is an important issue of increasing concern for our members.

While Advocis is a strong supporter of consumer protection, we believe that layering on more rules on compliant market participants is not always the most effective and efficient way to achieve this objective. With respect to the Conduct Rules and the implementation of the Client Relationship Model as integral parts of the Proposed Rule, we believe that private-sector solutions should be considered before regulation, since not every investor violation, whether it is real or perceived, can or should be remedied with a regulatory rule or policy response.

Therefore, we encourage the CSA to consider conducting a robust cost/benefit analysis to fully examine the impact of the proposed regulations on all stakeholders before any regulatory changes come into effect. The analysis should also consider alternative approaches, such as greater opportunities to implement a principles-based approach to regulation. In this respect, we are pleased to see that the CSA is considering principles over rules in some areas of market conduct. Moreover, we believe that the cost/benefit analysis should be shared with market participants to help them understand the rationale for any increased regulation. Prescriptive rules that do not directly ensure enhanced consumer protection impose additional regulatory burdens and costs on our small business members.

Advocis wishes to contribute to the policy development process to ensure that its views and concerns are appropriately addressed. We believe this will be beneficial to the CSA, especially if our views are taken into consideration at the very early stages of policy development, as CSA members will have the opportunity to consider input from the largest, broad-based group representing Canada's financial advisor community. The professional financial advisor provides guidance and advice to consumers as they interact with financial institutions, access financial instruments and plan for their futures, which is based on mutual trust. Having the views of financial advisors reflected in the CSA's deliberations is crucial, as financial advisors are frequently the direct link to consumers within the complex financial services distribution channel.

Moreover, Advocis brings a unique and valuable perspective to the policy discussion at a time when regulators are looking for ways to harmonize, modernize, and streamline regulation. As a majority of our members are self-employed independent financial advisors, dual-licensed for life and health insurance and mutual funds, are not direct participants of the capital markets, and are regulated by provincial insurance regulators, the issue of convergence in the financial services industry is important to them. As many of our members are subject to two provincial regulatory regimes (insurance and securities) we would like to see cross-pillar regulatory harmonization that is principles-based and not administratively costly or burdensome for our members.

Harmonization of rules and enforcement practices includes strengthening CSA members' relationship with the recognized Self Regulatory Organizations (SROs), namely the Investment Dealers Association (IDA) and the Mutual Fund Dealers Association (MFDA), for the purpose of ensuring that securities laws, policies, rules and principles are accurately reflected in SRO policies and rules, and appropriately and consistently applied. We note that the interests of dealers and advisors are often very different, and SROs do not always reflect the interests of advisors as their direct members are the dealer firms.

While we note that the IDA and MFDA set by-laws, policies and rules for their members (indirectly impacting our members by virtue of being Approved Persons of the dealer), they do not represent the interests of financial advisors. Consequently, while many of our members (as Approved Persons of SRO member dealers) would be exempt from certain provisions of the Proposed Rule, particularly many of the Conduct Rules, they are still subject to complying with the MFDA and IDA rules that are written primarily for dealers. Advocis believes direct consultation with financial advisors on the Proposed Rule is beneficial, especially in the early stages of policy development. Financial advisors have a unique perspective on consumers' needs which should be reflected in policies that directly impact both consumers and advisors.

### ***Small-Business Perspective***

From a small-business perspective, Advocis is of the view that the rule should i) be targeted to a specific segment of the market to address a particular problem or issue that has been clearly defined and rigorously analyzed, ii) provide regulatory guidance (in the form of principles-based regulation) that focuses on outcomes and high-level rules as a means of achieving regulatory objectives, and iii) place more emphasis on investigation and enforcement of regulatory policies and rules and punish "bad behaviour" of a few individuals rather than create overly burdensome regulations on those who are already compliant.

Any new requirements should be principles-based by focusing on the outcomes that requires firms and their representatives to achieve, rather than on the process or actions firms and advisors must take. This would provide both firms and advisors with the flexibility they need to find the most efficient way to achieve the desired outcomes. A focused approach on protecting the consumer should be based on the commensurate consumer risks and corresponding benefit of added regulation, among other specific factors.

Greater emphasis needs to be placed on investigation, enforcement, and punishment of "bad behaviour" of a few individuals rather than creating overly burdensome regulations on compliant market participants. As a significant number of investor complaints involve misappropriation of client funds and fraud, we believe that the bodies established to resolve these issues should have the necessary recourse to investigate complaints and significant enforcement powers to ensure that rules and principles are taken seriously. Advocis believes that those who perpetrate such crimes against consumers should be appropriately punished.

### ***Acceptable Business Structures - Small-Business vs. Large Fully-Integrated Firms***

Advocis is pleased that the CSA is beginning to recognize that a significant portion of market participants can be independent contractors and not simply employees of large, vertically-integrated firms. The Proposed Rule and draft legislative amendments for Ontario have made some changes in this respect by clarifying that a representative of a registered mutual fund dealer can be in a principal-agent relationship with a registered dealer. It is our hope that *non-traditional business structures* (i.e., independent contractors), like those Advocis represents, can be

reconciled with the existing regulatory regimes or accommodated when modifications are made to the regimes.

As we have indicated in the past, we believe that non-traditional business structures should continue to exist as they provide a valuable service to the Canadian investing public. Given that investment products are evolving rapidly and becoming more complex in some areas, the CSA should recognize that consumers are turning to professionals increasingly for assistance when making financial decisions given this increased complexity of a more diverse marketplace. Maintaining a healthy independent distribution channel servicing consumers should be a key consideration of regulators to ensure the Canadian public has access to competent financial advisors and quality financial advice.

Traditional business structures are typical of large fully-integrated financial institutions such as banks and investment dealers who trade in securities and have the means to ensure that they are in compliance with comprehensive and complex securities regulations and rules from a supervisory standpoint and that reflect their core functions of the overall financial services distribution channel.

Rules should not be written only for large firms and dealers, whose interests are often very different from those of advisors. It is the advisor that forges and maintains the relationship with the client based on trust and personal suitability. A principles-based regulatory approach would give flexibility to advisors in better meeting the financial needs of their clients as financial professionals. Placing greater emphasis on developing rules that cause greater burdens for compliant advisors is not in the public's best interest.

While our small-business members may, in some cases, operate under *non-traditional* business structures and may present a regulatory challenge to the CSA, they nonetheless represent a legitimate and significant segment of Canada's financial services industry. As such, their recognition and accommodation by regulators in major policy initiatives such as this one is essential so that they can continue to carry on their businesses and provide valued financial services advice to millions of Canadians in a cost effective and efficient manner.

### ***Providing Flexibility to Accommodate Independent Owner-Operators***

Advocis would like to work with the CSA to find workable registration categories within the Proposed Rule that addresses the concerns of non-traditional business structures such as independent owner-operators who are typically dual-licensed financial advisors who sell insurance and mutual fund products.

Advocis continues to explore various models that can fit within these registration requirements (including a variation of the Independent Owner-Operator model that may be familiar to some CSA representatives) and that can be easily applied to our members and administered by regulators. At this point, we wish to reiterate our request that the CSA provide its confirmation that it is willing to consider including a placeholder in its Proposed Rule to allow for this possibility.

### ***Advisor Incorporation***

It is our understanding that advisor incorporation will not be addressed within the Proposed Rule, while originally it formed part of the Registration Reform Project. While this issue is being dealt with separately and no longer forms part of this reform initiative, we believe that the CSA should make it a priority and work with the industry toward a permanent solution.

The approach taken last year by the Manitoba Securities Commission and earlier this month by the New Brunswick Securities Commission to allow securities related commissions and fees to be paid by a registered dealer directly to a corporation of an individual registrant under certain circumstances, and providing an exemption to the corporation from registering, should be considered as a commencement point for discussions on a permanent solution.

In this respect, Advocis will be making formal representations to CSA members on our concept for a permanent solution to initiate a constructive dialogue on this issue. It is our hope that we can work with all CSA members in a timely fashion to forge a permanent solution. The industry is anxious to see progress on this issue as financial advisors remain one of the only professions that cannot incorporate as a business in any consistent manner across Canada.

### ***Examples of Principles-based Approach to Regulation***

Advocis strongly supports consumer protection, and believes that it can be more effectively achieved through principles-based regulation that is broad in nature, an approach currently being adopted by the Financial Services Authority (FSA), the UK's integrated regulator of financial services.

According to an April 2007 FSA paper: *Principles-based Regulation – Focusing on the Outcomes that Matter*, prescriptive rules have not prevented misconduct among financial market participants, but have instead resulted in “ever-expanding rule books ... that have become an increasing burden on our own [the FSA's] and the industry's resources”.

Advocis concurs with the FSA's position, and believes that prescriptive rules that do not directly ensure enhanced consumer protection impose additional regulatory burdens and costs on our small-business members. These added costs make it more difficult for our members to compete in the highly competitive financial services sector, potentially resulting in fewer advisors in Canada and ultimately less choice for consumers.

The Government of British Columbia continues to demonstrate its commitment to results-based regulation that costs less, is more effective in protecting investors, and promotes competitiveness and innovation. We believe that BC has gone further than any other province to advance sensible regulations that are “friendly” to the consumer/investor and create a workable operating environment for existing registrants.

According to the BC Securities Commission Service Plan, 2007-2010:

*Regulation inevitably imposes costs through regulatory fees, compliance costs, and restrictions on business activity. Investors ultimately pay these costs, so regulatory interventions should generate the greatest investor protection and market integrity benefits for the least cost... Rules are often not the best choice of tool, because they tend to be the most intrusive and most costly alternative... However, if a rule is necessary, it should have these attributes:*

- *The focus should be on outcomes ..., rather than merely prescribe a process on the assumption that the resulting process will achieve the outcome.*
- *The scope of the rule should be limited to what is necessary to achieve the desired outcome.*
- *The rule should be clear and simple.*

In addition, we note that a principles-based approach to regulation is being implemented successfully in Canada by provincial insurance regulators.



Recent regulatory initiatives in the Canadian insurance sector illustrate how principles-based regulation, with the support and efforts of the industry, can be effective in promoting widespread compliance of regulatory requirements. Canada's insurance regulators under the auspices of the Canadian Council of Insurance Regulators and the Canadian Insurance Services Regulatory Organizations recommended a principles-based approach to enhance and harmonize best practices across the industry and in all jurisdictions to deal with the issue of managing potential conflicts of interest. The market conduct areas examined by the insurance regulators include similar aspects of the advisor-client relationship that the CSA is contemplating under the conduct rules (Client Relationship Model) for securities representatives.

Advocis believes that at this juncture, the CSA should seriously consider adopting similar approaches in its efforts to balance the goals of investor protection and the efficient operation of capital markets and its market participants.

## **Specific Comments**

### ***Permitted Clients (Part 1, Definitions)***

Advocis is supportive of the CSA's inclusion in this draft of the Proposed Rule of a new category of investor, the "permitted client," as a subset of "accredited investor" (as defined in NI 45-106) consisting primarily of institutional, corporate (greater than \$100 million in shareholder equity) and very high net worth individuals (greater than \$5 million in financial assets). We agree with the CSA that, at the upper end of the accredited investor spectrum, there are investors who are sufficiently sophisticated, or have sufficient resources to obtain expert advice, and that they may neither need nor wish for the same level of protection as other investors.

The Proposed Rule waives the suitability obligations when exempt market dealers are dealing with permitted clients, and permitted clients of advisers and dealers, other than exempt market dealers, will have the ability to waive the requirement for the adviser or dealer to make investment suitability determinations for them. This implies that registrants will have a reduced suitability review obligation when dealing with permitted clients, which will result in reduced regulatory burden for this client segment.

However, it is not clear that the reduced regulatory obligations for this new category of client will apply to advisors that are approved persons under the SRO regulatory regime. It is our understanding that the MFDA, for example, will still need to formally exempt advisors and dealers from suitability requirements for this new category of investor. We strongly encourage the CSA to ensure that the permitted client rules apply consistently between advisors under the SRO regulatory framework and non-SRO advisors under the Proposed Rule.

### ***Fit and Proper Requirements (Part 4)***

In general, Advocis agrees with the CSA that there should be fit and proper requirements to ensure the suitability of individuals and firms for registration. While we continue to support the CSA's three cornerstone concept: proficiency, integrity, and solvency, we believe that their respective qualification requirements could be modified to better accommodate various market participants.

In general, Advocis believes that one of the most effective ways to protect consumers is to ensure that the registrant is a recognized financial services professional. Advocis takes the view that professional financial advice is delivered by an accredited financial advisor who:

- has a professional designation,

- adheres to a professional code of conduct,
- maintains membership in a recognized professional body,
- subscribes to practice standards,
- acquires competency-based continuing education credits, and
- maintains adequate errors and omissions (E&O) insurance coverage to protect both the consumer and the financial advisor.

### ***Proficiency (Part 4, Division 1)***

The newly proposed *Proficiency Principle* states that, when a registered individual performs an activity that requires registration, the individual must have the education and experience reasonably necessary to perform the activity. This principle begins to address a number of the issues outlined above regarding the necessary conditions of being a qualified financial services intermediary.

As we had indicated in our earlier submission, it is our understanding that under the Registration Reform initiative, the CSA is considering proposing changes to the registration requirements or proficiency standards that would no longer allow provincial jurisdictions like British Columbia to formally recognize “financial planning” as a distinct activity or the designations obtained for the purpose of holding out as a qualified “financial planner”.

Advocis believes strongly that one of the most effective ways to protect consumers is to ensure that they receive professional financial services advice delivered by an accredited financial advisor who has a professional designation. We support jurisdictions like BC that recognize the expertise of an advisor and the higher proficiency standards of those who hold out as a financial planner.

To the extent that the CSA is considering changing the proficiency standards of registrants, we would be interested in meeting with the CSA to discuss this important issue to ensure that high proficiency standards are maintained. Furthermore, should the CSA consider examining the financial planning aspects of the overall process of providing financial advice to consumers, we strongly encourage it to consult with Advocis early on in the process.

### ***Conduct Rules (Part 5)***

As noted above and in our previous submission, Advocis has some concerns with the CSA’s Conduct Rules, especially as they relate to the implementation of the Client Relationship Model by the two SROs. These rules and principles will directly guide the way in which professional financial advisors interact with their clients. In general, Advocis believes that prescribing rules regarding the relationship between financial advisors and consumers is inappropriate and creates an external framework for the regulation of advice-givers in their relationship with consumers of financial advice. SROs and their dealers have become increasingly prescriptive on issues such as suitability that can often restrict the ability of advisors in offering a full range of investment options to suit their clients’ needs.

We have provided comments to the IDA on its proposed rule changes to implement the Client Relationship Model, a copy of which has been provided to each member of the CSA. We are awaiting the release of the MFDA’s proposed rule changes and will be commenting extensively on those proposals once they are made public. A copy of our submission to the MFDA will also be provided to the CSA members to encourage a consistent approach is taken between the Proposed Rule and the MFDA’s interpretation and implementation of the conduct rules and Client Relationship Model.

### ***Providing Relationship Disclosure Information (Part 5, sub-section 5.4)***

Advocis is supportive of the CSA's decision to abandon the prescriptive Relationship Disclosure Document in favour of providing relationship disclosure information that is more principle-based. The new approach, where registrants would provide information that a reasonable client would consider important with respect to the client/advisor relationship, is a positive step forward.

Advocis supports meaningful disclosure to retail investors that is easily understood, relevant to the transaction, mitigates real or potential conflicts of interest and will help investors make more informed decisions with respect to the risks associated with financial products.

We would encourage the CSA to ensure that the SROs adopt this approach in examining how best to implement this requirement for approved persons of dealers so that there is consistency between the rules and principles that apply to advisors operating under one of the SROs and non-SRO registrants under the Proposed Rule.

### ***Know-your-client (Part 5, sub-section 5.3) & Suitability (sub-section 5.5)***

We recognize the know-your-client and suitability obligation that financial advisors have to their clients. However, we believe that the suitability obligation is defined by the business relationship contracted between the buyer and seller of the financial services or products and should not be overly prescriptive.

Many of Advocis' members who are financial advisors typically use a *Letter of Undertaking* to define the scope of the advisor's role in the client/advisor relationship and an *Investment Policy Statement* that captures the agreed points of reference by which the investor's objectives are to be implemented and achieved. We believe that an *investment policy statement* tailored to a client's specific needs and risk tolerance is a more effective means for determining investment portfolio suitability than the typical KYC checklist.

Recently, the MFDA issued a Member Regulation Notice - Suitability Guidelines (MR-0069) clarifying its position on suitability and the know-your-client information. The Guideline reflects both existing regulatory obligations as well as new guidelines in certain areas, which will result in future corresponding rule and policy amendments according to the notice. We believe that this process needs to be integrated with the CSA Proposed Rule that is more principle-based in nature and general in scope.

We submit that an *investment policy statement* should also be recognized by the CSA as an acceptable means for determining a client's investment portfolio suitability, as an alternative to a prescriptive KYC checklist, which is promoted by the SROs.

### ***Disclosure when recommending use of borrowed money (Part 5, sub-section 5.8)***

We believe that a client should be made aware that leverage (using borrowed money to invest) is not a short-term strategy, since there are certain risks associated with this type of investment strategy. The prescribed written disclosure statement provided to the client should include a duration comment indicating that borrowing money to invest should only be considered as part of a long-term investment strategy.

### ***Compliance System (Part 5, Division 5)***

As cited above, the Proposed Rule will generally impose certain unnecessary regulatory burdens on our members who do not directly participate in the Canadian capital markets,

and it should therefore be amended to allow for CSA exemptions recognizing cross-pillar harmonization where appropriate. Under such a framework, we would have no specific concerns with the conduct rules' proposed compliance requirements, particularly as they are not new, are intended to be principles-based, and provide firms flexibility to demonstrate to regulators that they have an effective compliance system.

### ***Complaint Handling (Part 5, Division 6)***

Advocis is a strong proponent of the need for consumer dispute resolution mechanisms so that consumers may have their complaints adequately addressed or obtain information about the regulatory process. Advocis believes that the complaint-handling rule seems reasonable and we do not have any specific concerns with the requirements. We support the CSA's position that recognizes that different complaint resolution mechanisms are available depending on the sector in which the registrant is licensed.

In addition, Advocis strongly encourages its members to obtain errors and omissions insurance to help resolve professional liability complaints, a mandatory requirement for insurance advisors. Errors and omissions insurance applies to the advice that financial advisors provide regarding investment funds and should be explored more closely by the CSA as a means of dealing with consumer dispute resolution.

### ***Conflicts of Interest (Part 6 of Proposed Rule)***

Advocis recognizes the need for a mechanism to manage potential conflicts of interest and enhance consumer confidence in the market. Advocis also recognizes the challenges regulators must have in dealing with this issue given the various interests involved and the different ways they could be assessed and balanced.

The Proposed Rule sets out an over-arching principle that requires registrants to identify and deal with conflicts, including some prescriptive requirements outlining the manner in which they must be addressed. While the rule is comprehensive, it is also complex and onerous, requiring firms to establish internal systems to evaluate the balance struck between competing interests. Advocis believes that broader principles would be simpler and more effective.

The ultimate objective in developing conflict of interest provisions is to ensure that the interests of the client are best served. The insurance industry has recently dealt with the same issue and regulators have adopted broad-based principles as a means of managing potential conflicts of interest, which include maintaining the priority of the client's interest, meaningful disclosure of conflicts of interest and product suitability. Under this approach, if the broker or agent can effectively demonstrate that the product recommendation is suitable to the client, and has made appropriate disclosures, then any actual or potential conflict of interest arising from compensation, ownership or financial relationships is likely to have been effectively managed.

We encourage the CSA to move away from a complex approach in developing its final conflict of interest rules, and we would be interested in discussing in more detail the alternative approaches that the insurance regulators have adopted and which the industry has implemented.

### ***Tied Selling (sub-section 6.10)***

As a matter of consumer protection, Advocis is in favour of the proposed tied selling provisions that do not permit a person or company to require another person or company to purchase or use to buy, sell or use any products or services as a condition, or on terms that would appear to a reasonable person to be a condition, of buying or selling particular securities. This is

consistent with the prohibition of various tied selling activities in other areas in the financial services sector such as insurance and banking activities.

### ***Referral Arrangements (Part 6, Division 2)***

The provisions for referral arrangements have not materially changed between this version of the Proposed Rule and the 2007 version. Therefore, we would like to reiterate our previous position on this important aspect of the Rule.

In general, Advocis supports the intent of the Rule in its attempt to address and reduce the various issues that are associated with referral arrangements. However, the rules as drafted are very prescriptive in their requirements and places the onus solely on registrants to ensure that clients are protected.

It appears as though the referral arrangement rules are, in part, a response to the emergence of more sophisticated and complex financial products, the desire for advisors to have significant knowledge of these products, and to ensure clients are equally aware. Indeed, there are risks inherent in any new products, which can be magnified if disclosure from advisors to clients regarding risk, fees or conflicts is inadequate in circumstances where financial advisors have not followed the appropriate rules and regulations in dealing with their clients, including knowledge of products in referral arrangements.

Notwithstanding, significant efforts must also be made to appropriately assess the form and structure of new financial vehicles in terms of their viability and sustainability before they go to market and are exposed to retail investors. While additional effort needs to be focused on compliance activities and investor education to enhance the level and quality of information disclosed to investors and to improve their understanding of this information when making their investment decisions, significant effort must also be placed in reviewing and vetting financial products before investors are exposed to them. Only then will any additional obligations of financial advisors relating to referral arrangements be of benefit to investors from a consumer protection standpoint.

We believe that the final Rule should outline how the CSA will take steps to ensure that investment products are appropriately vetted to prevent unsuitable and fraudulent products from entering the market, before they are inadvertently sold or referred by financial advisors.

### **Conclusion**

Consumer protection is of paramount importance in this reform initiative, as Canadians have been hurt by fraud, whether it has been through fraudulent products entering the retail market or through the “bad behaviour” of advisors. Regulatory responses and approaches to address this must be balanced with allowing compliant intermediaries to allocate a significant portion of their time and effort in dealing with their clients and in upholding the priority of the client’s interest.

A significant segment of the Canadian population does not have a professional financial advisor and this access is becoming more difficult as compliance costs on the distribution system are ultimately borne by the consumer. In order for most Canadians to take full advantage of new investment vehicles and opportunities, such as the new federal tax-free savings accounts, they will require access to professional advisors. Additional layers of regulation and overly burdensome compliance requirements limit advisors’ ability to perform their client obligations. This can have the effect of reducing access of consumers to these valued professionals, which is not in the public’s interest if one of the overriding objectives is to assist Canadians in appropriately saving and planning for their future. One of Advocis’ key goals is to ensure Canadians have

access to qualified financial advice while ensuring consumers are well-informed and adequately protected. This should ultimately be accomplished within an environment that promotes a level playing field for all financial services market players.

We urge the CSA to consider our concerns and recommendations, and amend the Proposed Rule to reflect the needs of our members. Advocis members represent a significant part of the financial services sector in Canada, and they wish to continue to conduct their businesses within registration categories that are acceptable to both Advocis members and the CSA. It is our goal that our members work within a regulatory framework that meets the objectives of all market participants and securities regulators without imposing undue hardship on advisors who are in compliance with securities rules. We thank the CSA for the opportunity to provide our comments on this important regulatory reform initiative.