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June 1st, 2009

Mr. Robert Day
Manager, Business Planning
Ontario Securities Commission
20 Queen Street west
Suite 1900, Box 55
Toronto, Ontario
M5H 3S8

Dear Mr. Day:

Re: Ontario Securities Commission 2009-2010 Statement of Priorities

Thank you for providing Advocis with the opportunity to comment on the Ontario Securities Commission's (OSC's) *2009-2010 Statement of Priorities (Statement of Priorities)*.

Advocis, The Financial Advisors Association of Canada, is the largest and oldest voluntary professional membership association of financial advisors and planners in Canada. Our members are provincially licensed to sell life and health insurance, mutual funds and other securities, and are primarily owners and operators of their own small businesses who create thousands of jobs across the province. Advocis members are professional financial advisors who provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans, disability coverage, long-term care and critical illness insurance to millions of Canadian households and businesses. Our 5,000 members in Ontario provide financial advice and services to hundreds of thousands of consumers.

General Comments

The OSC has identified four broadly based goals in their *Statement of Priorities*:

1. identify the important issues and deal with them in a timely way;
2. deliver fair, vigorous and timely enforcement and compliance programs;
3. champion investor protection, especially for retail investors; and
4. support and promote a more flexible, efficient and accountable organization.

The established goals of the OSC are critical to the proper functioning of our capital markets. The four goals identified by the OSC are largely interrelated, and this is reflected in our comments. While we generally support the OSC goals, our response will highlight obstacles that will limit the OSC success. It is our experience that entrenched practices are resulting in regulatory inertia that, unless recognized and changed, will be an obstacle to the OSC successfully meeting its stated priorities. To further their mandate, the OSC notes the following challenges:

- pursue specific initiatives that demonstrate a commitment both to protect investors from fraud and misleading sales practices and to incorporate their views in the development of regulatory changes;
- understand the long term impact of market changes; and
- focus on compliance as an integral part of ongoing regulatory enforcement.

Investor protection, long-term market changes, and a focus on compliance as an integral component to enforcement are all critical. Advocis believes that success with respect to each of these points requires that the regulator look at these issues broadly, in terms of national and international implications. Equally important, the OSC must consider these issues from the point of view of the relationship at the most fundamental level, that of the client and advisor. We believe the client/advisor relationship is currently mismanaged. A failure to address systemic problems at the domestic level in relation to the client/advisor relationship will have long term and negative implications for consumers.

The OSC, in responding to the Standing Committee on Agencies, made a number of public comments suggestive of an intention to maintain the status quo in relation to serious issues with direct relevance to the regulation of the client/advisor relationship. Specifically, the OSC claims:

- its requirement and processes ensure that all relevant stakeholders are always consulted;
- problems that are proposed to be addressed by regulation are always clearly identified, and the costs and benefits of proposed regulation are always given appropriate consideration;
- it takes a practical approach to assessing regulatory compliance and recognizes that compliance standards may vary on the size and structure of a firm; and
- the regulator always maintains an appropriate balance between rules and principles in its approach to regulation.

The OSC fails to acknowledge that there is an imbalance in regulation that favours the interests and business model of market-dominant dealers and places costly burdens on compliant small players.

We believe that a more balanced approach to regulation that accommodates a wider range of market participants and business models would benefit investors by ensuring continued diversity, choice and competition in the marketplace.

The OSC states, “Investor protection is a critical element of our two part mandate, we recognize that to serve the interests of all investors, especially retail investors, it is important to obtain their input on matters related to securities regulation. We also believe that informed investors are better equipped to protect themselves and to help regulators protect them. Therefore, we will continue to review our internal processes for adequately addressing investor concerns during the development of securities regulation.”¹ We support this position entirely. However, how one defines investor protection will determine how one is to measure the OSC’s success in achieving this goal. An increased focus on investor education and the establishment of an Investor Secretariat are positive steps². Advocis believes that to ensure consumer protection and serve the interests of all investors, the current proposed initiatives in the *Statement of Priorities* do not go far enough. If we view investor protection and interests more broadly, then ensuring continued consumer choice in relation to the provision of investment advice should be a central focus of the OSC and SROs. Advocis proposes that an Advisor Secretariat or Panel be established to further this goal.

¹ (2009) 32 OSCB 3772, May 2009.

² The Expert Panel on Securities Regulation similarly proposed a Financial Literacy Task Force and an Investor Panel under the proposed Canadian Securities Commission.

The OSC further states, “[w]e need to examine opportunities to better align our disclosure regime and compliance and enforcement approaches internally, in concert with recognized self-regulatory organizations (SROs) and other entities, as well as more broadly to improve the ability of the regulatory system to recognize and address risks that emerge as a consequence of the convergence of financial markets and products.”³ We again agree with this general statement. Convergence between financial sectors and products will continue. It is important that the OSC, other CSA members, and SROs work in concert with their counterparts on the Joint Forum to address conflicting and overlapping regulation. A more principles/outcomes-based approach to regulation already exists in the insurance sector, and has been recommended for the proposed Canadian Securities Commission. Such an approach to regulation lends itself to a more flexible platform from which to develop harmonized regulation between financial sectors. We are strongly of the view that increased rule making and added compliance responsibilities on already compliant market participants would be the incorrect choice and direction for the securities sector to adopt if greater harmonization between financial sectors is to be achieved.

Key Advocis Priorities

- The guiding core regulatory principles that should direct action on the part of regulators are: act only in the case of market failures, information asymmetries or matters of consumer protection; identify the problem through detailed consultation and analysis; and, employ principles/outcomes-based responses, which includes prescriptive rules if there is clear evidence that absent a prescriptive policy response, harm will be done to the market or consumers.
- A process to identifying trends must be established. A downturn in the market does not signal the need for more regulation. Finance and investments are a system of risk transfer. The function of law and regulation is to permit risks and the rewards associated with taking them to be transferred from protection buyer to risk takers, and to circulate amongst risk takers in the financial markets. The incorrect identification and reaction to trends can be potentially harmful to the delicate balance of risk transfer that the financial markets are premised upon.
- There is a need for an Investor Secretariat⁴. The OSC’s recognition of this need is encouraging. However, we believe that there is also a clear need for an Advisor Secretariat or Panel in the regulatory structure. An Advisor Secretariat would represent an important voice that promotes consumer protection, innovation, and competition in the field of financial services.
- We believe that consumers should have ample access to professional financial advice, products and services and financial planning, and should be able to choose among a diverse range of financial services providers.
- We strongly believe that the current regulatory framework and the direction in which regulation is going, does not favour a diverse range of choices for consumers and is limiting access to professional financial advisors.
- We believe that the promotion of financial literacy is crucially important. Our members as financial professionals spend more time than most anyone educating Canadians about their finances. A regulatory framework that drives out accredited professional financial advisors will leave investors less able to understand financial matters.
- We believe that, in many instances, higher compliance costs and the increased regulatory burden imposed by regulatory requirements are not adequately justified. Often when new regulatory requirements are proposed there is no clear problem or risk to consumers, and

³ (2009) 32 OSCB 3773, May 2009.

⁴ This is consistent with the recommendation of the Expert Panel on Securities Regulation for the establishment of a Consumer Panel.

the additional rules and compliance costs offer no real consumer protection benefits. This saddles compliant financial advisors with more and more regulatory compliance costs and increases costs for consumers, but provides little benefit.

Analysis and Commentary:

Our analysis and commentary will examine in greater detail the four goals established by the OSC in its *Statement of Priorities*.

A stated OSC goal is to deal with today's concerns, while anticipating tomorrow's challenges. To this end the OSC proposes to:

- consult and collaborate with investors, issuers, intermediaries, other industry participants and professionals to identify important issues;
- identify trends and emerging issues, and develop solutions to address them efficiently and effectively;
- work with the Government of Ontario, other securities regulators and market participants to strengthen the Canadian securities regulatory system; to support efforts to move towards a common securities regulator; to continue to harmonize, streamline and modernize securities laws and ease the regulatory burden on market participants; and,
- continue to examine alternative securities regulatory approaches that provide a balanced regulatory approach and adopt best regulatory practices from other Canadian and international jurisdictions to support Ontario markets and investors. The OSC will work to enhance the global competitiveness of our capital markets as well as foster co-operative relationships with securities and other regulators.⁵

Advocis has clearly indicated to the OSC, other CSA members, and SROs its willingness to work cooperatively with them in the identification of problems and the development of solutions. Certainly, the increased complexities in the financial markets, the convergence between sectors and financial products require greater industry participation to enhance the expertise of the regulators. It has been our experience that the SROs and the OSC fail to adequately consult with all stakeholders early in the policy process. Rather, larger market players are consulted to the early exclusion of organizations such as Advocis. Accordingly, while the *Statement of Priorities* proposes to consult and collaborate with investors, issuers and intermediaries, we are concerned that the consultation process will continue to marginalize independent advisors. We believe that this oversight will have negative long term implications for consumers and reduce innovation and the scope of advice available to consumers.

The identification of trends and emerging issues can best be achieved through a broad consultative process. Broadly identifying trends and issues will, in our view, require a shift in attitude by the SROs and the OSC. Stakeholders, outside of the large vertically integrated financial institutions, can bring an important perspective to the analysis of risks and trends that frame regulatory responses.

Remaining a competitive capital market is critical for Canada's domestic economic health. The global capital markets have undergone extraordinary, and increasingly rapid change over the last 25 years with no foreseeable slow down to the speed of innovation anticipated. In tandem with the change has been the increasingly important role the capital markets play in the overall health of the global economy. The immobilization and dematerialization of securities have provided solutions to the technical barriers that once limited the volume and speed of transactions. Set off and netting developed by trade associations has provided greater business certainty and reduced the risks

⁵ (2009) 32 OSCB 3773, May 1, 2009.

associated with delayed or failed transactions. It has also benefited consumers as the cost of products, which factor in systemic risks, are adjusted to account for the reduction in failed trades and the subsequent legal actions that often follow. The resulting interest in securities allow for the continued creation of innovative investment vehicles that professional investment advisors and their clients use in developing, reviewing and revising long term investment plans aimed at providing the client with financial security and independence. These innovations also place increased stress on regulators who are under constant pressure to provide the necessary environment that allows market participants to maximize investment opportunities, with insufficient resources to keep pace with innovations in the market. While some risks are minimized through innovation, other risks materialize. The management of domestic and global capital markets now requires the combined resources of government regulator(s) and the regulated industry itself to assess risks and respond appropriately.

Convergence between financial sectors and products is a clear and continuing trend. Functions traditionally performed in one sector (i.e. insurance) are now undertaken in others, and financial techniques are emerging which combine characteristics of various traditional transaction types. Structured products may be offered in a range of alternative legal 'wrappers'. For example, a capital-protected product might be offered alternatively as a bond, or an insurance policy. Securitization, a type of transaction whereby a portfolio of income-producing financial assets are economically translated into debt securities, are issued in the capital markets, under which the rights of investors are backed by the underlying portfolio. Credit derivatives represent an important form of financial contract that transfers credit risk between the parties. Together, securitization and credit derivatives are a dominant force, drawing ever more categories of business into the capital markets as an ever-wider range of assets and risks are economically converted into asset-backed securities. The complexity of the products, their reach, the intrinsic legal issues they raise, and the speed of innovation and introduction of new products exceeds the resources of regulators.

With respect to the emergence of more sophisticated and complex financial products, we accept that the risk inherent in new products 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. 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. 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.

The absence of Advocis, and other marginalized stakeholders, in the early discussions that form the basis of policy responses to opportunities and risks in the evolving capital market is contrary to the OSC stated goals. The establishment of an Advisor Secretariat would go a long way in addressing this problem as advisors, along with investors (through the proposed Investor Secretariat) would be 'at the table' from the beginning. Bringing these voices, their knowledge and expertise, and concerns to the early stages of the policy discussions is critical. Inviting investor and advisor participation only after a proposal has been issued for public consultation is no longer an acceptable approach. Currently neither the OSC nor the SROs are making appropriate use of the resources associations like Advocis are making available.

The OSC's desire to work toward a common securities regulator is a matter that Advocis strongly supports, but we are concerned with the platform from which such an entity would operate. The federal government has indicated its intention to reform securities regulation in Canada, and we are pleased that Ontario was an early and enthusiastic supporter of this reform. We believe that a common securities regulator must operate from a principles/outcomes-based platform.

Regardless of the outcome of the current push for a common regulator, Advocis supports a regulatory system that is principles/outcomes-based, especially considering the piling on of rules and regulations that currently exist. Every effort should be made to ensure that regulators act appropriately to identify market failures, information asymmetry, and consumer protection.

The core regulatory principle that should guide regulators are:

- act only in the case of market failures, information asymmetries or matters of consumer protection;
- identify the problem through detailed consultation and analysis; and
- employ the least prescriptive regulatory response that will address the issue and achieve the desired regulatory outcome.

We recognize that there are times when prescriptive policy intervention will be necessary, however, we feel that the OSC, and other securities regulators⁶, are not fully utilizing the regulatory tools available to them in achieving policy objectives and resorting to prescription prematurely. The net effect is to remove creativity and innovation that market participants can provide and to incorrectly identify problems without considering the markets ability for self-correction in many instances. In cases of consumer protection, information asymmetries or market failure we believe that more coordination is required between regulators, including SRO's and market participants in finding the appropriate regulatory response and solution.

Such an approach to regulation requires regulators to adopt a sound approach, one based on detailed consultation with industry and individual participants in the capital markets. At the same time capital market participants must take an active interest and participate in the formulation of regulation and rules. In brief, Advocis believes in a principles/outcomes-based approach to regulation where the proper balance is struck between the use of principles and prescription to achieve the desired regulatory outcome.

Built into every policy instrument should be a requirement for a five year review. If the evidence gathered through the filing requirements indicate that the policy instrument has not achieved its stated purpose, or has ancillary effects that are harmful or inadvertently restrict market practices, then the policy must be set down for immediate review. The review should consider whether the regulation is justified, needs amendment or should be repealed. As capital markets are increasingly international, it is imperative that we regulate in a manner that encourages innovation and investment without compromising consumer protection. In striking the right balance between investor protection and increased market efficiency there is a need on the part of regulators to provide a robust cost/benefit analysis for all proposed rules and regulations. The onus is on regulators to demonstrate that the benefit to investors and markets clearly outweigh the costs of the regulation⁷.

⁶ Namely the Mutual Fund Dealers Association of Canada and the Investment Industry Regulatory Organization of Canada.

⁷ With respect to this point we noted the MFDA's lack of attention to the use of cost/benefit analysis. In their April 24, 2009 republication of the CRM rules and policies the MFDA did not do a cost/benefit analysis but stated the following, "MFDA staff believe that the Proposed Amendments strike an appropriate balance between managing costs considerations and appropriately addressing the regulatory issues identified by the MFDA." This is a very self serving comment to justify regulatory intervention. As the MFDA has a history of not considering the consequences of their actions on non-members, a robust cost/benefit analysis should be a mandated part of the MFDA process.

We note that in response to Advocis' call for a principles/outcomes-based approach to regulation, the OSC asserted that they "balance rules and principles", and that the SROs when they issue rules articulate the principles that they rely on. The OSC also asserted that "the UK regulator is signaling that it is moving away from a principles-based approach to a more outcomes-based approach." We believe the OSC's statement mischaracterizes the position of the Financial Services Authority (FSA) in the United Kingdom (UK). It is clear from recent pronouncements made by Hector Sants, the Chief Executive of the FSA, that they remain committed to a regulatory philosophy of principles/outcomes-based regulation⁸. Principles/outcomes-based regulation starts by articulating clear principles and identifies desired regulatory outcomes. It further requires the OSC and other regulators to choose the least prescriptive means available in achieving the desired regulatory outcome. It follows that regulators would select the appropriate regulatory response from the varied options available to them in order to achieve the desired outcome. The tools available to them include general principles, notices, policies, rule, national instruments and legislation.

We believe that the prevailing rules-based approach leads to overly prescriptive rules and costly compliance regimes that offer little or no benefits or enhancement of consumer protection. Statements in SRO rules and by-laws that refer to broad principles and purposes do not necessarily mean that their approach is principles/outcome-based, and in our view often serve as a means to introduce highly prescriptive SRO requirements.

A regulatory system operating from a principles/outcomes-based platform in no way hails the end to regulatory oversight, rather, it recognizes the limitations of governments in providing the specialized experience and knowledge that industry can provide, and places increased responsibility on the regulated community itself to provide solutions that are consistent with the general principles established by regulators.

Part of the OSC mandate is to deliver fair, vigorous and timely enforcement and compliance programs. The OSC states, "[t]imely and appropriate compliance and enforcement are integral to fostering confidence in capital markets and preventing harm to investors." Accordingly, the OSC will:

- continue to focus on compliance reviews of market participants to identify and prevent violations of Ontario securities law and ensure effective coordination among OSC branches in addressing improper market conduct; and
- identify gaps in the enforcement framework and co-operate with other regulators and agencies to find practical solutions.⁹

It is vitally important that the OSC and SROs adopt the same approach with respect to this issue. While the stated purpose notes the delivery of vigorous and timely enforcement, our experience is that enforcement is secondary to the ever increasing burden of more rules. Compliance is critical, but to burden compliant market participants with new rules fails to address the current short comings in enforcement. Punishing the few who violate laws and rules makes more sense than saddling compliant market participants with added costs, both in real terms and in terms of time spent ensuring compliance at the expense of meeting with their clients.

In a principles/outcomes-based regulatory environment the individual will no longer have available to them the argument that they have lived up to the letter of the law as has proven to be a successful

⁸ In February 2009, FSA Chief Executive Hector Sants described the FSA's regulatory approach both as principles-based and outcomes-based. He noted that a principles-based system is by definition focused on achieving outcomes, and that this is often misunderstood. He notes on page 11 of the *FSA Business Plan 2009-2010* that "[p]rinciples-based regulation means, wherever possible, moving away from prescriptive rules to a higher-level articulation of what we expect firms to do." It does not mean doing away with rules.

⁹ (2009) 32 OSCB 3775, May 1, 2009.

defense under a prescriptive regulatory regime. Investors may be better served through a principles/outcomes-based approach as the scope of enforcement actions will be broad.

Rules that impose more compliance burdens on compliant advisors do not serve the public interest. The OSC should give more priority to investigation and enforcing regulatory policies and rules, and to punish the misconduct of the few, rather than imposing burdensome regulations on those who are already compliant.

We believe that enforcement of existing rules and the rooting out of ‘bad apples’ would be far more effective in strengthening our markets, international reputation with respect to enforcement, provide better consumer protection and result in preserving consumer choice. The current trend is resulting in unsustainable compliance costs that can only be absorbed by large vertically integrated financial services firms. A continuation of the current approach will ultimately result in the demise of independent advisors to the serious detriment of consumers. The SRO’s focus on the interests of their members to the detriment of non-members merely exacerbates the problem.

The OSC states, “[t]he interests and needs of investors particularly retail investors, will continue to be strongly reflected in all the OSC’s operations. In addition to our enforcement activities, investor education and awareness and timely access to accurate information are important components of investor protection. We will:

- continue to reflect investor interests in all that we do;
- continue to support investor education initiatives;
- continue to support plain-language investor communication initiatives; and
- work with the SROs and lead or support initiatives that recognize the importance of the advisor to the retail investors, and strengthen and improve the advisor/retail investor relationship.¹⁰

We have already stated our support for continuing investor education. An emphasis on plain-language is an important initiative¹¹ and consistent with a principles/outcomes-based approach to securities regulation.

A continuation of the existing regulatory structure and environment will result in the consolidation of financial advice, with small business and independent advisors systematically squeezed out of the market. Should this come to pass, the market for financial advice will be dominated by large vertically integrated financial services firms, selling proprietary products. Consumers will have less choice and there will be less innovation in the market. Over the years we have seen a dramatic increase in regulations and rules that place unjustified compliance requirements on advisors. The increasing cost of compliance can only be absorbed by larger organizations that are able to spread the compliance cost over a larger client base. Independent advisors do not share the luxury of a client base that can absorb these costs, and as a result, the small business, professional advisor model is in serious jeopardy.

Compounding the problem is the fact that the regulation and rules being developed are often not necessary. The prescriptive approach to regulation employed at the CSA and SRO level are developed largely without meaningful input from consumers or advisors. In fact, there is no formal structure in the current system for consumers or advisors to actively participate in the policy process at the early stage. It should not be surprising then, that the current system creates policies that are

¹⁰ (2009) 32 OSCB 3775 May 1, 2009.

¹¹ The Federal Minister of Finance has indicated his support for plain-language as a feature of the proposed Canadian Securities Commission.

harmful to the long-term financial interests of consumers, and the very existence of small business, professional financial advisors.

Advocis would welcome leadership from the OSC in fostering a workable relationship between the SROs and non-members with respect to the advisor/investor relationship. The status quo is simply unacceptable and ultimately harmful to investors.

Again, thank you for the opportunity to provide our thoughts on the OSC's *2009-2010 Statement of Priorities*. I would be pleased to discuss our comments with you further at your convenience

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized 'G' followed by a long horizontal line that ends in a small arrowhead pointing to the right.

Greg Pollock
President and CEO