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VIA E-MAIL

May 9, 2016

Robert Day
Senior Specialist Business Planning
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, ON M5H 3S8

Dear Sirs/Mesdames:

Re: Ontario Securities Commission Notice 11-774 – *Statement of Priorities* Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2017

We are writing in response to the request for comments regarding the Statement of Priorities for Financial Year To End March 31, 2017 (the "Statement of Priorities"). We appreciate the opportunity to comment on the Statement of Priorities.

Invesco Canada Ltd. is a wholly-owned subsidiary of Invesco Ltd. Invesco is a leading independent global investment management company, dedicated to helping people worldwide build their financial security. As of March 31, 2016, Invesco and its operating subsidiaries had assets under management of approximately US$771.5 billion. Invesco operates in more than 20 countries in North America, Europe and Asia.

We have not in the past commented on the draft Statement of Priorities. We are changing our practice this year because we are of the view that while the Ontario Securities Commission ("OSC") does many things very well, it sometimes loses sight of issues and of promises made previously. We are writing, therefore, to reinforce some of these ideas and to provide the OSC with some items to ponder.

Goal 1 – Deliver Strong Investor Protection

Investor protection is a primary purpose of the *Securities Act* (Ontario) (the "Act") along with fostering efficient capital markets. Therefore, we believe that a focus on strong investor protection by the OSC is logical, appropriate, and timely. We note that this is a goal virtually every year. Our concern with this goal, however, is the focus on regulation rather than on enforcement.

While it is difficult to dispute the action items under Putting the Interests of Investors First, we do not believe that additional regulation is necessarily the answer. The Act, regulations, rules and policies (collectively, the "Rules") are extensive. The Carswell printed version, which appears to be written in 8 point font with little white space on any page, runs over 2800 pages long. It is obviously difficult to keep track of that volume of Rules but, more importantly, many of those Rules are vague and difficult to understand. Adding more Rules, therefore, does not provide one with optimism that anything will change.

For several years, in private and public discussions with securities regulators, we have advocated for a greater emphasis on enforcement. We will address this issue in greater detail later in this letter; however, we believe the Rules are generally quite good and, so, we are skeptical that more Rules are needed at this time. We believe that better enforcement and more transparency into enforcement efforts (including situations where Staff address non-compliance without enforcement) the outcomes of which were not a Commission tribunal decision, would be of assistance. There have been several sales practices issues over the last few years of which many registrants (in the mutual fund arena) are aware and had thought those practices were not permitted, yet there has not been a word about those incidents publicly from OSC Staff. This sends a message to registrants that such behaviours are satisfactory, which is surprising. Yet, in the absence of regulatory transparency, other registrants are left in a state of uncertainty that could lead to a questioning of their previous views.

The current approach raises two issues. Absent enforcement proceedings, non-compliance matters are often addressed by Staff with the result that the outcome is unclear and, hence, interpretation of the Rule itself becomes uncertain. Furthermore, many of these incidents get addressed in a Staff Notice, well after the occurrence, with a simple statement that such behaviour is not acceptable but without an indication that the registrant actually suffered a penalty in any form as a result of the non-compliance. Such an outcome sends the opposite signal to registrants than that which Staff intends.

It is clear that the structure of the securities regulatory system in Canada depends upon a certain degree of registrant self-regulation. While it may be difficult for a registrant's legal or compliance department to attempt to enforce a view expressed in a Staff Notice and for which there were no obvious consequences to the registrant in question, their task is made significantly easier when the Staff view is supported by a statement regarding the consequences to the registrant. This could come in the form of a simple statement in the Staff Notice as to what private agreement was entered into with the registrant (without naming the registrant) or in the form of a judicial or quasi-judicial decision. By altering the practice of Staff in this manner, therefore, we believe that compliance would be significantly enhanced.

Without a statement of the consequences of an action, a Staff Notice may be perceived by some as being a mere "suggestion". At Invesco, we believe laws fall into one of two categories: the black and white – where you know something is permitted or not with near certainty; and the grey, which requires some interpretation. We respect the black and white and where a practice is not permitted we do not engage in it. However, we are aware of market participants who analyze compliance differently. That is, they do not see black and white nor analyze it in that manner; rather, they assess "detection risk" and act when such risk is low. To bring

such registrants back "onside", therefore requires action by the OSC to increase "detection risk". We believe the approach outlined in the previous paragraph would accomplish that.

The foregoing strongly relates to the following declaration contained in the Statement of Priorities: "We will continue to seek improvements to the culture of financial services business, including the incentive structures they use." While National Instrument 31-103 mandates that a registrant maintain a culture of compliance, a culture is not something that can be maintained by regulatory fiat. We do not know if every registrant exhibits such a culture, although we suspect that is not the case. A compliance culture will develop if registrants see real consequences to their actions. The reality is that even in the published cases, the cost of the recalcitrant behaviour rarely appears to measure up to the damage done to clients. We believe that it should be the priority of the OSC, in the name of investor protection, to change this.

In terms of specific action items under this goal, we believe the plan to "finalize analysis of advisor compensation practices and identify those practices that appear inconsistent with current regulatory expectations" is written too narrowly. Compensation is one part of the problem but non-compensation incentives exist and these tend to exacerbate certain inherent conflicts of interest, especially those relating to the sale of proprietary products by dealers. Based on the Canadian Securities Administrators ("CSA") Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients* it is clear that the OSC and its fellow CSA members are aware of this issue. The Consultation Paper implies – and the Brondesbury Report and the Cumming Report emphatically demonstrate – that the sale of proprietary product is potentially as big a conflict as certain compensation practices and the former report notes that incentives in that space may be through means other than cash compensation. This should be a priority of the OSC.

We note that a subset of this goal is to "advance retail investor protection, engagement and education through the OSC's Investor Office." We strongly support this focus. The issues listed in this section are important issues in today's Ontario and we are encouraged with the regulatory focus on this area as well as the means listed by which the OSC intends to act on these issues. We support research before engaging in regulatory reform and follow up research to measure the impact and outcomes of regulation and would hope that such research leads to action.

Goal 2 – Deliver Responsive Regulation

We support the OSC's resolve to monitor recent regulatory changes, especially CRM2 and POS; however, given the newness of these reforms, neither of which has been fully implemented as of the date of this letter, we think that this would be better undertaken as a priority in 2018 so that a proper assessment can be made. We are concerned that if conducted too early, the information received will be meaningless, yet regulators will feel compelled to act (or not act) on such findings. We also fear that a "second" review will simply not occur or will occur too far into the future to address "unintended consequences" that adversely impact certain registrants.

Earlier, we referred to previous promises made that have not been kept. We are referring primarily to oft-abandoned efforts to review and reform NI 81-102. We note that when NI 81-107 was introduced, the OSC promised that after a few years, it would undertake a review of Part 2 of NI 81-102 with a view to repealing certain investment restrictions and bringing such matters under the purview of Independent Review Committees. NI 81-107 is now nine years old and such review has never occurred.

Under the previous Director of the Investment Funds and Structured Products Branch, the NI 81-102 modernization project was launched. The first phase dealt with codifying relief granted since the introduction of NI 81-102. The second phase sought to apply Rules that apply to conventional mutual funds to closed-end funds and exchange-traded funds. The third phase has never occurred and has seemingly been abandoned. The third phase was supposed to be a full review of Part 2.

When an authority makes a commitment and reneges, its moral authority to govern is weakened. This is problematic from the perspective of instilling a culture of compliance and it is problematic in that it hinders the ability of the regulator to be responsive as registrants become reluctant to engage with regulators and, therefore, many of the real issues cannot be brought to their attention. Furthermore, issues may be brought to their attention but registrant participation in assisting the reform effort wanes and this leads to poor regulation. As such, we strongly encourage the OSC to keep its promises and seek to modernize NI 81-102 on a priority basis, before the mutual fund industry – probably the most heavily regulated industry in Canada – is saddled with even more regulation.

Goal 3 – Deliver Effective Compliance, Supervision and Enforcement

As noted at the beginning of this letter, we strongly support this goal. We do note a point of caution, however. In preparing this letter, we reviewed the annual enforcement reports for 2015 for each of the Investment Industry Regulatory Organization of Canada (IIROC), the Mutual Fund Dealers Association (MFDA) and the CSA, as well as for the Ombudsman for Banking Services and Investments (OBSI). Despite the intense regulatory focus on the retail wealth management sector, we were surprised by how little enforcement there really is.

To put this in context, the CSA in its report notes that financial wealth in Canada is approximately $3.6 trillion and there are 123,883 individual registrants. Given the focus on retail wealth management, one would expect to see a lot of cases, based on these numbers. Note that if 1% of registrants were "bad", then we would expect a minimum of 1,238 cases, at 2% that figure is 2,477. Arguably, a 2% rate of problematic registrants is in the range of normal and does not infer a crisis. Based on the statistics, the 2% figure is not even reached.

IIROC received 1,341 complaints in 2015, a number that has been in decline over the past 5 years, it referred 98 cases to the CSA, and it engaged in 52 prosecutions against 68 individuals and 18 firms. We note that IIROC is the largest self-regulatory organization in the country. Total sanctions, including both at the firm level and the individual level, were a mere $4.6 million. It is hard to get excited about such a figure in a $3.6 trillion market. The top complaint received by IIROC related to unsuitable investments but that only totalled 33 complaints.

The MFDA record is not much better, with only 444 cases opened which led to 69 proceedings being commenced. The MFDA issued 85 warning letters and 86 cautionary letters, implying that those complaints did not merit much attention. The MFDA only concluded 65 hearings. While this might seem like a lot, in the context of the prevailing view of the wealth management industry we believe that this is a rather small number of hearings. We note that the MFDA issued $5.4 million in fines.

In summary, then, between the 2 SRO's, there were about $10 million of fines issued in a $3.6 trillion market. There were approximately 1800 cases, well below 2% of all registrants, which implies that over 98% are compliant and/or do a good job. These statistics do not significantly improve when the CSA and OBSI statistics are included.

The CSA commenced 108 proceedings involving 165 individuals and 101 companies and concluded 145 cases involving 233 individuals and 117 companies. The CSA statistics, of course, are not limited to retail wealth management and many of the issues raised in those cases are irrelevant for retail investor protection. But even with the 108 proceedings, the overall number is well short of 2% of registrants. The CSA did issue $138 million in fines, but $112 million was attributable to four cases.

OBSI only opened 298 cases, which still leaves us well short of the 2% mark noted above. They made awards of over $4.6 million.

Our concern is that this data suggests that the rate of non-compliance is overblown by the media and the regulatory community has done nothing to correct that (mis)perception. Alternatively, the data is so unimpressive due to a lack of enforcement. In our experience, most registrants are compliant and, as such, we tend to believe the former explanation; however, it is entirely possible that the latter is the correct explanation. The OSC should express an opinion on this prior to proceeding with new regulatory initiatives. If there is indeed a misperception, the OSC should step back and consider the impact of that on confidence in Canadian capital markets. If there is a lack of enforcement, we encourage you to consider the suggestions set forth earlier in this letter.

Goal 4 – Promote Financial Stability Through Effective Oversight

We are supportive of this goal. We disagree, however, that securities regulators have a meaningful role to play in cyber-security. While regulators can offer views in this area, they lack the expertise to regulate in this area.

To the extent a registrant operates under a standard of care that requires it exercise the degree of care, diligence and skill that a reasonably prudent person would exercise in the circumstances, we believe that private enforcement of cyber-security will be most effective. The largest financial services firms globally are setting very high standards in this space and these will, over time, come to be expected of all. Those who fail in this regard will face massive class action lawsuits the result of which will be to encourage others to pay proper attention to this risk.

Goal 5 – Be An Innovative, Accountable and Efficient Organization

While supportive of this concept, we believe this is a broad meaningless statement. An organization is driven by its people and we support and encourage the action item regarding development of people and expertise. We believe, however, that the OSC needs to refocus its talent management efforts and seek to fill vacant positions with individuals with extensive industry experience. All too often, especially among the OSC's legal staff we find that there is not much industry experience beyond working for the OSC. As such, the practicality needed to be an effective regulator is missing. At a more immediate level, the OSC should strongly encourage six month exchanges of its Staff with registrants to assist both parties in better understanding the issues faced by the other. At a former employer we did just that with the Investment Funds Branch (as it then was) and both the individuals exchanged and the organizations involved agreed that this was a worthwhile endeavour that brought to each organization a better and helpful understanding of the issues faced by the other.

I'd be pleased to discuss any of these responses at your convenience.

Yours Truly,

Invesco Canada Ltd.

Eric Adelson
Senior Vice President
Head of Legal – Canada