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September 30, 2016

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Services Commission (New Brunswick)
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Nova Scotia Securities Commission

Attention: Robert Blair, Secretary (Acting)
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
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comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
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Dear Sirs / Mesdames:

Canadian Securities Administrators (CSA) Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients

We are writing in response to the Canadian Securities Administrators' ("CSA") request for comments on CSA Consultation Paper 33-404, *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients*, dated April 28, 2016 (the **Consultation Paper**) and in particular, the potential addition of a regulatory best interest standard (**BIS**) to the current standard of care for registrants. Thank you for the opportunity to comment on this initiative. Capitalized terms used in this response have the same meaning as in the Consultation Paper unless otherwise indicated.

The proposed BIS standard is described in the Consultation Paper as a "regulatory conduct standard" that would require every registered dealer and registered advisor to deal fairly, honestly and in good faith with any client, and to act in clients' best interests. The duty to act in the best interests of the client is characterized as an "overarching principle", and stated to extend even to "objectively help[ing] to formulate the client's best interests". This obligation would be in addition to the proposed targeted reforms.

While eight provinces are part of the CSA initiative to publish the Consultation Paper, only the Ontario Securities Commission (**OSC**) and the Financial and Consumer Services Commission of New Brunswick have endorsed the proposed standard. They are of the view that the proposed best interest standard would enhance and strengthen the client registrant relationship.

Other jurisdictions which are accepting comments on the Consultation Paper are not endorsing the introduction of a BIS. Quebec, Alberta, Manitoba and Nova Scotia have "strong reservations" regarding BIS and British Columbia has expressed concern than an "overarching" standard may not be workable and may result in the "over-reliance by clients on registrants". Saskatchewan recognizes it is a major change and will review comments.

We also have significant concerns with a best interest standard, as set out below.

No Compelling Regulatory Rationale for Imposing a Best Interests Standard in Canada

We are of the view that there is no compelling need to implement a BIS for all registered dealers and advisors in Canada at this time.

SRO members are already subject to high standards of conduct, and carefully calibrated rules relating to matters including conflicts of interest, know your client and know your product obligations. Significant changes have recently been implemented through CRM1 and CRM2 with a view to enhanced investor protection.

At a minimum, before imposing a BIS, the impact of the recent Point of Sale and Client Relationship Model – Phase 2 (CRM2) amendments should be carefully evaluated.

Impact on Civil Negligence Claims Against Registrants

The Consultation Paper asserts that the statutory best interest standard would not establish a fiduciary duty, because the intent of introducing a best interest standard "is not to establish a statutory fiduciary duty for registrants". This assertion is completely inconsistent with a recent decision of the OSC. In *Re Crown Hill Corporation* (2013) 36 O.S.C.B. 721, the OSC characterized s. 116(a) of the Ontario *Securities Act,* which requires every investment fund manager to exercise its powers and duties of the office honestly, in good faith and in the best interests of the investment fund, as imposing a fiduciary duty on fund managers (see paragraphs 103, 112 and 236). That characterization was maintained on appeal to the Ontario Divisional Court. (*Pushka v. Ontario Securities Commission*, 2016 ONSC 3041.) Accordingly, it is unclear how the content of the proposed statutory best interests would differ, if at all, from a civil fiduciary standard of conduct.

Regardless of what it is called, the reality is that to introduce this standard into securities legislation will have significant consequences for registrants in civil negligence claims for damages. Courts routinely refer to the rules and regulations applicable to registrants to inform the standard of care in civil negligence cases. (See, for example, *Hunt et al v. TD Securities*, 66 OR (3d) 41 (C.A.) and S*tradiotto v. BMO Nesbitt Burns* 2014 ONSC 3477). To impose a general BIS on all dealers and advisors will have the effect of elevating the standard of care in negligence claims to that expected of fiduciaries. This will have far reaching economic consequences for registrants.

Impact on Clients

The proposed standard appears to be directed at protecting the most unsophisticated of investors who are heavily reliant upon advice from an advisor. This is problematic for several reasons.

It ignores the important distinction between retail and institutional clients, who are typically quite sophisticated and not in need of the additional protections that a best interest standard may provide.

It fails to recognize that not all clients want or expect their advisor or dealer to act as a paternalistic arbiter of what is best for them.

The types of inquiries necessary to determine whether an investment is in the "best interest" of the client appear to be more extensive and intrusive than those described in NI 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Requirements* (**NI 31-103**), section 13.2(2) which are used to establish whether an investment is suitable for the client. It is possible that this could potentially extend to inquiries about the client's health in order to assess whether a long or short-term investment horizon is appropriate, the client's security of employment and available sources of funds to invest, and the existence or likelihood of significant financial obligations arising for the client in the future. Such a paternalistic approach may drive clients who are unwilling to share such information, or who consider themselves to be reasonably sophisticated, to invest without the benefit of advice.

Under the proposed BIS advisors could be required to question a client's decision to borrow money to invest and to ensure that an investment in securities using borrowed money is in the client's best interest, and not merely suitable as is currently required (See IIROC Notice 14-0044). Some clients would likely resent this approach as it would limit their investment opportunities.

If an overarching best interest standard is truly needed, a more nuanced approach to its application is advisable.

Impact on Registered Advisors

The best interest standard will impose significant new burdens on advisors.

Determining what is in a client's "best interest" is both quantitatively and qualitatively different than determining what is suitable for the client. It would require the advisor to have extensive knowledge of the client's personal circumstances, and to consider a broad universe of potentially suitable investment products, both proprietary and non-proprietary (including their respective costs, historical returns, expected yields, risks, etc.). This would be a complex, time consuming, multi-faceted exercise that will not necessarily yield a clear answer or one "best" strategy for the client.

It is unclear how "best interest" should be determined when there is a conflict between what appears to the registrant to be objectively best for the client, and the client's own subjective view of what is best for him or her. The proposal ignores the reality that advisors are not always, or necessarily, in a better position than the client to determine what is in fact best for the client.

It is likely that the additional obligations created by the proposed standard would also make it more difficult for advisors to provide services and advice to clients in a timely and cost effective manner. To require a registrant to perform a best interest analysis for every client order for the purchase or sale of a security, even if unsolicited, may conflict with the registrant's contractual obligation to follow a client's instructions, particularly where conditions do not allow the registrant to perform the best interest analysis in a timely manner.

Impact on Registered Dealers

The Consultation Paper does not distinguish between dealers offering only order execution services, and those dealers that offer advice. The rationale and impact of imposing this standard on order execution only dealers is unclear. Would such a dealer be required to establish that it is in the best interest of the client to use its services rather than those of a full service dealer? Conversely, would a full service dealer have an obligation to advise a client who only rarely seeks investment advice to use the services of a discount broker instead?

The Consultation Paper proposal does not explain how a dealer can satisfy a best interests standard when the interests of its many clients conflict. For example, if a new issue is over-subscribed, it may be in the best interests of all of its clients seeking an allocation to get as many securities of the new issue as possible rather than have such securities allocated in a more equitable manner among clients. In those circumstances it is impossible to satisfy the standard *vis-à-vis* each individual client.

The proposed best interest standard will impose a host of new and costly obligations including in relation to know your client and know your product obligations, training, supervision and compliance. It will require dealers to equip their advisors to have access to systems and information appropriate to the task of determining what is "best", including potentially whether what is "best" for the client is an investment product not offered by the dealer. It will necessitate a higher level of training and competence of compliance personnel.

A best interest standard would also require a registered dealer to establish and maintain a system that is reasonably designed to achieve compliance in all aspects of the dealer's business with the obligation to act in the client's best interest. This would likely require a wholesale rewrite of existing policies and procedures and the content of training provided to staff, in relation to everything from account opening, to client communications, to training, to the handling of client complaints and arbitration.

Supervision and compliance obligations of the dealer will be significantly more onerous if the best interest standard becomes part of Ontario, New Brunswick securities legislation and potentially other jurisdictions. Reviewing for "best interest" as opposed to suitability would require the dealer to review and second guess investment recommendations and decisions for both retail and institutional clients against the universe of all potentially suitable investment options and their different features, including cost. The feasibility of this as a practical matter is questionable. Adherence to a best interests standard will be much harder for supervisors to assess and review because it is much more fact-intensive than review of adherence to a suitability standard.

As described in the Consultation Paper, the obligation in NI 31-103, section 13.15 to document and respond to each client complaint "in a manner that a reasonable investor would consider fair and effective" could potentially be elevated to a requirement to respond to the standard of what is in the best interest of the client.

The requirement proposed in the Consultation Paper to put clients' interests first, including to "interpret law and agreements with clients in a manner favourable to the client's interest where reasonably conflicting interpretations arise" could constrain the ability of registered dealers and advisers to defend investor claims and complaints in arbitrations, litigation and mediation, and lead to an increase in frivolous claims against registrants, resulting in increased expense. It would upset the "balanced approach" to dealing with client complaints as currently contemplated in IIROC Rule 2500B. To require registrants to put client interests first in relation to every client complaint would be unfairly prejudicial to registrants, and further undermine an industry that is already facing significant economic pressures.

As indicated above, a more nuanced approach to the application of best interest standard is required.

Regulatory Uncertainty

SRO rules, policies, notices and guidance already set out detailed requirements concerning the conduct of dealers and advisers in all aspects of their relationship with clients. However, complying with an SRO Rule may not be enough to avoid regulatory consequences of failing to comply with a best interest standard. Superimposing an "overarching" best interest standard on those carefully constructed regulatory regimes would inject a significant amount of uncertainty and regulatory exposure for registrants. In addition, if the best interest standard is only supported by a few but not all jurisdictions, it will result in a non-harmonized, fragmented regulatory system, thereby creating additional complexity for both registrants and investors.

Conclusion

For the reasons articulated above, we urge the participating jurisdictions to closely consider alternatives to the implementation of a best interest standard of global application to all dealers and advisors.

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This letter has been prepared by certain members of the Litigation Group of the Toronto office of Norton Rose Fulbright Canada LLP. It does not necessarily reflect the views of all partners of that group or the firm. If you have any questions concerning these comments, please contact Linda Fuerst directly at (416) 216-2951 or by email at linda.fuerst@nortonrosefulbright.com or Jeremy Devereux directly at (416) 216-4073 or by email at jeremy.devereux@nortonrosefulbright.com.

Yours truly,

Linda Fuerst *Jeremy Devereux*

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