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

Attention:

Josée Turcotte
Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
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CSA Members:

Re: CSA Consultation Paper 33-404: Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward Their Clients

Introduction

We are writing to give you our comments on the Canadian Securities Administrators' ("CSA") *Consultation Paper 33-404 – Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*, published on April 28, 2016 (the "Consultation Paper").

Sun Life Financial Investment Services (Canada) Inc. ("SLFISI") is one of Canada's largest mutual fund dealers with assets under administration of approximately $20 billion and over 2,700 advisors operating from more than 1,100 locations across Canada. SLFISI is part of the Sun Life Financial group of companies.

We support the submission filed by the Investment Funds Institute of Canada ("IFIC") and welcome this opportunity to supplement IFIC's comments.

We support the principle that advisors must put the interests of clients first in providing retail investment advice. The vast majority of advisors strive to do that every day. We believe in the value of advice. There is a substantial body of research to support the value of advice in improving outcomes for clients.

CRM2 and Point of Sale ("POS") will improve transparency and help clients understand their investments. They will improve the client-registrant relationship. But, there are other aspects of the client-registrant relationship that require improvement. We agree that changes are needed.

However, some of the initiatives in the Consultation Paper could result in unintended consequences that outweigh the potential benefits, namely:

- Investors may have fewer investment options as dealers narrow their shelves, or seek a "one size fits all" approach.
- Less affluent investors may no longer be able to access advice as advisors focus on more affluent investors to adapt to the proposed new standards.
- The additional compliance costs of some of the proposals could accelerate consolidation at the dealer level. This could reduce competition and lessen access to advice. Smaller organizations are more likely to consolidate.
- Investors may be confused, rather than educated by the introduction of new labels, and classifications.

The risk of unintended consequences increases when a number of major reforms are being implemented at the same time. In the United Kingdom, the Retail Distribution Review led to an advice gap, as outlined in the Financial Advice Market Review (March 2016). Commentators in the UK have noted "RDR, whilst introducing many important reforms in the retail advisory market has exacerbated the advice gap denying the mass market access to professional financial help and incentivised firms to develop vertically integrated, restricted advice models at the expense of independent advice." ("Freeing the future? Market impacts of the pension freedom reforms", KPMG, 2015). In Canada, the industry is in the midst of implementing CRM2 and Point of Sale. The addition of the Targeted Reforms and a best interest standard would increase the risk of unintended consequences.

The Role of Advisors and the Value of Advice

Canada has a strong, vibrant financial services industry that serves its clients and the public interest well. Advisors are a critically important part of that industry. The vast majority of advisors do an excellent job of working with their clients to encourage them to save and help them plan for their financial futures. They strive to put their client's interests first.

Research in the Canadian context reviews the value that advisors provide. This research is summarized in Appendix B of the IFIC submission on the Consultation Paper . A study by Montmarquette and Vienot-Briot in 2012 found that, compared to non-advised households, advised households accumulated 2.73 times more assets over 15 years. Updated research published in 2016 found that over 15 years, advised households accumulated 3.9 times the value of assets of equivalent non-advised households ("The Gamma Factor and the Value of Financial Advice", Montmarquette and Viennot-Briot, CIRANO, August 2016). Confidence in financial advisors is high, with 95 per cent of mutual fund investors acknowledging that they trust their advisor to provide them with sound advice. More than 9 out of 10 investors (91 per cent) are satisfied with the value for money they receive in terms of both service and performance (Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry, Pollara, 2016). There is considerable evidence that clients have been well served by their advisors.

However, at page 3956, the Consultation Paper states that "clients have misplaced reliance or trust on their registrants". We suggest that in reaching this conclusion, the Consultation Paper is taking a narrow view of the role of advisors and the value they deliver to clients. The key research relied upon in the Consultation Paper focuses on past fund performance in evaluating the role of an advisor. The critical role of advisors in encouraging their clients to save, and plan for their future, is not considered (see Appendix B of the IFIC Submission on the Consultation Paper for a discussion of the limitations of this research.). This broader role of advisors has a large impact on the financial health of clients. Advised clients have higher levels of net worth and investable assets. They are more successful at saving, have greater discipline through volatile markets and are more likely to use registered accounts (Ipsos Reid, "Value of Financial Advice", prepared for IFIC - October 2011). Advisors take a holistic approach to helping clients achieve financial security. They help clients plan for retirement and the education of their children and grandchildren. They work with clients to mitigate the risks of market changes, outliving their retirement income, premature death, and disability.

Effective policy decisions cannot be made without considering these vitally important elements of the value that advisors provide.

Regulatory Best Interest Standard

We support the principle that advisors should put the interests of their client first in the provision of retail investment advice and recommendations. The existing regulatory environment supports that principle especially through the work of the SROs. The Targeted Reforms outlined in the Consultation Paper will reinforce that principle.

However, we share the views of several CSA members who "…share strong reservations on the actual benefits of the introduction of a regulatory best interest standard over and above the targeted reforms, and are concerned with the potential unintended outcomes of the codification of such an aspirational standard of conduct." (Consultation Paper, page 3948). We agree with those CSA members that:

> "The proposed best interest standard will create legal uncertainty. It does not create a clear standard for registrants to follow or for regulators to enforce." (Consultation Paper, page 3969).
>
> "The CRM2 and Point of Sale Initiatives are intended to improve communication in the client-registrant relationship around costs and investment performance. Their effectiveness should be measured before we consider a best interest standard." (Consultation Paper, page 3970).

The uncertainty created by a broad principle such as the best interest standard may detract from, rather than add to, the effectiveness of the specific guidance provided by the Targeted Reforms. We urge the CSA to focus on effective, national implementation of the Targeted Reforms along with CRM2 and POS. The CSA recently announced a research project on the effectiveness of CRM2 and POS. That research should be completed and assessed before a best interest standard is considered.

Targeted Reforms

We agree with the general principles underlying the Targeted Reforms in the Consultation Paper. There are improvements that need to be made to enhance the registrant-client relationship. In our comments below we note aspects of the Targeted Reforms that may not address the underlying issues raised in the Consultation Paper and may not improve the registrant/client relationship. We also note that some of the proposals may have unintended consequences that negatively impact clients.

Proprietary Products

The Targeted Reforms would require firms to identify themselves as "proprietary" or "mixed/non-proprietary". The industry is too complex to be neatly classified into these two categories. There are too many different types of dealers, products and relationships between manufacturers and distributors.

The "proprietary" vs "mixed/non-proprietary" distinction may mislead and confuse clients. For example, a "proprietary" dealer may offer a broader range of products than a "mixed" dealer. A "proprietary" firm may also offer a broad range of sub-advised funds giving clients access to several unaffiliated investment managers and different investment approaches.

The definition of "proprietary products" does not address these different types of relationships and business structures. Products where conflicts of interest and concentration risks are low and well managed should not be caught by the definition. For example, a mutual fund with sub-advisors that are unrelated to the fund manager should not be labelled as a proprietary product.

To provide clients with meaningful accurate disclosure the "proprietary" vs "mixed/non-proprietary" distinction should be abandoned. Rather, dealer firms should be required to disclose the scope of its product shelf and the nature of their relationships with the fund companies on their shelf. Given the wide variety of business models in the industry, mandatory disclosure wording should be avoided. Rather firms should be required to clearly describe who they are and the products and services they offer. This approach builds on existing MFDA requirements (see MFDA Rule 2.2.5 and MFDA Staff Notice MSN-0075). Clients can then decide if they want to deal with the firm and then select the products and services they want.

Product Shelf Comparison and Optimization

The proposed product shelf comparison and optimization processes would require "mixed/non-proprietary" firms to frequently review a broad "universe" of products available in the marketplace in determining the products it puts on its shelf. The standards a dealer must use in this review are either vaguely defined ("fair and unbiased") or unrealistically high ("most likely to achieve"). Dealers are not permitted to consider their own business model, capabilities and expertise in deciding what products they should offer. Any decisions to include funds from an affiliated fund company could be open to challenge as "unfair" or "biased". These proposals could have the unintended consequence of driving many dealers to adopt a shelf of exclusively proprietary products so they are not subject to this requirement. Or dealers may limit the funds on their shelf to a small number of tried and true options. In either event, choice for clients would be limited. It could also be more difficult for new innovative products or new fund companies to get access to limited shelf space.

These proposals appear to be designed to ensure that "mixed/non-proprietary" firms actually offer a broad range of products consistent with describing themselves as "mixed/non-proprietary" firm. This need flows from trying to divide a complex industry into two categories based on whether the firm offers proprietary products. As discussed above, we recommend that the "proprietary" vs "mixed/non-proprietary" distinction be discarded. In

its place, a firm should be required to accurately disclose who they are and the products and services they offer.

An Advisor Can't Know Every Product on the Shelf

The proposed product selection element of the suitability review process would require advisors to review the structure, features, product strategy, costs and risks of all of the products on the firm's product shelf.

Some advisors in a firm focus on older retired clients. Other advisors focus on younger millennial clients. Still others deal with professionals and business clients in their forties and fifties. Clients in each of these markets have different product needs. Many firms have products on their shelf to meet the specific needs of each of these client segments. It is unlikely that an individual advisor will be active in all of these segments. There is no need for an advisor to know a product that is not designed for the client segments the advisor serves. The advisor should spend their time serving their clients and understanding the products appropriate for the clients segments they do serve. If their firm has a broad product shelf with hundreds of funds, it isn't practical for advisors to have an in-depth understanding of every product on their firm's shelf. Further, advisors can't review every client's circumstances against every product on the firm's shelf, every time a client's circumstances change, the representative makes a recommendation, or the client submits a new trade.

These proposals could result in firms narrowing their product shelves so their advisors only have to know and consider a reasonable number of products in their suitability review. This could reduce choice for advisors and clients. It could also make it more difficult for new fund companies and innovative products to find space on dealer product shelves.

We encourage the CSA to focus the know your product requirements for advisors on ensuring that advisors understand the structure, product strategy, features, costs and risks of the products that a representative actively offers. The MFDA already has know your product requirements that address these issues (see MFDA Rule 2.2.1 – KYC (c) and (e) and MFDA Notice MSN -0048). We support the inclusion of similar requirements in NI 31-103 to ensure that similar rules apply to non-SRO firms.

Titles and Designations

We support the need to regulate titles and ensure that clients are not confused or misled. However, none of the three options proposed in the Targeted Reforms will improve the current situation.

- The options don't use terms that are familiar to clients. They don't describe the services provided in ways that are meaningful to clients.

• The titles also cast some types of representatives and firms in a negative light that is inappropriate. Words like "restricted" and "salesperson" imply there is something wrong or inadequate about the services being provided. It is incorrect to assume that representatives who are focused on proprietary products are not providing advice. It is also incorrect to categorize them as mere salespersons.

• As noted earlier, there are many different types of "proprietary" firms and products. Treating all of them in the same way and mandating the same title for all them is misleading for clients and unfair to many registrants.

• Titles should reflect what the registrant does for the client rather than a legal category or the scope of the product shelf.

We agree that there are too many titles and designations being used in the industry. Some titles and designations are confusing and misleading for clients.

Dealers play the key role in overseeing the use of titles by their representatives. Principles-based rules should be established requiring dealers to ensure that titles and designations used by their representatives are not misleading. These rules should set out a list of titles and designations that representatives are permitted to use. The list of permitted titles should include "Advisor" and "Financial Advisor". These titles are broadly used and well understood by clients. Titles such as "Financial Planner" should be permitted but restricted to those who have appropriate accreditation (i.e. a "Certified Financial Planner" designation).

Improving the Know Your Client and Suitability Processes

The MFDA has detailed Know Your Client ("KYC") and suitability rules that serve clients well. Some enhancements could be made so these processes are less transaction driven and more focused on analyzing the specific needs of individual clients. Product and account costs should be considered in the suitability assessment. We have the following additional comments on the proposals in this area.

A Scaled Approach to KYC and Suitability

The Targeted Reforms propose solutions that make sense for affluent clients who need and want a comprehensive financial plan before investing. But, the Targeted Reforms appear to require a KYC process for every client similar to the preparation of a financial plan.

Clients starting out by putting $50 per month into their RRSP or TFSA don't need a detailed financial plan. The existing KYC process and suitability assessment (along with an assessment of the appropriate product and account cost model) is sufficient for them. These clients need basic advice to start saving using simple investments and appropriate registered plans. These clients can't afford the cost of a financial plan. Based on our

research, we estimate that the Targeted Reforms could roughly double the time required to complete the KYC and account opening process for a new client of modest means (from 2 to 3 hours today, including client meetings, analysis, preparation and documentation, to 5 to 6 hours under the Targeted Reforms to do a financial plan that meets appropriate professional standards).

SLFISI has many clients with smaller accounts. As of June 30 2016,

- SLFISI's average account size is $38,151.
- 76% percent of SLFISI's accounts have assets of less than $50,000.
- 87% percent of SLFISI's accounts have assets of less than $100,000.
- 25% of our accounts (over 125,000 accounts) have pre-authorized monthly purchases of $500 or less, and 14% of accounts (over 70,000 accounts) were under $100 per month.

SLFISI plays a significant role in helping clients in these underserved markets. If these Targeted Reforms of the KYC process were enacted in their current form, we are concerned that it may no longer be economically viable for many advisors to serve these clients. These clients may have a much more difficult time accessing financial advice.

The proposals may result in clients receiving a level of service that isn't suited to their circumstances, that they don't want and aren't willing to pay for. Some affluent clients may not want a comprehensive review of their financial situation because they have obtained that review from another source (e.g. an accountant, another advisor, or financial planner). Some of these clients may refuse to provide the detailed information called for in the Targeted Reforms if they simply want to make an annual RRSP or TFSA contribution.

A client-focused approach to KYC and suitability is needed. Such an approach would permit scalable services to be provided based on the financial circumstances and needs of the client. This approach would ensure that the information needed to provide those services is collected and suitability is assessed based on that information.

Timing of KYC Updates and Suitability Reviews

Advisors need to update their client's KYC information when there are changes in the client's circumstances. A fixed frequency of 12 months may not be appropriate for many clients. For clients with high levels of risk and little diversification, more frequent updates are appropriate. For clients in diversified managed solutions products, KYC updates may not be needed every 12 months if there is no material change to clients' personal and financial circumstances. The rules in this area should provide flexibility to adapt the frequency of the review to the client's preferences and circumstances.

Firms should include an invitation in their quarterly account statements for clients to contact their advisor for an update if their circumstances or objectives have changed.

Target Rate of Return

It isn't appropriate to require that a target rate of return be established and used in the suitability analysis for every account. This could create expectations on the part of the client that there is a commitment from the firm to deliver this rate of return. It is unlikely that disclosure would be adequate to explain the risks associated with seeking that rate of return or to change the client's expectation that there is a guarantee or commitment. A target rate of return may encourage advisors and clients to chase returns to attain the target rate rather than selecting investments that are well-suited to the client's needs and objectives. It won't improve the quality of the suitability assessment and could reduce overall portfolio performance if there are too many changes being made in a client's mutual fund portfolio in an attempt to meet the targeted return.

"Most likely to Achieve"

The "most likely to achieve" standard required in the suitability review is unrealistic and could also lead to unmet expectations. There could be many views on which investments are most likely to achieve a specific client's investment objectives. It isn't possible to objectively identify a specific investment as the "most likely" to achieve the client's goals. Advisors and firms should be required to establish suitability. They should put their client first in developing their recommendations. But they can't predict the future. Hindsight regarding past performance and comparison to other similar investments will most likely be applied and it could create an unrealistic and unachievable standard for advisors and firms to meet.

Restricted Registration Category Disclosure

The proposed disclosure for restricted category firms assumes that all clients have a realistic option of getting advice and services from a firm that deals in a full range of securities products. However, that option may not be available for clients with smaller accounts. As noted above, the average account size at SLFISI is $38,151. Full service investment dealer firms typically do not handle small accounts such as these. It would be misleading to give clients disclosure stating that investment options covering the full range of securities are available to them, when as a practical matter they are not.

Proficiency

Strong initial and ongoing proficiency requirements are critical to ensuring that clients are well served by their advisors.

The lack of any continuing education requirements for mutual fund advisors is a serious gap. We agree that Continuing Education ("CE") requirements should be adopted for registrants. It will be important to ensure that CE programs offered by dealers, fund companies, industry associations and educational providers are eligible for accreditation. An efficient process for accrediting CE programs will also be important. The MFDA is well positioned to play that role.

We also support enhancing initial proficiency standards. Existing programs should be enhanced to ensure that advisors understand their obligations under the Targeted Reforms, CRM2, Point of Sale and any other regulatory changes. For mutual fund advisors, these programs should be focused on mutual fund matters without undue time spent on other types of securities.

Conclusion

As the CSA makes improvements in the registrant-client relationship it is important to do so in a way that recognizes the value that advisors provide in improving outcomes for clients. Reforms need to be developed and implemented in ways that avoid unintended outcomes that may be detrimental to clients, especially clients with smaller amounts to invest. Major regulatory changes in other jurisdictions have led to an advice gap for small investors. It is important that we avoid this outcome in Canada.

CRM2 and Point of Sale have brought fundamental changes that should have many benefits for clients. The Targeted Reforms will also improve the registrant-client relationship. The CSA has launched a long term research project to assess the impact of CRM2 and Point of Sale. We urge the CSA to complete that research before considering whether a regulatory best interest standard, or other fundamental regulatory change, is needed.

Thank you for this opportunity to comment on these important issues. If you would like to discuss these matters further or have any questions please contact me at 519-888-2420 or Nick.DiRenzo@sunlife.com.

Sincerely,

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