Canadian Independent
ASSET MANAGEMENT

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Delivered By Email:

comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Nova Scotia Securities Commission
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:

The Secretary
Secretary Ontario Securities Commission
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Me Anne-Marie Beudoin
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Autorité des marchés financiers
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Dear Sirs and Mesdames:

Client Focused Reforms - Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP

We welcome the opportunity to provide our comments to the Canadian Securities Administrators (the "CSA") with respect to the Proposed Amendments to National Instrument 31-103 ("NI 31-103") and Companion Policy 31-103CP ("31-103CP or "Companion Policy") (together, the "Client Focused Reforms"). We are encouraged that the concerns we raised in our previous comment letter have been heard and are shared by the CSA.

As an independent Canadian asset management company, we partner with leading investment advisors at both IIROC and MFDA firms. These advisors continue to become more frustrated and challenged with avoiding conflict. We continue to be concerned by the stories told to us by these advisors, of the pressure put on them by their dealers to sell proprietary products regardless of what is actually in the best interests of their clients. We also are concerned with what we are experiencing directly. Top percentile investment funds, award winners in their categories, yet they do not make it on the recommended lists at the Bank controlled IIROC and MFDA dealers.

As you know, from your own CSA sponsored research (Cummings and Brondesbury Reports), fund flows from affiliated dealers of the investment fund manager, show little or no sensitivity to past performance, and this lack of sensitivity is associated with reduced future outperformance (proprietary funds are recommended to Canadians, regardless of how poor their performance is).

We are encouraged by the guidance in the Companion Policy which includes extensive KYP expectations regarding proprietary products. It is clear that a proper KYP process will involve understanding how a particular approved security generally compares to similar securities in the marketplace, which includes approved proprietary products.

Clearly you know and understand the issue and are targeting it. We still wonder why, knowing the inherent conflict, the CSA does not just simply ban the distribution of proprietary products through related MFDA and IIROC dealer channels? Indeed, it is our understanding that this is the position that has been taken by securities regulators in the United States. Under existing rules, material conflicts of interest must be identified (existing and potential conflicts). The new rules will require all conflicts (not simply "material" conflicts), including those that are "reasonably foreseeable," to be catalogued and managed in "the best interests of the client." If the conflict cannot be managed in the best interests of the client, it must be "avoided" [prohibited]. When will you ever make someone actually avoid the conflict?

Having been educated by the stories from our investment advisor partners, we do not believe that dealers will have any serious intention of implementing effective controls on the sale of proprietary products, unless those controls are mandated and rigorously enforced by you and by IIROC and the MFDA (together, the "SROs").

With respect to rigorous enforcement, we certainly have seen the efforts of the OSC targeting mutual fund managers with respect to NI 81-105 sales practices. But, as has been the case for the last decade we have seen little or no enforcement by the MFDA or IIROC in this area. Why doesn't the CSA require the MFDA and IIROC to enforce the rules that already exist relating to sales practices and the sale of proprietary products?

This uneven enforcement of current conflict rules is a major concern of ours with respect to the Client Focused Reforms. They are smartly drafted, but well written rules do little if not

enforced. And indeed, like the Sales Practice rules may do greater harm to the competitiveness and fairness of the industry if applied only selectively - enforced rigorously by the securities commissions and ignored by the MFDA and IIROC.

The enhanced KYP process contemplated by the Client Focused Reforms and control of the Dealers 'approved lists' all lies within the jurisdiction of the MFDA and IIROC and outside of the direct control of the CSA. How can we be confident that they will watch to make sure the thumb of conflict of interest is not on the scale, as head office 'gatekeepers' at the Dealers decide whether to recommend the sale of their own product or a third party's. The Bank owned MFDA sales channels currently sell over 95% of related investment products only. It doesn't matter if these are mediocre. The house fund gets sold, not the best fund available. Despite the overwhelming empirical data, the MFDA has done little to address this conflict. And anything they have done, apparently has been completely ineffective.

If an investment product gets sold even if its below average, there is no incentive on the manufacturer to make sure that its performance is the best it can be. We worry that not prohibiting this conflict, will result in all Bank owned MFDA dealers simply disclosing in small print 'we only sell our own product'. There, disclosure has address the conflict. If you allow this to occur, almost 100% of the retail investment market will be without choice, and without competition. These massive own-product only MFDA dealers we will have no incentive to try to deliver the best investment results possible. Why hire the best portfolio manager available, when the mutual funds will get sold anyway…might as well hire the cheapest. Imagine if bank-owned MFDA couldn't sell their own products, the head office gatekeepers of the Dealer would then have the universe of asset manager to select from, who would truly compete on performance and price. All these prescriptive rules wouldn't be necessary, and we wouldn't be worried about how they are going to be enforced.

The main objections that will be voiced by the industry with respect to the Client Focused Reforms are that (i) it will be too burdensome on a dealer and their investment advisors to have to screen the thousands of investment products currently on their product shelves, and for the advisors to know not only the products they are recommending, but all the other products on their shelf; and (ii) that this burden will result in less choice for Canadian investors because the dealers will be 'forced' to shrink product shelves and limit product choice in order to practically comply with the new requirement.

Unfortunately, we do agree with the industry at large, that the unintended consequence of implementing the Client Focused Reforms will be for dealers to shrink product shelves to a small number of products 'recommended' by dealer head offices, and that this will exacerbate the already entrenched trend of dealers favouring their related investment products.

In particular, one very focused rule is 13.2.1(4) – that states that registered individuals must only purchase or recommend securities approved by their firm. This mandates that only head office staff of the Dealer can decide what is on the shelves of the Dealer. This rule plays right into the hands of Dealers who have the conflict – they can now force their advisors to buy exactly what they

tell them too. I think this rule while well meaning could have a terrible impact. An independent minded investment advisor who wants to find the best investment product for his or her client, cannot do so, unless it has been approved by his head office. Head Office staff at one bank have already chosen to remove all mutual fund families from their shelves unless they have at least $500 million or more with their dealer. How could a new mutual fund company even get started in Canada in this environment? At least now, an independent minded investment advisor could seek out smaller mutual fund companies and choose to buy their funds if they could be convinced that the price and performance would produce the best results for their clients. Now they are at the mercy of whatever someone in head office deems to 'the best' for their clients.

In closing, while we support your efforts to craft better rules to address conflicts of interest, more rules and more guidance, cannot replace effective enforcement. In fact we are somewhat terrified that ineffective and uneven enforcement of these rules could exacerbate the very conflicts you are seeking to address. MFDA and IIROC compliance staff will need to be extremely engaged and vigilant for the Client Focused Reformed to work. You need to ensure that they are and history gives us cause to worry.

We once again thank the CSA for the opportunity to comment upon the Client Focused Reforms. We welcome all opportunities for further consultations, in writing or in person. We wish to keep our identity confidential and so have submitted our comment letter using the pseudonym "Canadian Independent Asset Management". Please feel free to contact us at independentassetmanager@gmail.com. We would be pleased to disclose our identity privately to CSA members.

Yours very truly,

Canadian Independent Asset Management

President & CEO
Canadian Independent Asset Management