FAIR

Canadian Foundation *for* Advancement *of* Investor Rights
Fondation canadienne *pour* l'avancement *des* droits *des* investisseurs

October 19, 2018

Alberta Securities Commission
Autorité des marchés financiers
British Columbia Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Financial and Consumer Services Commission (New Brunswick)
Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Superintendent of Securities, Nunavut
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
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RE: CSA Notice and Request for Comment – Reforms to Enhance the Client-Registrant Relationship (Client Focused Reforms)

FAIR Canada is pleased to provide comments on proposed amendments to National Instrument 31-103 and Companion Policy 31-103CP (together the "Proposed Amendments") that aim, according to the Consultation Document, "to better align the interests of securities advisers, dealers and representatives ("Registrants") with the interests of their clients, to improve outcomes for clients, and to make clearer to clients the nature and the terms of their relationship with registrants."[1]

[1] (2018), 41 OSCB (Supp-1) at 1.

FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice for Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit www.faircanada.ca for more information.

1. General Comments

1.1. FAIR Canada commends the CSA for pursuing reforms to the client-registrant relationship with the goal to better align the interests of registrants and clients so that advice is not compromised by compensation related and other conflicts that result in the firm and their representative placing their own interests above those of their clients, to improve outcomes for clients and to make clearer the nature and terms of their relationship with registrants.

1.2. While FAIR Canada commends the CSA for arriving at a harmonized proposal, and we regard some of the Proposed Amendments positively (such as Know Your Product requirements, enhanced Know Your Client Requirements and changes to suitability requirements – all discussed below) we continue to strongly believe that a statutory best interest standard is necessary, desirable and feasible, with respect to securities advisers, dealers and representatives ("Registrants") in their conduct towards retail investors.

1.3. The benefits that would flow from implementing a statutory best interest standard are:

- The provision of objective, professional advice;
- Better clarity as to the nature and terms of the relationship with the registrant and reduction in complexity;
- Better protection for consumers;
- Better financial outcomes for consumers;
- More effective competition;
- Increase in the level of professionalism in the financial services industry; and
- Increase in the level of trust in the financial services market.

1.4. There are many problems that exist for ordinary Canadians who seek financial or investment advice or purchase investment products from registrants under the existing rules and industry practices. The problems (as previously detailed in our September 2016 submission) include:

a) Many Canadians believes that dealers and their financial advisors are required to provide advice based on their client's best interests which is a reasonable belief and expectation when receiving "advice" but, in fact, most Registrants simply sell (or distribute) products under a suitability standard (the Expectations Gap);

b) Canadians rely heavily on the advice they receive from registrants for various reasons (Reliance);

c) Registrants are expected to and should have knowledge and expertise about the capital markets and securities being offered to Canadians while many Canadians have low financial literacy or have otherwise busy lives and cannot or do not wish to spend the time to have the same level of knowledge leading to an asymmetry in knowledge and experience

between registrants and Canadians (this is not to say that these people are not otherwise very intelligent and capable) (Knowledge Asymmetry);

d) Titles often mislead Canadians as what the standard of conduct is (for example, using the word "advisor" despite not having be act in the best interest of their clients) and falsely convey high levels of seniority, knowledge, experience or executive authority (Inflated and Misleading Titles);

e) The level of education and initial proficiency is too low and Canadians are not able to understand the plethora of designations and credentials that exist. (Low Proficiency);

f) There continues to be increased product complexity and product proliferation which has been augmented by the CSA permitting the sale of alternative mutual funds to retail investors[2] as well as the use of prospectus exemptions permitting ordinary retail investors to be sold exempt market products[3] (Product Proliferation and Complexity);

g) Many consumers are unaware of the importance of costs and don't know about the costs they are paying – either costs of the product (especially indirect costs such as trailing commissions) or cost of advice with the latest study suggesting that even when investors learn about the fees they are paying, they don't seem to know what to do about it[4] (Cost Complexity and Opaqueness);

h) There has been a steady decline in registered pension plan coverage while demographic changes mean there will be increasing numbers of older Canadians with the anticipated greatest transfer of wealth ever to occur in the coming decades. Those without pension plan coverage are unlikely to have adequate savings to serve them in their retirement years (Increased Self-Reliance and Retirement Income Inadequacy);

i) There is persistent low economic growth and low interest rates which increases risk taking as investors, often seniors, search for higher yield (Increase in Risk Taking); and

j) Investors are unable to assess quality as mutual funds and other recommended products are credence goods.

1.5. While the CSA has recognized that "the status quo must change"[5], the Proposed Amendments, after two previous consultations (one in 2012 and one in 2016), do not require a high enough standard of conduct (best interest) and, as a result, do not prohibit structures or conduct that

[2] CSA Notice of Amendments Modernization of Investment Fund Product Regulation – Alternative Mutual Funds, Supplement to the OSC Bulletin, October 4, 2018 (2018) 41 OSCB, available online: http://osc.gov.on.ca/documents/en/Securities-Category8/csa_20181004_81-102_alternative-mutual-funds.pdf
[3] Unofficial Consultation – October 5, 2018, National Instrument 45-106 Prospectus Exemptions, available online: https://www.bcsc.bc.ca/Securities_Law/Policies/Policy4/PDF/45-106__NI___October_5__2018/.
[4] https://www.investmentexecutive.com/news/from-the-regulators/investors-not-acting-on-crm2-fee-disclosure-reports/
[5] (2016), 39 OSCB 3947 at 3947.

would simplify compliance by Registrants and oversight by regulators and will not result in professional, objective advice.

1.6. FAIR Canada's view is that the Proposed Amendments nudge Registrants in their conduct but will not achieve the profound shift necessary to ensure Canadians receive the objective, professional financial advice that is needed and rightfully expected as they do not prohibit compensation structures that misalign the interests of Registrants with their clients (instead relying on problematic conflict of interest provisions).

1.7. **A statutory best interest standard is needed both as a prescriptive obligation towards clients and as a guiding principle in Registrants' conduct towards clients.** This would lead to transformation of the investment industry so that Canadians can achieve financial security.

1.8. Improving the ability of Canadians to accumulate savings for their retirement or other financial goals should be a priority of all governments, both provincial, territorial and federal. Governments and territories successfully came together to enact reforms expanding the Canada Pension Plan. In the same spirit, we urge them to support the implementation of a statutory best interest standard requirement for Registrants. After so much debate, discussion, analysis and time, Canadians deserve profound change.

1.9. The reforms require Registrants to go through the KYP, KYC, conflict of interest and suitability process but never requires Registrants recommend the option(s) or investment strategy(ies) that best meets the individuals' needs and circumstances versus the other suitable options that could be chosen. The reforms focus on processes but also need to focus on evaluating the outcomes that derive from the processes.

1.10. FAIR Canada below provides some comments on the Proposed Amendments and provides recommendation to make the set of proposals more effective in achieving their stated goals.

2. Conflicts of Interest – "Addressing Conflicts of Interest in the best interest of the Client"

2.1. The Proposed Amendments try to square the circle – they take as given all the various conflicts of interest and then permit Registrants to "address" these conflicts through the application of various controls and policies and procedures. The Proposed Amendments should require that Registrants act fairly, honestly, and with a duty of loyalty; that is, act in good faith and in the best interests of the investor (but they do not). **Addressing conflicts in the best interest of the investor is not the same having a duty of loyalty (i.e. acting in the best interests) towards the investor in the advice and services provided.**

2.2. The difference in the obligations towards clients of these two different standards or approaches has been amply demonstrated through the application of existing SRO rules; IIROC and the MFDA already have conflicts of interest rules that require conflicts to be addressed in the best

interest of clients.[6] Please see the following chart which compares the language of the Proposed conflicts of interest rule with the existing MFDA and IIROC rules:

IIROC Rule 42	MFDA Rule 2.1.4	Proposed Amendment
42.2 Approved Person responsibility to address conflicts of interest … (2) The Approved Person **must address** all existing or potential material conflicts of interest between the Approved Person and the client in a fair, equitable and transparent manner, and **consistent with the best interests of the client or clients.** (3) Any existing or potential material conflict of interest between the Approved Person and the client that cannot be addressed in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients, **must be avoided**. 42.3 Dealer Member responsibility to address conflicts of interest … (2) The Dealer Member **must address** the existing or potential material conflict of interest in a fair, equitable and transparent manner, and	b. In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person **shall ensure that it is addressed** by the exercise of responsible business judgment **influenced only by the best interests of the client** and in compliance with Rules 2.1.4(c) and (d). c. Any conflict or potential conflict of interest that arises as referred to in Rule 2.1.4(a) shall be immediately disclosed in writing to the client by the Member, or by the Approved Person as the Member directs, prior to the Member or Approved Person proceeding with the proposed transaction giving rise to the conflict or potential conflict of interest. d. Each Member shall **develop and maintain written policies and procedures** to ensure compliance with Rules 2.1.4(a), (b) and (c).	13.4.2 A registered firm's responsibility to address conflicts of interest (1) A registered firm **must address, in the best interest of a client**, all conflicts of interest between itself, including each individual acting on its behalf, and the client. (2) A registered firm **must avoid** any conflict of interest between the firm, including each individual acting on its behalf, and a client **if the conflict is not, or cannot be, addressed in the best interest of the client.** 13.4.3 A registered individual's responsibility to address conflicts of interest (1) A registered individual **must address, in the best interest of a client**, all conflicts of interest between the individual and the client. (2) A registered individual **must avoid** any conflict of interest between the registered individual and a client if the conflict is not, or cannot be, **addressed in the best interest of the client.** (3) A registered individual must not engage in any dealing or advising activity in connection with a conflict of interest identified by the registered

[6] See Appendix C of FAIR Canada's submission to the CSA dated September 30, 2016 at page 61; available online: http://faircanada.ca/wp-content/uploads/2017/11/160930-Final-FAIR-Canada-Submission-Regulatory-Best-Interest-REVISED.pdf.

considering the best interests of the client or clients. (3) Any existing or potential material conflict of interest between the Dealer Member and the client that cannot be addressed in a fair, equitable and transparent manner, and considering the best interests of the client or clients, **must be avoided**. … 42.5 Conflicts of interest policies and procedures (1) Each Dealer Member shall **develop and maintain written policies and procedures** to be followed in identifying, avoiding, disclosing and addressing material conflict of interest situations.		individual under subsection 13.4.1(1) unless (a) the conflict has **been addressed in the best interest of the client**, and (b) the registered individual's sponsoring firm has given the registered individual its consent to proceed with the activity.

2.3. Such provisions have not resulted in objective, professional advice in the best interest of investors nor prevented compensation related arrangements and incentive practices that reward registrant behaviour that benefits the firm at the expense of its clients. In fact, such behaviour has flourished with the CSA, IIROC and the MFDA having issued notices at the end of 2016[7] (and IIROC a second notice in 2017[8]) relating to compensation related arrangements which describe a litany of compensation related arrangements and incentive practices.

2.4. The impact on investors include – holding higher-cost mutual funds (thereby reducing returns), being sold proprietary funds rather than third party funds (which are likely suboptimal), being charged embedded fees in fee-based accounts (overcharged and possibly poorer performing fund), failing to record interest earned on fund assets, being sold IPOs given commissions earned

[7] CSA Staff Notice 33-318, *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives* (15 December 2016), online: <http://www.osc.gov.on.ca/documents/en/Securities-Category3/csa_20161215_33-318_incentives.pdf> [CSA Staff Notice 33-318]; IIROC Notice, *Managing Conflicts in the Best Interests of the Client* (15 December 2016), online: < http://www.iiroc.ca/Documents/2016/4dd98e70-f053-4980-bc75-10ceb6f3940d_en.pdf>; MFDA Bulletin #0705-C, *supra* note 17, online: <http://mfda.ca/bulletin/review-of-compensation-incentives-and-conflicts-of-interest/>.

[8] IIROC Notice, *Managing Conflicts in the Best Interest of the Client* (6 April 2017), online: <http://www.iiroc.ca/Documents/2016/F58C9465-AFC5-42F3-A5D1-6C5BFDF19CF3_en.pdf>.

(high risk), being inappropriately placed in DSC funds, being sold funds due to payments and gifts by mutual fund manufacturers such as bottles of champagne, Tiffany necklaces, and lavish parties, and sports and entertainment tickets rather than as a result of choosing the investment is better for the investor (note the lack of any enforcement action against violations of NI 81-105 from 1998 until the first case in 2017).

2.5. **A best interest standard would prevent compensation structures that undermine investors' interests. Conflict of interest rules that address conflicts in the best interest of clients permit them so long as controls and oversight are put in place (which, to date, proven ineffective).**

2.6. Also problematic is the fact that the Proposed Amendments rely on Registrants to identify their own conflicts of interest and address them through documentation of firm's sales practices, compensation arrangements and incentive practices, and the implementation of controls (or "filters") and/or policies and procedures. While this may result in some modification to Registrant behaviour over time, the provisions are complex, change is uncertain, unclear and quite possibly illusory.

Suggested Improvements to Current Proposal re Conflicts of Interest

2.7. Without requiring the avoidance of remuneration structures that engender material conflicts of interest that harm investors and the market we believe that investors will not obtain objective professional advice in their best interests. This certainly has been the experience of many other jurisdictions, leading them to enact specific provisions prohibiting compensation structures that provide incentives that work against the interests of clients. We need to get rid of the obstacles preventing Registrants from working in the interests of their clients. That would be the more simple, straightforward and effective approach. **We recommend the CSA prohibit compensation structures that provide incentives that work against the interests of clients. The Proposed Amendments should explicitly prohibit certain conflicts tied to financial incentives not merely leave it to Registrants to determine if they have addressed such conflicts in the best interests of the client.** Such an approach would improve market efficiency, simplify compliance, and improve investor protection. It would also be in conformity with our international obligations through IOSCO and the G20.

2.8. For example, the rule should prohibit any arrangement by way of remuneration, sales targets or otherwise that could provide an incentive to its individual registrants to recommend a particular investment over another or a particular product line (such as DSC mutual funds) over another.

2.9. A prohibition on compensation structures and practices that engender conflicts of interest will not only protect investors but will also improve the environment for the benefit of individual registrants who seek to provide the best possible advice to their clients. We have seen through the CBC Go Public revelations on bank sales practices, that firms place employees under significant pressure through sales targets and other incentives, which undermines the interests of consumers. This led numerous employees to come forward and complain about the sales practices they were being pressured to engage in.

2.10. FAIR Canada also believes that the CSA has set the bar too low with the requirement to "address" conflicts. "Address" according to the Oxford dictionary means "think about and begin to deal with". FAIR Canada recommends that Registrants should be required to do more than "address".

2.11. If the CSA determines it is going to continue with its Proposed Amendments, in addition to avoidance, **we recommend, at a minimum, that Registrants be required to "actively mitigate" conflicts of interest.** "Mitigate" means "lessen the gravity of (an offence or mistake) or make (something bad) less severe, serious or painful". It is essential that the Proposed Amendment not adopt the problematic language of "address".

Conflict of Interest Disclosure

2.12. It is also essential that disclosure not be the technique relied upon to address or mitigate a conflict of interest as research has amply demonstrated that this is ineffective, and problematic. We refer you to our discussion on disclosure of conflicts of interest in our earlier submission on 33-404.[9]

2.13. Section 13.4.5(5) states that "A registered firm must not rely solely on disclosure to address, in the best interest of the client, conflicts of interest identified under subsections 13.4(1) and 13.4.1(2)." However, by not prohibiting the most harmful conflicts, the Proposed Amendments do place too heavy a reliance upon disclosure. The rule itself suggests that the use of one control mechanism, in addition to disclosure, to "address" conflicts of interest, will be in compliance with the rule. This is deeply problematic.

2.14. The Guidance under "Conflicts Disclosure" demonstrates that the CSA is still too reliant on disclosure as way to "address" conflicts of interest. While the guidance properly states that:

> "Not only does disclosure sometimes fail to mitigate the risks related to conflicts of interest, but in some instances disclosure of conflicts may aggravate the potential risks to a client's interests."

It goes on to contradict, however, this statement. Regulators (and firms) have no reasonable basis to:

> "…expect that clients will use disclosure about conflicts of interest to help inform their decision when evaluating the registrant's business practices, conflicts management and overall performance on an ongoing basis. As a result, the disclosure that clients receive is critical to their ability to make an informed decision about how to manage and evaluate their relationship with the registrant."

[9] http://faircanada.ca/wp-content/uploads/2017/11/160930-Final-FAIR-Canada-Submission-Regulatory-Best-Interest-REVISED.pdf at pages 12-18.

Putting such an onus on investors places unreasonable agency costs on investors to expend resources to ensure that the Registrant is not acting contrary to their interests; however, investors have been documented as being unable to do this.

2.15. Much behavioural economics, empirical and other research, client complaints and enforcement proceedings demonstrate that such an expectation of clients is not reasonable. This places unrealistic expectations on clients to understand, analyze and appropriately evaluate disclosure about conflicts of interest. We believe that if the CSA prevented financial incentives and compensation practices that engender conflicts of interest, it would reduce the need for conflicts of interest disclosure as well as simplify compliance and oversight.

3. Know Your Client

3.1. FAIR Canada supports the enhancements to the Know Your Client process which includes a requirement that registrants must take reasonable steps to obtain information from the client as to the client's personal circumstances, financial circumstances, investment needs and objectives, investment knowledge, risk profile and investment time horizon.

3.2. Many investor complaints highlight problems with the KYC process – such as not accurately recording the information; getting the client to sign boilerplate documents containing purported information, however inaccurate, without any review or discussion because the client trusted the registrant, believed he or she completed the documents truthfully and is acting in his or her best interest; signing blank forms which is filled in later by an assistant with incorrect information; or clients who do not understanding what he or she are signing as they were not reviewed and their significance was not discussed.

3.3. **FAIR Canada recommends that the Proposed Amendments include a rule requiring Registrants to exercise reasonable diligence, care, skill, and prudence in gathering and determining the information contained in section 13.2(2)(c) and document this process** (personal circumstances, client's financial information, client's investment knowledge, the client's risk profile and client's investment horizon).

3.4. **The onus to ensure accurate recording of client information should be on Registrants.** Discussions need to occur to explain what terms mean and the significance of the KYC process. For example, many investors do not know what "extensive investment expertise" or "sophisticated investment knowledge" means - it should not simply mean that they have had an investment account for many years, but, rather, that they have had experience in analyzing and making independent investment decisions with respect to different types of securities. In addition, many investors do not think of their investment objectives as aggressive, growth, balanced or income and do not know what these categories mean. **We recommend that the KYC process be required to record the actual life objective that has led the investor to open the account** – saving for retirement, saving for a down payment on a house, saving for a child's education, etc.

3.5. **Registrants should take reasonable steps to verify that the information is accurate.** For example, the registrant should request documents to verify income and/or net worth. Documents could include pay stubs, account statements or CSA Notices of Assessment.

3.6. **FAIR Canada also recommends that firms be required to send the completed KYC information within 30 days of opening an account, and/or within 30 days of updating the information and it should be sent to the client once it has been reviewed by the registrant in accordance with section 13.2(4.1).** This will assist with the requirement to "take reasonable steps to obtain a client's confirmation of the accuracy of the information collected…including any significant changes to the information" set out in section 13.2(3.1).

3.7. **FAIR Canada recommends that firms should utilize technological capabilities so that any changes to the client's KYC information triggers an oversight response at the firms.** This will help ensure that changes are not made improperly to justify a recommendation of the individual registrant that is inconsistent with the original KYC information.

3.8. The Know Your Client process is a critical process in determining suitability and the requirements, as augmented by our recommendations above, (if followed) should engender more meaningful suitability discussions.

3.9. We understand the work undertaken by the Ontario Securities Commission's Investor Advisory Panel's on risk profiling informed these changes. **We recommend, as in the Facilitator's Report[10], that the Proposed Amendments include a definition of "risk profile" in the rule in addition to the provision of guidance set out in the Companion Policy, which includes the elements of the client's risk capacity well as their risk tolerance.**

3.10. We support the inclusion of triggering events which require the registrant to review the information collected. In practice, we believe this should necessitate a registrant taking reasonable steps to review the information collected under this section with the client annually rather than every three years (for non-Portfolio Managers or Exempt Market Dealers). We believe that material changes in market or economic conditions may necessitate a change in investment strategy and this should be added as a trigger.

4. Know Your Product

4.1. FAIR Canada supports the Know Your Product rule (as enhanced as recommended below) which will require a firm to only make a security available to its clients once it has taken reasonable steps to understand the security, including "how the security compares to similar securities available in the market"; provides approval of the security; and requires monitoring and assessing the security on an ongoing basis. In addition, registered individuals will have obligations to take reasonable steps to understand the securities that are available through the registered firm and how those securities compare; the structure, features, returns and risks of

[10] http://osc.gov.on.ca/documents/en/Investors/iap_20170123_risk-profiling-report.pdf, at page ii.

the security, the initial and ongoing costs of the security and the impact of those costs; and to only recommend a security that is approved by the firm.[11]

4.2. Requiring Registrants to Know your Product is fundamental to ensuring that Registrants meet their suitability obligations, including providing recommendations that put the client's interest first and that discharges their conflict of interest obligations. While many Canadians do not understand investment products, it may also be the case that some Registrants are not as familiar with the securities that are being recommended to their clients as they should be. This certainly was demonstrated when leveraged and inverse ETFs first came on the market and were misunderstood and mis-sold to retail investors as something to hold long-term in their RRSPs. In fact, such mis-selling of these products still occurs. It is quite likely that many individual registrants will not be familiar with alternative mutual funds that will be accessible to retail investors. A Know Your Product rule is necessary in ensuring investors are adequately protection as well as to ensure confidence in our markets.

4.3. **We recommend that individual registrants know, at a general level, how securities available at the firm compare to those securities available in the marketplace, not just at the firm.** Whether a recommendation is suitable, and whether that recommendation puts the client's interest first, must involve more than simply reviewing the alternatives available on the firm's product list. If there is a product available at the firm that is "suitable", but there is an investment product available in the marketplace that would be significantly better for the client (better net return or same return at a significantly lower level of risk) then the registrant should have to so advise the client. **FAIR Canada therefore recommends amending section 13.2.1(3)(a) so that individual registrants must understand "…at a general level, the securities that are available through the registered firm for the registered individual to purchase or sell for, or recommend to, clients, and how those securities compare, *at a general level through using reasonable diligence, with other securities available in the marketplace.*"**

4.4. Such an amendment would also help the firm determine the competitiveness of its product shelf and thereby discharge its know your product obligations under section 13.2.1(1)(iii). It also will facilitate compliance with the guidance provided in Companion Policy 31-103 at section 13.3 wherein "If the registrant cannot recommend a suitable type of account or security to the client because these are not available at the firm, we expect the registrant to decline to provide the securities or the services to the client." If the individual registrant never has to compare to the marketplace, they are unlikely to find that there is no product on their shelf that is not "suitable" for the client. Necessary training will be needed for individual registrants.

5. Suitability Determinations

5.1. Despite the wide parameters as to what is suitable, the suitability of recommendations continues to engender complaints due to problems. OBSI advises that over the past five years, issues related to suitability and/or suitability of margin or leverage have made up 55 per cent of

[11] We do not understand why the term "sponsoring" firm has been utilized in section 13.2.1(4) and ask for clarification as to its meaning.

its investments related case load. Compliance reviews of Exempt Market Dealers continue to demonstrate a lack of adherence to suitability requirements[12].

5.2. The revised suitability obligation is to be applied as follows: "Before a registrant acts by opening an account for a client, purchasing, selling, depositing, exchanging or transferring securities for a client's account, taking any other investment action for a client or making a recommendation or decision to take any such action" the registrant must determine, on a reasonable basis, that the "action" is suitable based on certain enumerated factors and "the action puts the client's interest first".

5.3. **FAIR Canada recommends that the rules be clarified so that Registrants have a clear obligation towards their clients regarding all financial recommendations or investment or retirement planning advice or courses of action that may precede the recommendation of a particular securities transaction, investment strategy or investment action or opening of an account.** Such "advice" often occurs in order to earn the client's trust and obtain the assets at the firm for management.

5.4. For example, an individual registrant may recommend to a prospective client that they retire early and/or commute the value of their pension (i.e. elect a lump sum payment in lieu of a defined benefit pension) which is then turned over to the registrant for investment. Such a recommendation can have a significant impact on an individual's retirement security. **FAIR Canada recommends that a fiduciary duty should be applied to any generalized retirement planning, financial or investment recommendation that encourages bringing assets to the firm**: including but not limited to taking early retirement, electing a lump sum in lieu of a pension, or refinancing a home to use the equity to invest. **In addition**, **Registrants should be required to provide a written explanation of the recommendation and the reasons for it to the client, which should include a discussion of the actual costs and compensation.**

5.5. **FAIR Canada recommends that suitability should require as one of the enumerated factors, a consideration of a reasonable range of alternative actions available to the individual registrant through the registered firm *or generally available in the marketplace* at the time the determination is made.** In order to put the client's interest first, Registrants must provide recommendations that are suitable based on not only what is offered at the firm, but what would put the client's interest first, generally in the marketplace. The individual registrant should not be able to recommend a product to the client and thereby discharge its duty to put the client's interest first, if the products on its shelf would only just meet suitability requirements while an investment product exists in the marketplace that would be much better for the client. If this is the case, the individual registrant should be required to so advise the client. Otherwise, the conflict of interest that the Registrant has, is being resolved at the expense of the investor.

[12] See for example, ASC Notice 33-705, "Exempt market dealer sweep" (10 May 2017), online: http://www.albertasecurities.com/Regulatory%20Instruments/5331553%20_%20EMD_Project_Staff_Notice%2033-705.pdf.

Costs to be a Factor in Determining Suitability

5.6. FAIR Canada supports the addition of costs of the account and the features and the potential and actual impact of costs on the client's returns, as factors in determining what is suitable. Given the importance of costs in determining long-term returns from investments, and indeed the fact that costs are a good predictor of future fund performance, all things being equal the lower cost product should be recommended over the more expensive one. Therefore, we agree with the guidance which states that "Unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1))."

5.7. However, in the absence of removing conflicted compensation structures such as embedded commissions and having an obligation to act in the client's best interest, we are skeptical of how much impact the enumerated cost factor will have on client outcomes. It is quite possible that Registrants will be able to justify their recommendations on a number of factors and their incentives to do so will still be present given the wide parameters of suitability.

5.8. The guidance provides that if a Registrant determines that a specific higher cost security is better for a client than other suitable securities, the Registrant must "include an assessment of the relative costs of, including the relative compensation associated with, various options available when documenting the reasonable basis for their suitability determinations". **FAIR Canada recommends that Registrants be required to disclose, in writing, to the client an explanation as to why the recommended security is the one that is suitable and puts the client's interest first despite there being a lower cost alternative, and explain the actual costs to the investor, including the compensation associated with the recommendation versus the other alternatives**.

5.9. FAIR Canada supports having a portfolio approach to suitability. **We recommend that Registrants be required to make reasonable efforts to understand the client's portfolio of investments not only comprised of accounts at the firm, but elsewhere (such as assets held in a workplace DC pension plan) in order to provide recommendations that take into consideration the client's entire portfolio of investments.**

Leveraged Investing

5.10. Investors continue to suffer losses from Registrants recommending they borrow to invest. The added compensation that is generated from these recommendations drives these recommendations rather than the best interests of the client (through larger commissions or added fee-based compensation through a larger amount of assets under management, coupled with the payment of referral fees form lenders). **FAIR Canada recommends that Registrants not be permitted to earn any compensation in respect of amounts they recommend the investor borrow in order to invest. In the absence of personal gain from such a recommendation, such a recommendation will only be made if it puts the interests of the investor first. We therefore call on the CSA to immediately prohibit the receipt of commissions or fees in respect of amounts borrowed to invest based on a leveraging strategy.** Firms and their registrants should

not benefit from recommending that the client borrow to invest given the inherent conflict in doing so. For fee-based accounts, the fee should be calculated based on net assets under management – dealers should be precluded from charging asset-based fees on monies that are borrowed for investment purposes, as in Australia.[13]

5.11. **FAIR Canada also recommends that referral fees from lenders to Registrants that incent representatives to recommend leveraging strategies should be prohibited.** We note that the referral fee provisions set out in the Proposed Amendments, as currently drafted, do not prohibit the payment of referral fees from lenders (non-registrants) to Registrants. It should.

5.12. **FAIR Canada also recommends that the disclosure when recommending the use of borrowed money, as set out in current section 13.13 should be reworked using a behavioural insights lens. Testing of this disclosure with investors is needed. A better starting point is The Financial and Consumer Services Commission of New Brunswick's information about the risks to consider before borrowing money to invest:**

"Three Key points to consider before borrowing money to invest:

1. **You could lose money**.
Whether your leveraged investment makes money or not, you still must pay back the loan, plus interest.

2. **It may cost more to invest**.
Even if your leveraged investment makes money, you don't get to keep it all. You still have to pay the interest costs on the loan. These could be higher than your returns. There can also be set-up fees, on-going maintenance fees and a fee for early withdrawal of the loan or the investment.

3. **You could damage your credit**.
If you are relying on the returns from leveraged investments to cover the cost of borrowing, you could default on the loan if the value of the investment decreases.

The risks of borrowing to invest are high. Be sure to fully understand all associated borrowing costs before making any final decision and be ready to cover any potential losses with other savings. "

6. Referral Fees

6.1. FAIR Canada supports reforming the rules regarding referral fees and trying to address regulatory arbitrage. However, we are of the view that the Consultation Document provides insufficient empirical evidence, qualitative information or analysis to assess the limitations on

[13] Australian Securities and Investments Commission REP 28, "Response to submissions on CP 189 Future of Finance Advice: Conflicted remuneration" (4 March 2013), online: < http://asic.gov.au/regulatory-resources/find-a-document/reports/rep328-response-to-submissions-on-cp-189-future-of-financial-advice-conflicted-remuneration/> [ASIC Response}.

referral fees that have been proposed (no longer than 36 months and 25% of the fees or commissions collected from the client).[14]

6.2. **FAIR Canada continues to recommend that a best interest standard be implemented so that any referral arrangement only occur in the context of a client's best interest, and therefore, when there is an absence of any conflict of interest.** We support the provisions which provide for the need to have the arrangements in writing, to be recorded on the books of the Registrant, and that such arrangements are disclosed to clients with full transparency about the referral fee, its amount and the purpose of the arrangement.

6.3. **As discussed above, FAIR Canada recommends that referral fees from lenders to Registrants to encourage borrowing to invest be immediately prohibited.** As stated in CSA Consultation Document 81-408 at page 104: "Recommendations that clients borrow to invest in funds on a DSC basis [and we would add on an embedded commission basis more generally] enable the dealer and their representative to increase the total compensation they can earn from the investment. Specifically, they may receive a referral fee from the financial institution in connection with their client's loan in addition to the 5% upfront commission (plus the ongoing trailing commission) they may receive from the investment fund manager on the purchase transaction."[15] Despite the CSA being alert to the issue, the Proposed Amendments permits such payments: "registered firms and registered individuals may accept a referral fee from both registrants and non-registrants." Such payments undermine the best interests of clients, create significant misaligned incentives, harm investors and undermine confidence in our capital markets and need to be immediately prohibited.

7. Relationship Disclosure Information

7.1. FAIR Canada supports a requirement for registered firms to make public information available about the types of advice options it offers clients, the services it provides and the types of investments available, in plain language, on the main page of its website. We do not agree that firms should have the option to deliver it by email or in paper form if requested, instead of the obligation to post it on the website (as is suggested in the guidance) and it should also be emailed or mailed, if requested by an investor. **FAIR Canada recommends that the CSA require this information to be posted on the main page of firms' websites, posted and accessible in print at the firm and available upon request by email or by mail.**

7.2. **FAIR Canada recommends that key disclosures and terms be tested with investors to ensure understanding.** For example, do investors understand what "proprietary products" mean and will investors be able to understand how they are paying if they "choose" embedded commissions? FAIR Canada also recommends that firms be required to list main categories of securities they do not offer, for example, we do not sell exchange traded funds or individual

[14] We do agree that the referral fee should not result in an increase in the amount of fees or commission that would otherwise be paid by a client to the party who received the referral for the same product or service.
[15] http://www.osc.gov.on.ca/documents/en/Securities-Category8/sn_20170110_81-408_consultation-discontinuing-embedded-commissions.pdf at page 104.

securities (i.e. individual stocks such as Bell Canada, Apple, etc.) as many investors are not even aware of investment products other than mutual funds and equate RRSPs with such funds.

7.3. FAIR Canada notes that in the United States, there is a proposed client relationship summary form that is being proposed to be required. The SEC was conducting testing of the document and stakeholders have called for the SEC to make public the results of its investor testing. Many stakeholders have panned the proposed document. We recommend that the CSA test with investors the public information that will be required to be made to determine its efficacy and take note of findings from the SEC investor testing.

7.4. FAIR Canada cautions that many clients do not read the lengthy relationship disclosure information that is provided upon account opening, and this should not be relied upon to address the Expectations Gap.

7.5. FAIR Canada supports disclosure that lets investors know prospectively what their total costs will be prior to engaging with a firm. We refer the CSA to our letter to the MFDA on expanding cost disclosure[16], and urge the CSA, MFDA and IIROC to benchmark to leading jurisdictions, and to test proposed disclosure with investors so that disclosure is in the best interests of investors. "How" costs are disclosed should be given as much consideration as "what" costs are disclosed. Quality, simplicity and comprehensibility need to be key considerations as well as likely impact on investor decision-making and behaviours.

7.6. **FAIR Canada recommends that the CSA test summary relationship disclosure information with investors with a view to prescribing the format of the information and the language of the disclosure so that it is more likely to be reviewed and is more comprehensible to investors**. Format may be just as important as content and format when viewing online may need to be different than format when received in print form.

8. Dispute Resolution for Investors

8.1. **FAIR Canada repeats its recommendations that the complaint handling process of the SROs be required to be in conformity with sections 13.16(3)and (4) of NI 31-103, that firms cease using the term internal ombudsman and that OBSI be given binding decision-making under section 13.16.** [17] As the recent CSA Staff Notice 31-351, Complying With Requirements Regarding The Ombudsman For Banking Services and Investments, dated December 7, 2017[18] attests - a fair and effective dispute resolution process is important for investor protection in Canada and is vital to the integrity and confidence of the capital markets.

[16] http://faircanada.ca/wp-content/uploads/2018/07/180712-FAIR-Canada-Submission-re-MFDA-Discussion-Paper-on-Expanding-Cost-Reporting.pdf.
[17] http://faircanada.ca/wp-content/uploads/2017/10/171011-Final-Joint-FAIR-Canada-and-PIAC-Letter-re-Use-of-Internal-Ombudsman-2.pdf and http://faircanada.ca/wp-content/uploads/2018/02/180221-Final-letter-to-JRC.pdf.
[18] http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20171207_31-351_ombudsman-banking-services-investments.htm

9. Misleading Communications in Holding Out

9.1. FAIR Canada supports the inclusion of section 13.18 which prevents misleading a person when a registered individual holds himself or herself out and a registered firm holds itself out as to: their proficiency, experience or qualifications of the registrant; the nature of the person's relationship or potential relationship with the registrant; and the products or services provided, or to be provided, by the registrant.

9.2. The use of the titles "financial advisor" or "investment advisor" if not subject to a fiduciary or statutory best interest standard, is a significant misleading communication that needs to be addressed in the section 13.18 regarding misleading communications and through reforms to the rules regarding titles; otherwise the proposed rule will be flawed. Consultation on reform to titles, including proposed title alternatives, was part of CSA 33-404, comments were received, and reforms should not be further delayed**. FAIR Canada recommends that title reforms occur at the same time as the Proposed Amendments.**

10. Other Reforms Postponed

10.1. FAIR Canada is disappointed that the following reforms that are long overdue and part and parcel of the goals of the current consultation have been moved into "longer-term projects":

- Reviewing proficiency standards; and
- Reviewing titles and designations, including the use of "advisor" to describe individuals who are not registered in a category of adviser.

10.2. Canada lags other jurisdictions in the area of education and proficiency and the oversight of such standards.

10.3. **FAIR Canada urges the CSA to not further delay reforms on proficiency**. Education requirements and proficiency qualifications are needed to ensure that Registrants can meet their obligations under the Proposed Amendments and in order to support the provision of professional, objective advice. We refer you to the proficiency and continuing education standards in Canada and in other leading jurisdictions set out in Appendix B to our submission on CSA 33-404.[19] While the mandating of training programs under section 3.4.1 is a start, more robust educational requirements and proficiency needs to occur.

11. Transition Period

11.1. FAIR Canada calls on an immediate ban on the payment of referral fees from lenders to Registrants to encourage borrowing to invest or leveraged investing. FAIR Canada believes there

[19] FAIR Canada Letter to CSA dated September 30, 2016, Appendix B at page 48; online: http://faircanada.ca/wp-content/uploads/2017/11/160930-Final-FAIR-Canada-Submission-Regulatory-Best-Interest-REVISED.pdf.

should be 6 months to provide the publicly available information, and two years to implement the remaining amendments.

We thank you for the opportunity to provide our comments and views in this response. We welcome its public posting and would be pleased to discuss this letter with you at your convenience. Feel free to contact Marian Passmore at 647-256-6691/marian.passmore@faircanada.ca.

Sincerely,

Canadian Foundation for Advancement of Investor Rights