2009 Ontario Pre-Budget Submission

to the

Legislative Assembly of Ontario

Standing Committee on Finance and Economic Affairs

January 16, 2009

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Executive Summary

Government needs to take a fresh look at financial services regulation.

A high level review of financial services regulation over a number of years provides clearly observable facts. Regulatory budgets are growing to accommodate the ever increasing reach of the regulators. Regulation and compliance are often needlessly and increasingly complex as regulation comes from not only the Ontario Securities Commission but through their proxies, the SROs. Providers of financial services are increasingly ensnared by more and more rules-based regulatory requirements while consumers are less and less able to afford and to access professional financial advice. At the same time, big risks and big threats continue to touch down and cause harm to consumers and undermine the financial services marketplace, and negatively affect the economy.

The regulators continue to regulate and to impose costs on compliant financial advisors, but consistently fail to deal effectively with massive frauds, and fail to identify and deal effectively with bad actors through their enforcement powers.

Advocis believes that significant change is needed to improve this deteriorating situation.

Government should offer ongoing direction to regulators to ensure that Ontarians have access to professional financial advice and choice in financial services. Accordingly we urge the Ministry of Finance to offer direction to the Ontario Securities Commission, and through the OSC to IIROC and the MFDA, with the primary goals of:

- preserving consumer choice and access to professional financial advisors and to a range of choices in the financial services marketplace;
- ensuring that financial regulation is even-handed and does not favour large financial institutions and dealers and their economic model over small business, entrepreneurial financial advisors;
- ensuring that financial advisors are consulted as key stakeholders in respect of proposed regulatory initiatives that affect them;
- ensuring that new rules and compliance burdens are only imposed when necessary to address clearly identified problems, and only after less costly principles-based approaches have been considered; and
- encouraging regulators to obtain objective cost-benefit analyses of regulatory proposals and to implement smart, principles-based approaches to regulation.

Advocis is not asking the Government of Ontario for a handout or a subsidy. We are not calling for less regulation, but for more appropriate and effective regulation that will protect the public without hampering the ability of professional financial advisors to serve Ontarians in these challenging times.

RECOMMENDATION 1: The Ontario Ministry of Finance should make it a priority to ensure that small business, independent and entrepreneurial financial advisors and planners continue to be a vital segment of the financial services sector in order to create diversity in the

marketplace, provide ample choice for consumers and allow consumers to have access to professional, independent financial advice.

RECOMMENDATION 2: The Ministry of Finance should establish government policy objectives for its financial services regulators so that:

- Regulatory initiatives do not place an unfair burden of regulation on one segment of the industry versus another and maintain a level playing field at all times.

- New regulations are examined carefully to determine if they have major implications for consumer choice.

RECOMMENDATION 3: Financial services regulators should consider a principles-based approach to regulation, before proceeding to impose prescriptive rules-based regulation.

RECOMMENDATION 4: The Ministry of Finance should develop policies and procedures for regulators (including SROs) to ensure that all stakeholders that are likely to be directly affected by regulatory proposals are consulted at an early stage in the policy development process.

RECOMMENDATION 5: The Ministry of Finance should impose requirements on regulators to ensure that before implementing any new major regulatory requirement:

- Regulators develop a clearly articulated statement of the problem that the regulation is trying to address backed by research demonstrating its severity.

- A robust cost-benefit analysis is prepared with documented methodologies which examine the benefits of clearly enhancing consumer protection in light of a serious problem, and the costs to market participants from the increased compliance burden and any resulting potential costs to consumers.

I. Introduction

Advocis appreciates the opportunity to make a pre-budget submission to the Legislative Assembly of Ontario Standing Committee on Finance and Economic Affairs (the "Committee").

Advocis – who we are

Advocis is the Financial Advisors Association of Canada. We are the largest and oldest voluntary professional membership association of financial advisors and financial planners in Canada. Our association was founded in 1906, as the Life Underwriters Association of Canada.

We have more than five thousand members in Ontario who provide comprehensive financial planning and investment advice, retirement and estate planning, risk management, employee benefit plans and disability coverage, to more than a million Ontario households and businesses.

Our members are provincially licensed to sell life and health insurance and mutual funds and other securities, and are primarily independent owners and operators of small businesses – entrepreneurs who create thousands of jobs across the province.

Advocis financial advisors maintain lasting relationships with their clients based on trust. They take a long-term planning perspective and are helping to guide clients, young and old, individuals, families and businesses during these tough times of economic downturn and financial market turmoil.

Advocis believes that:

1. **Ontarians should have ample access to professional financial advice, products and services and financial planning services, and should be able to choose among a diverse range of financial service providers.**

2. **Independent-minded, entrepreneurial, small business professional financial advisors provide valuable services to Ontarians in delivering professional financial advice, products and services and have a significant place in the financial services sector.**

3. **The existing regulatory framework, and the direction in which regulation is being developed, does not favour a diverse range of choices for Ontarians and is limiting access to professional financial advisors. The regulatory framework and the compliance burdens that are being imposed are skewed in favour of larger, integrated financial institutions.**

Financial Advisors and the Current Economic Crisis

Advocis is not asking the Government of Ontario for a handout or a subsidy.

We are not calling for less regulation, but for more appropriate and effective regulation that will protect the public without hampering the ability of professional financial advisors to serve Ontarians in these challenging times.

We are calling on the Government to embrace smart, principles-based regulation that recognizes the value of financial advisors to Ontarians, and engages financial advisors appropriately as stakeholders in the regulation of financial services to bring about a more level playing field in the financial services marketplace.

Such an approach can help to reduce the regulatory burdens on small business financial advisors and preserve diversity in the marketplace and choice for Ontarians, without compromising investor protection.

Saving, Investment and Retirement Planning

Professional financial advisors and financial planners are a vital component of the financial services sector. They help Canadians save, invest and plan intelligently.

It is no less important for individual Canadians and business enterprises, than it is for their governments, to be served by professional financial advisors, to help them understand their financial needs and prospects, to save, to invest prudently, to address a variety of risks, and to meet future financial needs.

We believe that government can play a constructive role in promoting a diverse financial services sector and financial services regulation that serves Ontarians and all Canadians effectively. It is important for government to set appropriate overarching economic policy and regulatory principles in order to achieve these objectives.

Why Advocis members are different - Professionalism

A crucial characteristic of Advocis members is professionalism based on education, best practices, high standards of proficiency and professional conduct. Advocis promotes the professionalism of financial advisors. We do this through:

- Our Code of Professional Conduct;
- Guidance on best practices;
- Errors and omissions insurance coverage that protects consumers;
- Professional designations - the Certified Life Underwriter (CLU) and the Registered Health Underwriter (RHU), supported by comprehensive and up-to-date curriculum and rigorous standards; and
- Mandatory competency-based continuing education.

II. General Comments

A Diverse Financial Services Sector

Advocis believes that qualified, professional financial advisors and planners offer Ontarians vitally important services to help them save, invest and plan for their financial future.

It has been estimated that there are approximately 25,000 active financial advisors in Ontario (dealing in financial products and services such as life and health insurance, mutual funds, comprehensive financial planning) that are small business, often sole proprietor, financial advisors not including employees of large financial institutions. These professional financial advisors are a vital part of the financial services marketplace. Advocis believes that it is

extremely important that a strong and healthy financial advisory sector continues to serve the needs of Ontario and Canadian consumers of financial products, services and advice.

Direct and indirect regulation of financial advisors, particularly in the securities sector, is highly prescriptive (rules-based). Increasingly costly compliance burdens and prescriptive rules that accord with the business model of the large financial institutions, and are applied to small business financial advisors, make it increasingly difficult for smaller firms and for independent financial advisors to serve the public. This has resulted in the financial services sector being increasingly dominated by large, vertically-integrated financial institutions that have an employee-employer business model. In our view, the current regulatory structure favours these organizations by placing a disproportionately larger regulatory burden on small, independent financial advisors. The regulatory burden is significantly higher for these advisors, and puts their businesses at risk due to high compliance costs. It makes professional financial advice less affordable and less accessible for many. It also creates barriers to entry for new financial advisors coming into the industry, which in turn will negatively impact consumers in the future.

The ever-increasing regulatory compliance burden raises the costs involved in providing financial services to Ontarians, and as a result is increasing the costs to the consumer and puts professional financial advice out of reach for many. All manner of financial service providers - financial institutions, investment dealers, mutual fund dealers, insurance brokers and agents, independent financial advisors and financial planners – all are obliged to cover these costs if they are to remain in business. A wide range of costs must be covered: legal and regulatory advice, regulatory fees, SRO membership, printing and mailing, increased liability risks, time spent explaining forms to clients, etc. The threshold where financial advisors can cover their costs continues to rise. This has been referred to as regulatory creep – the layering on of regulation to an unbearable point where it is no longer cost effective to continue to provide services to consumers, and advisors leave the industry altogether.

The net effect of regulatory creep will be an increased concentration in the delivery of financial products and services by fewer, larger financial institutions, and less choice and diversity in the marketplace for Ontario consumers.

Since it is vitally important for Ontarians to continue to have ample access to financial advisors for financial advice, financial products and financial plans, we believe that the government of Ontario has an important role to play in ensuring that Ontarians continue to have a range of choices in the financial services marketplace. Financial services regulation has a direct impact on market participants in terms of costs, the way they can deliver products, services and advice. The regulatory approach can ultimately shape the financial services industry and consumer choice. Without clear guidance from government on how regulation should encourage consumer choice and diversity in the marketplace, these matters are left largely with regulators, which typically have a narrow mandate and perspective.

Our members offer professional financial advice and objective financial planning services to the public, operating as small businesspersons in the communities where their clients live. The services that our members offer go far beyond the sale of insurance and investment products – our members strive to develop life-long relationships with their clients to assist them though all stages of their life as it relates to their financial needs.

We believe that diversity in the financial services sector is essential to ensuring that Canadians have access to professional financial advice and planning services. That diversity is under

threat, because of the layering of prescriptive rules-based regulation that typically favours the business model of large financial institutions.

RECOMMENDATION 1: The Ontario Ministry of Finance should make it a priority to ensure that small business, entrepreneurial financial advisors and planners continue to be a vital segment of the financial services sector in order to create diversity in the marketplace, provide ample choice for consumers and allow consumers to access professional, independent financial advice.

The Regulatory Challenge

We believe Ontarians need more professional advice, not less of it.

Unfortunately, in our view, the current direction of regulation in Ontario makes it increasingly difficult for financial advisors to serve Ontarians.

A more appropriate approach to regulation is needed.

More and more rules from the Ontario Securities Commission and its recognized self-regulatory organizations (SROs), namely the Mutual Fund Dealers Association (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC) are imposing large compliance costs on financial advisors, often without clear consumer protection benefits.

Financial Services Regulation in Ontario: The Key Players
The Ontario Securities Commission (OSC) is the Ontario government agency that administers the Ontario Securities Act and regulates investment and mutual fund dealers and their salespersons who distribute financial products. The primary mandates of the OSC are investor protection and fostering of fair and efficient capital markets. The OSC is accountable to and subject to oversight by the Minister of Finance, and OSC rulemaking is subject to approval by the Minister.

The Financial Services Commission of Ontario (FSCO) is the Ontario government agency responsible for administering the Insurance Act and regulating the insurance industry, in particular the distribution of insurance products to consumers. FSCO reports to the Minister of Finance.

Much of the day-to-day regulation of investment dealers and mutual fund dealers and their sales-forces, is undertaken by two "self regulatory organizations", the Investment Industry Regulatory Organization of Canada (IIROC) (successor to the Investment Dealers Association of Canada), and the Mutual Fund Dealers Association of Canada (MFDA).

Both IIROC and the MFDA have been formally recognized as SROs by the OSC. They are subject to regulatory oversight by the OSC and other provincial securities regulators.

Oversight
The OSC and FSCO, as government agencies, are responsible for carrying out their legislative mandates and are subject to direction by the Minister of Finance. They also are responsible for carrying out their mandates in a manner that is consistent with government policy.

The Government of Ontario historically has accorded wide latitude to the OSC and FSCO in carrying out their mandates, and does not interfere in the exercise of the agencies' quasi-judicial functions. The Government also has historically refrained from other, "political" interference in the agencies' activities.

However, regulators are accountable to the government through the Minister of Finance, and the Minister is responsible for supervising those government agencies (and their oversight of the SROs) so that they carry out their mandates in a manner that is consistent with the goals of government policy.

Increasing compliance costs present a competitive challenge to small, independent financial advisors. These costs are more easily borne by large financial institutions and their compliance departments, which benefit from economies of scale, than by the smaller enterprises that offer alternatives to consumers.

These ever-increasing compliance costs necessarily affect the costs that must be passed on to consumers and the profitability of small enterprises, and threaten to put professional financial advice out of reach for many consumers. As a result, the ability of consumers to choose independent professional financial advice is deteriorating significantly.

Another key aspect of the regulatory challenge is highly prescriptive regulatory requirements, many of them imposed by the MFDA and IIROC.

We believe that the prevailing regulatory framework favours large players that have many employee salespersons, and disadvantages contracted small business advisors. This ultimately threatens consumer access to independent financial professionals.

RECOMMENDATION 2: The Ministry of Finance should establish government policy objectives for its financial services regulators so that:

- **Regulatory initiatives do not place an unfair burden of regulation on one segment of the industry versus another and maintain a level playing field at all times**
- **New regulations are examined carefully to determine if they have major implications for consumer choice.**

III. What Is Needed – Smarter Regulation

Principles-based Regulation

Viable alternatives exist to current approaches being employed by financial services regulators, particularly securities regulators. Layering more rules and regulations governing how advisors interact with their clients is adding unsustainable regulatory burdens and compliance costs on professional financial advisors. Rules-based regulation (prescriptive regulation) suggests that a hard-and-fast rule can address every situation and behaviour. This is a flawed approach if the result is substantial compliance costs but little in the way of improved consumer protection. Principles-based regulation, on the other hand, is focused on outcomes and provides greater flexibility to deal with new circumstances, new products and new challenges. Given the already significant degree of prescriptive regulation found in the Securities Act and in the current MFDA and IIROC rulebooks, a principles-based approach to regulation should be considered.

Government should ensure that regulators strike the right balance between prescription and principles and ensure that regulators do more than give lip service to implementing principles-based regulation. A principles-based approach allows financial market participants more freedom and flexibility, while providing consumer protection and sound financial markets.

The core regulatory principles that should guide regulators are:

- act only in the case of market failures, information asymmetries or matters of consumer protection;
- identify the problem through detailed consultation and analysis; and
- employ principles-based regulatory responses unless there is clear evidence that absent a prescriptive policy response, harm will be done to the market or consumers.

It is also critically important that filing requirements allow regulators to gather information that will help them determine if the policy response has properly identified and corrected the identified problem. Built into every policy instrument should be a requirement for a five year review. If the evidence gathered through the filing requirements indicate that the policy instrument has not achieved its stated purpose, or has ancillary effects that are harmful or inadvertently restrict market practices, then the policy must be set down for immediate review. The review should consider whether the regulation is justified, needs amendment or should be repealed. As capital markets are increasingly international, it is imperative that we regulate in a manner that encourages innovation and investment without compromising consumer protection. In striking the right balance between investor protection and increased market efficiency there is a need on the part of regulators to provide a robust cost/benefit analysis for all proposed rules and regulations. The onus is on regulators to demonstrate that the benefit to investors and markets clearly outweigh the costs of the regulation.

Principles-based regulation places greater emphasis on individual accountability. The Financial Services Authority in the UK has only eleven high-level regulatory principles for businesses including acting with skill, care, and due diligence. The focus is on regulatory outcomes and the individual participant will make their own decision, yet be accountable to the regulators and the public. Advocis' Code of Professional Conduct mirrors this approach through the establishment of broad principles regarding business conduct. The code specifically addresses the best interest of the client, acting with integrity, competently, and, in accordance with the spirit and letter of the law. These general principles are supported by explanatory notes, and demonstrate the positive effect that principles-based regulation can have through allowing those who are regulated to help define the details. The onus in a principles-based environment is placed on the individual to determine the acceptable course of action.

In a principles-based regulatory environment the individual will no longer have available to them the argument that they have lived up to the letter of the law as has proved to be a successful defense under a prescriptive regulatory regime. Investors may be better served through a principles-based approach as the scope of enforcement actions will be broad.

Rules that impose more compliance burdens on compliant advisors do not serve the public interest. Regulators should give more priority to investigating and enforcing regulatory policies and rules, and to punishing the misconduct of the few, rather than imposing burdensome regulations on those who are already compliant.

Lessons from the UK – Towards Principles-based Regulation

Regulatory intervention has a direct impact on the composition and structure of financial services. By way of example one need look no further than the developments that have taken place in the United Kingdom (UK). The UK consolidated regulation of most financial services markets, exchanges and firms under the Financial Services Authority (FSA) through the Financial Services Markets Act 2000 (FSMA). The UK financial services reform began in 1997 with the renaming of the Securities and Investment Board (SIB) to the FSA and consolidation of banking supervision and investment services regulation in 1998. As of December 1, 2001, the FSMA transferred complete regulatory and registry function from the SIB to the FSA as well as from a number of self-regulatory organizations[1], including that of financial advisors. The FSA assumed responsibility for mortgage and long-term care insurance regulation October 3, 2004 followed by general insurance as of January 14, 2005. [2] The end result was that the FSA regulates most financial services markets, exchanges and firms in the UK. It is the single regulator for deposit taking, insurance, investment business, mortgage lending, mortgage advice and general insurance advice.

The experiences and outcomes from the FSA reforms are worthy of consideration. These outcomes were not in and of themselves a result of regulatory consolidation into one regulator, but rather resulted from a heavily prescriptive and rules-based approach to regulation, among other factors. There is a general concern it is particularly difficult for smaller firms to review the volume of regulatory material issued by the FSA.[3] The FSA Managing Director, Regulatory Services, acknowledges that independent financial advisors were struggling to remain profitable for a variety of reasons including costs associated with regulation.[4] Indeed, a survey conducted in the UK noted that respondents expressed concerns that compliance costs were undermining profitability and could force marginal competitors out of business.[5] Not only were concerns raised with respect to cost forcing advisors out of the UK market, but individual firms were also responding to the cost pressures by re-examining their lines of business.[6] There have been references that the regulatory environment has been a contributing factor to changes in the structure of the retail intermediary marketplace and in some firms' demise. Many respected organizations cautioned increasing regulatory requirements and market conditions would negatively affect the financial services industry and consumers. There was growing sentiment that the regulatory burden in the UK was unacceptable and would impact competitiveness of financial services and a continuing reduction in the quality of independent advice available to consumers. The end result was a significant contraction in the number of advisors and smaller firms in the financial services marketplace, and reduced access to financial advisors by consumers in the UK.

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[1] Investment Management Regulatory Organization, Personal Investment Authority, Securities and Futures Authority, DTI Insurance Directorate, Building Societies Commission, Friendly Societies Commission, Register of Friendly Societies.
[2] *Essential facts about the Financial Services Authority*, Financial Services Authority, page 1.
[3] *Presentation, Ruthren Gemmell*, Chairman FSA Small Business Practitioner Panel, FSA July 21, 2005 public meeting; *Third Survey of the FSA's Regulatory Performance*, Financial Services Practitioner Panel, 2004, pages 25, 30.
[4] *Keynote Address*, David Kenmir, FSA Retail Intermediaries Sector Conference, February 24, 2005, page 4.
[5] *Burden of regulation threatening world's banks*, Association of Foreign Newsletter, April 2005, page 2
[6] *Third Survey of the FSA's Regulatory Performance*, Financial Services Practitioner Panel, 2004, page 35.

In our view, the UK experience can be viewed as the 'canary in the coal mine'. The Ontario marketplace is distinguishable from the UK in that Ontario is larger geographically and has a widely dispersed population outside of urban centers. It is this uniqueness that represents increased potential harm to consumers should the Ontario experience follow what is being noted in the UK. In Ontario, there is a need for financial advisors who can service both urban and remote communities. Maintaining the current regulatory trend where the interests of financial advisors and the welfare of their clients remain secondary to the development of regulation directed at larger vertically integrated institutions will result in a situation similar to the UK experience. What will be observed is the shrinking of small firms and independent advisors, and the expansion of larger vertically integrated financial service firms through the absorption of the profitable lines of business left behind. The consumer will be left with less choice and less independent advice.

The trend in the UK has given rise to significant concern from industry and regulators. Given Ontario's unique geographical construction, and the dispersed population outside of urban centers, one must question the wisdom in pursuing regulatory policies that will result in reduced consumer choice as small financial advisors are forced out of business due to poorly conceived regulation and the associated compliance costs.

UK's FSA has done an about-face as a result of negative marketplace consequences related, in part, to heavy, rules-based regulation, and is now a leading proponent of principles-based regulation.

According to an April 2007 FSA paper: *Principles-based Regulation – Focusing on the Outcomes that Matter*, prescriptive rules have not prevented misconduct among financial market participants, but have instead resulted in "ever-expanding rule books … that have become an increasing burden on our own [the FSA's] and the industry's resources."

According to the FSA:

> *Past experience suggests to us that prescriptive standards have been unable to prevent misconduct. The ever-expanding rule books of our predecessor bodies and our consolidated Handbook, designed to prevent misdemeanor, have not stopped further mis-selling, market misconduct or other detriment. Instead we believe that detailed rules have become an increasing burden on our own and the industry's resources.*

Principles-based regulation places greater emphasis on individual accountability. The FSA in the UK has promulgated its eleven regulatory principles for business such as acting with skill, care, and due diligence, and is focused on regulatory outcomes where individual participants will make their own decisions, yet be accountable to the regulators and the public.

Principles of the Joint Forum of Financial Market Regulators

In fact, the OSC and FSCO actually have *endorsed* taking a principles-based approach to regulation, but neither the OSC nor its SROs have begun to implement that approach to any great extent in practice.

Both the OSC and FSCO are leading participants in the Joint Forum of Financial Market Regulators ("Joint Forum"), a national grouping of provincial and territorial securities, insurance and pension regulators that works to develop and harmonize financial services regulation in Canada. [The Joint Forum was founded in 1999 by the Canadian Council of Insurance

Regulators (CCIR), the Canadian Securities Administrators (CSA), and the Canadian Association of Pension Supervisory Authorities (CAPSA). It also includes representation from the Canadian Insurance Services Regulatory Organizations (CISRO).]

The Joint Forum in 2005 released a document entitled *Principles and Practices for the Sale of Products and Services in the Financial* Sector. The purpose of this document was to set out best practices that should apply to the conduct of all financial intermediaries in their dealings with consumers of financial products and services, and to provide consumers with a benchmark to assess the conduct of any financial intermediary with whom they currently have a relationship, or are considering establishing a relationship. The paper was endorsed by all provincial insurance and securities regulators across Canada.

The eight principles and practices outlined by the Joint Forum in the paper are:

1. *Interests of the Client*
2. *Needs of the Client ("Know Your Client")*
3. *Professionalism*
4. *Confidentiality*
5. *Conflicts of Interest*
6. *Disclosure*
7. *Unfair Practices, and*
8. *Client Redress.*

In its backgrounder to the *Principles* document, the Joint Forum states that its preference is to develop voluntary principles that intermediaries would adopt. Therefore it set out to create principles and practices that industry associations and associations representing intermediaries would endorse on behalf of their members. For this reason, the principles and practices are expressed as high-level principles rather than specific details. The Joint Forum states that

> *"… a benefit of this approach is that they are general enough to dovetail with the existing codes of industry associations and voluntary codes can complement requirements set down by law and can be adapted to changing circumstances more quickly than a statutory code can. Once the principles and practices are widely adopted by industry associations, the Joint Forum is confident that they will come to be seen as the norm. Competition and market forces will operate to encourage higher standards to the benefit of consumers."*

Principles vs. Rules – Insurance vs. Securities

We believe it is instructive to compare the highly prescriptive rule-based approach taken by the OSC and its SROs, in the regulatory initiative that is referred to as the "Client Relationship Model" ("CRM"), with the more principles-based approach taken by provincial insurance regulators in an initiative that deals with similar subject-matter.

CCIR Principles for Managing Conflicts of Interest

Canadian insurance regulators have been working with the insurance industry to implement principles of conduct relating to conflict of interest and product suitability.

In 2006, the Canadian Council of Insurance Regulators and Canadian Insurance Services Regulatory Organizations recommended a principles-based approach to enhance and

harmonize best practices across the insurance industry and in all Canadian jurisdictions, to deal with the issue of managing conflicts of interest.

The CCIR Principles overlap with the CRM to a considerable extent, but aim to accomplish their regulatory objective without imposing prescriptive rules and costly compliance burdens.

The broad principles that the insurance regulators have proposed as standards of conduct are:

1. Priority of the client's interest;
2. Meaningful disclosure or real or perceived conflicts of interest; and
3. Product suitability.

The insurance industry has been working cooperatively with regulators to implement these principles at the company, agency and individual advisor levels. Recent surveys of insurance companies and insurance agents conducted by regulators have revealed that the implementation of these principles in practice has been met with a high degree of satisfaction by the regulators.

Securities Regulators, SROs, and the Client Relationship Model

On the other hand, the Ontario Securities Commission and the Canadian Securities Administrators (the national grouping of provincial and territorial securities regulators), as well as both the MFDA and IIROC, have over the course of the past few years been developing a new body of regulatory requirements that are referred to as the "Client Relationship Model" ("CRM").

The purposes of the CRM are to clarify requirements relating to how registrants deal with clients; how registrants will manage conflicts of interest; and the registrants' duty to assess the suitability of investments.

The SROs are implementing the CRM through extensive detailed rules and compliance burdens on registrants, and ultimately on many financial advisors, even in areas where the CSA has indicated a more principles-based approach may be appropriate.

In most instances, the regulators never actually identified any particular *problem* that had to be solved through the rules or principles of the CRM, above and beyond what is currently required under securities law and SRO rulebooks, and their largely prescriptive requirements. The regulators presume that their goals, because they are well intended, are sufficient justification for imposing these prescriptive requirements. The regulators never actually consider the impact of ever-increasing compliance burdens, nor whether the requirements actually are necessary. The regulators also do not consider the impact on various market participants, such as the added regulatory burden that will fall specifically on financial advisors, and whether the likely benefit is sufficient to justify imposing the additional compliance burden.

A Tick-the-Box approach

A result of the issuance of these prescriptive rules (in addition to the compliance burden) is that compliance and rule-enforcement efforts of the SROs tend to focus on mechanical and formal compliance - whether forms have been filed and appropriate boxes have been ticked, without enhancing consumer protection in any meaningful way.

We believe a principles-based approach to these matters would be a more effective way to protect investors than the prevailing rules-based approach.

Greater emphasis should be placed on investigation and enforcement of regulatory policies and rules, and punishing "bad behaviour" of a few individuals rather than creating overly burdensome regulations on those who are already compliant.

RECOMMENDATION 3: The Ministry of Finance should establish an overriding policy whereby principles-based regulation should be examined as a viable option for all new regulatory initiatives, and financial services regulators should justify why principles-based regulation cannot be effectively employed if prescriptive rules-based regulation is favoured.

IV. A Flawed Policy Development Process

Consultation: Financial Advisors as Key Stakeholders

We believe the policy development process of the MFDA and IIROC is deeply flawed due to regulatory capture of these SROs by their largest member firms and failure of the SROs to consult appropriately with financial advisors [regulatory capture is a term used to refer to situations in which a government regulatory agency created to act in the public interest instead acts in favour of the commercial interests that dominate in the industry or sector it is charged with regulating].

Large vertically-integrated financial institutions represent a significant proportion of the volume of business that the SROs regulate. Increasing regulatory burdens and compliance costs are more easily borne and administered by these large firms and their compliance departments and employee sales-forces, than by small financial advisors.

The SROs understandably look to their member firms as their primary stakeholders, when consulting on regulatory proposals. Historically, the regulatory staff of the SROs has given little consideration to the possible impact of regulatory proposals on financial advisors. Financial advisors who are often Approved Persons (as selling agents) of SRO members but are not themselves members of the SRO, often have not been consulted appropriately about initiatives that will affect them directly, especially in the early stages of regulatory policy development.

Financial advisors are the intermediaries that deal directly with consumers; thus we bring a unique perspective to the table when regulatory policy is being considered. We strongly believe that any initiative that will change the way financial advisors are permitted to interact with their clients should have our input directly. We wish to be actively involved in developing, reviewing and commenting on proposals for major regulatory initiatives and rule changes that will have a significant impact on our members, the entire advisor community and ultimately, on consumers. Getting the approach right in the early stages of policy development is crucial if regulators' objectives are to ensure that specific regulatory proposals that are being contemplated are appropriate, and the outcome of consumer protection is to be achieved.

An example of the failure to consult appropriately is discussed in Appendix 1, below, concerning IIROC's proposed Financial Planning Rule, which would subject all financial planning activities to close supervision by IIROC dealers, but was issued without prior consultation with all major groups representing professional financial planners.

Another example of inadequate recognition of financial advisors as stakeholders is found in the development of the Client Relationship Model. The first time financial advisors were given an opportunity to comment on the proposed conduct rules came in August 2007, three years after the SROs began working on the current version of the Client Relationship Model under the auspices of the CSA Registration Reform Project.

We believe it is essential for independent financial advisors to be at the table at an early stage in the regulatory process, when securities regulators and self-regulatory organizations are developing initiatives and policies that will have a direct impact on financial advisors and their ability to serve their clients. That is frequently not the case.

We commend both FSCO and the CCIR for continuing their tradition of consulting with stakeholders at the early stages of policy development. We believe that this is extremely important, since it is in the early stages of developing new policy directions where stakeholder input is the most valuable. It is our hope that other Canadian regulators will follow the example set by insurance regulators as a model for undertaking meaningful public consultations with consumers, financial advisors and other market participants.

RECOMMENDATION 4: The Ministry of Finance should develop policies and procedures for regulators (including SROs) to ensure that all stakeholders that are being directly impacted by regulatory proposals be consulted early on in the policy development process.

Burden of Justifying Regulation

We believe that regulators should be required to justify the imposition of prescriptive regulations that add to the cost of providing, and of obtaining, professional financial advice. Ever-increasing regulatory burden is putting professional financial advice beyond the reach of many Ontarians. If regulation cannot be shown to be necessary and cost-effective in achieving its purposes, it should not be imposed. It has long been accepted that government agencies and subordinate regulators *should* consider the impact of regulation and the expected costs in relation to the expected benefits.

All too often, regulators and proponents of specific regulatory initiatives take a perfunctory, boilerplate approach to justifying regulation. If the proponent has the formal authority to introduce a requirement that they consider to be worthy, then the requirements to identify a problem, to consider impact, and to weigh benefit against cost, seem often to become empty formalities that can be addressed by boilerplate phrases.

Rules and regulations should only be imposed where they are necessary to address clearly identified problems, and are likely to achieve the intended result in a cost-effective manner. Regulation should be developed following detailed consultation with all relevant industry and individual participants in the capital markets at early stages. Whenever rules and regulations are proposed, they should be supported by credible cost-benefit analysis and consideration of less burdensome alternatives. All too often, in our view, prescriptive regulation has been proposed and implemented, without serious consideration of costs and benefits and without consulting all relevant key stakeholders, including consumers.

RECOMMENDATION 5: The Ministry of Finance should impose requirements on regulators to ensure that before implementing any new major regulatory requirement that:

- **Regulators develop a clearly articulated statement of the problem that the regulation is trying to address backed by research demonstrating its severity**
- **A robust cost-benefit analysis is prepared with documented methodologies, which examines the benefits of clearly enhancing consumer protection in light of a serious problem, and the costs to market participants of increased compliance burden, as well as potential costs to consumers.**

Conclusion

Government should offer ongoing direction to regulators to ensure that Ontarians have access to professional financial advice and choice in financial services. Accordingly **we urge the Ministry of Finance to offer direction to the Ontario Securities Commission, and through the OSC to the MFDA and IIROC, with the primary goals of:**

- preserving consumer choice and access to professional financial advisors and to a range of choices in the financial services marketplace;
- ensuring that financial regulation is even-handed and does not favour large players and their economic model over small, entrepreneurial financial advisors;
- ensuring that independent financial advisors are consulted as key stakeholders in respect of proposed regulatory initiatives that affect them;
- ensuring that new rules and compliance burdens are only imposed when necessary to address problems, and only after less costly principles-based approaches have been considered; and
- encouraging regulators to obtain objective cost-benefit analysis of regulatory proposals and to consider less prescriptive principles-based approaches to regulation.

Advocis would welcome the opportunity to work with the Ministry of Finance to provide further input regarding our recommendations.

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Appendix 1

IIROC's Proposed Financial Planning Rule

Advocis has criticized proposals by the Investment Industry Regulatory Organization of Canada (IIROC*) to regulate financial planning activities of all dealer personnel, whether employees or agents, as ill-conceived and needlessly intrusive on financial planning activities that are unrelated to the dealer's business. [*IIROC is the main securities industry self-regulatory organization, and is subject to regulatory oversight by the Ontario Securities Commission. It was created in June 2008 by the merger of the Investment Dealers Association of Canada and Market Regulation Services Inc.]

The proposed rules were issued for comment in the summer with a very short response turnaround timeline and without prior consultation with financial advisors.

The proposed rule would permit investment dealers to supervise and apply detailed rules to financial planning activities of advisors that do not actually involve the purchase or sale of investment products through the dealer.

IIROC Dealer Members will be required to develop written policies for supervision of financial planners, and to approve for use any software that will be used in providing financial planning services to clients. Dealers also will be required to develop forms and standards for documenting all stages of the financial planning process.

Advocis is concerned that the proposals will undermine the independence of the financial planner and could bias the content of financial planning advice. Since IIROC dealer members will be responsible for supervising financial planning activities, it is not unreasonable to assume that the dealers will have considerable influence over the financial planning activities and the choices of financial products that financial planners recommend to clients.

In our view, there is no evidence that SROs and securities dealers, which focus their regulation and regulatory compliance on securities transactions, can supervise a complex, multidisciplinary financial planning process in a way that serves the interests of clients.

While Advocis supports minimum proficiency standards for individuals who hold themselves out as financial planners through attainment of professional designations, this proposed regulation is ill-conceived on many fronts:

a. It introduces detailed rules and will give investment dealers control over all aspects of advisors' financial planning activities with their clients to the detriment of consumers.
b. There is no evidence of any consumer harm under the current system, which is already heavily regulated.
c. It encroaches on activities in many other areas that are outside the scope of the investment regulator, such as insurance planning.
d. It tilts the playing field in favour of large financial institutions that have employees, as it forces an unfair compliance regime on independently-contracted advisors.
e. It creates a major conflict of interest since it prevents objective financial advice and compromises client-advisor confidentiality, since dealer firms will exercise control over the financial planning process to the detriment of consumers.
f. It reduces consumer access and choice of professional advice as it will drive out independent planners as these regulations will become unbearable for many.

Advocis is asking regulators to slow down the rulemaking and implementation process and initiate a more broad-based policy development process so that we can participate in constructive dialogue on more appropriate approaches to regulation. If this rule is finalized as drafted, consumers will be seriously disadvantaged.