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Expert Committee to
Consider Financial Advisory and
Financial Planning Policy Alternatives

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Re: Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives

Dear Sirs/Madam,

We are writing in response to the preliminary report Ontario Ministry of Finance's Expert Committee on Financial Advisory and Financial Planning Policy Alternatives (the "Expert Committee") which was released on April 5, 2016 ("the report). The report sets out the Expert Committee's initial policy recommendations on how to best reform Ontario's retail financial services sector.

PART ONE: EXECUTIVE SUMMARY AND CONTEXTUALIZING THE WORK OF THE EXPERT COMMITTEE

Advocis' Position on The Ontario Expert Committee's Preliminary Report

Reform must be rooted in the consumer realities of advisory and planning practice

The daily reality for consumers and advisors is that financial planning is a component of financial advice. The specific activities of financial planning are unavoidably and inextricably a part of the larger practice of providing financial advice. Realistically, this means that any regulatory reform in Ontario's financial advice sector will fail to reach all of Ontario's financial consumers unless this practice-based reality is formally reflected in the regulatory structures which oversee Ontario's retail financial services sector.

Effective consumer protection means ending "regulation without representation" of Ontario's advisors

Financial advisors are currently "regulated without representation" in Ontario: they lack formal and effective standing in the industry SROs, including the MFDA and IIROC – and are regulated by entities which do not consider the advisor-client relationship as meriting the same level of regulatory scrutiny and support that is applied to the lawyer-client relationship or the social worker-client one. Advocis believes that advisors need to be held to higher standards and that a form of advisor self-governance is the best way to achieve that end. This is why Advocis has repeatedly called for the Ontario government to introduce some form of professional governance model for financial advisors, and continues to advocate for the introduction of a Delegated Administrative Authority (DAA)[1] for Ontario's advisors.

Advocis' Position on Appendix A – Definitions: Terminology used in the Expert Committee's Report

Advocis recommends defining the terms "financial advice," "financial advisor" and "financial planner" to reflect the realities of the practitioner and the needs of the consumer. Advocis believes that its definitions reflect the actual regulatory and practice-based realities which inform how financial advisors work with their clients, and should therefore set the baseline for any effective reform of consumer-facing intermediaries in the province's retail financial services sector.

Advocis' Position on Recommendation 1: Regulation of Financial Planning

Advocis recommends the introduction of a DAA with a mandatory membership requirement, in order to immediately introduce unified oversight of *all* retail client-facing advisors, including financial planners. In contrast, the Expert Committee's preliminary set of recommendations would continue to leave advisor oversight under the auspices of organizations such as the MFDA, IIROC, FSCO and the OSC, thus maintaining much of the current *status quo*.

Advocis' Position on Recommendation 2: Harmonization

Advocis recommends the establishment of a mandatory minimum baseline of skills, education and other competencies which all financial advisors, including financial planners, would be obligated to meet. Again, we believe the best way attain what the Expert Committee describes as a "harmonized" and "universal" requirement for advisor skill and competency is through the introduction of a pan-sectoral (i.e., insurance, securities, mutual funds, etc.) framework which captures all of Ontario's advisors in a single professional body, instead of continuing to leave responsibility for their oversight dispersed across various regulatory, self-regulatory and industry bodies, such as the OSC, FSCO, IIROC, the MFDA, and the CLHIA.

Advocis' Position on Recommendations 3 and 4: A Statutory Best Interest Duty and Exceptions to it.

Advocis recommends another way forward for a best interest duty – one that accords better with the best interest obligations currently applied by IIROC and the MFDA – by embedding it within a code of professional conduct that is administered by an industry-wide DAA. A significant feature – indeed, perhaps *the* defining feature – of the "fiduciary concept" is its moral ambition, which lies in the

[1] See our submission to this Expert Committee of September 21, 2015. Online at http://www.advocis.ca/regulatory-affairs/RA-submissions/2015/Advocis-Submission-Expert-Committee-Sep15-with-Appendix.pdf.

expectation of the client of true good faith on the part of the intermediary. In this light, the ultimate focus of the fiduciary duty is trained on the fiduciary's motives and actions in fulfilling the client's instructions and advancing his overall financial interests, and not merely on the state of the client's accounts at any given point in time. Embedding a best interest obligation in the code of conduct of a DAA will make for a more robustly interpreted and applied obligation in Ontario's financial services sector – which is of course an outcome very much in any client's best interest.

Advocis' Position on Recommendation 5: Referral Arrangements and Disclosure of Referral Fees

Advocis believes that this recommendation should be abandoned unless or until the Expert Committee is able to adduce some empirical evidence of consumer harm which demonstrates the need to go beyond the existing rules and guidance of IIROC, the MFDA, the OSC, FSCO, and the CLHIA.

Advocis' Position on Recommendation 6: Titles and Holding Out

As noted above, Advocis recommends that the terms "financial advisor" and "financial planner" be defined in law, and that a number of today's leading designations be granted proficiency recognition by a DAA. The basic principle should be that an advisor cannot hold him- or herself out to the public in a manner that deceives or misleads – or could reasonably be expected to deceive or mislead – a client or prospective client with regard to the advisor's proficiency, qualifications, and product or service offering.

Advocis' Position on Recommendation 7: A Central Registry

Advocis supports Recommendation 7 and believes that Ontarians deserve a one-stop, industry-wide mechanism for verifying a financial advisor's registration status, licensing, professional and educational qualifications and credentials, and relevant disciplinary history information.

Advocis' Position on Recommendation 8: Financial Literacy and Investor Education

Advocis supports the Expert Committee's general position on financial literacy and recommends the development of a program which measures the progress of the numerous financial literacy efforts underway in Ontario, and, indeed, across Canada. Publication of this information could prove to be of tremendous benefit to Ontario's financial consumers. Regulators should also introduce "nudge"-style regulatory forms and reports for clients which emphasize the need for consultation with a professional advisor, as is now done with certain CSA exempt market forms.

Advocis' Position on The Expert Committee's Concerns on Consumer Complaints and Redress

As we submitted on September 21, 2015, Advocis recommends the creation of a DAA which would assume the oversight currently residing with the MFDA, IIROC and FSCO in relation to the conduct and competency of advisors.

What is the relationship of current regulatory initiatives to this Ontario Expert Committee?

The financial services sector needs more clarity from the Expert Committee with regard to the various proposals currently under way by the OSC, CSA, the MFDA, IIROC and the Expert Committee presently reviewing the mandates of FSCO, DICO and the FST. To better promote the public interest and facilitate an orderly review of options for the oversight and regulation of financial advisors, it would be extremely helpful if the Expert Committee could liaise with the Ontario government and Ontario's regulators and SROs to provide stakeholders with a better understanding of the Ontario government's expectations regarding these parallel, competing, and – at times – conflicting consultative reviews and reform projects.

Stakeholders need a post-implementation analysis of Fund Facts and CRM2 before further reform occurs

We believe the most efficient course of action for any reform effort must include determining the impact of the new Fund Facts delivery rules, which came into force on May 30, 2016, as well as the effects of the two new annual reports required under the CRM2, which come into force on July 15, 2016. Once these projects have been fully implemented in the marketplace, regulators can begin to analyze the behavioural changes which occurred in the conduct of firms, advisors, and consumers, at which point they will be properly positioned to determine what forms of further regulatory action are appropriate.

A number of major reform projects are already underway

There are a number of important reviews already underway which relate directly to the work of this Expert Committee. First, the industry is still waiting for a decision on the process begun with CSA Consultation Paper 81-407 *Mutual Fund Fees,* and then followed up with research commissioned by the CSA and OSC. Second, last September the MFDA released Bulletin #0656-P*, A Consultation Paper on Standards for Use of the Title "Financial Planner."* Third, the CSA has now released Consultation Paper 33-404 – *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives toward Their Clients.* This paper sets out an ambitious and comprehensive 10-point program of reform:

1. obligation to prioritize conflicts of interest for firms and advisors;
2. enhanced Know-Your-Client requirements for registrants ;
3. enhanced Know-Your-Product requirements for advisors;
4. enhanced Know-Your-Product requirements for firms;
5. additional suitability requirements;
6. enhanced relationship disclosure information;
7. additional proficiency requirements for advisors;
8. restrictions on the use of titles and designations;
9. enhancement of the roles of the Ultimate Designated Person and Chief Compliance Officer; and
10. creation of a statutory fiduciary duty.

Given the scope of this consultation paper alone, it should be clear that there is a dramatic need for improved communication to stakeholders – and for a higher degree of co-ordination among governmental and regulatory bodies – with regard to the full slate of these potentially far-reaching reform consultations and proposals presently under way in Ontario. A better understanding for all parties of the present consultative and review context would make for a more effective use of the resources of Ontario's regulators and industry constituents, and may even help to minimize unnecessary disruptions to the retail financial services sector – all of which would be in the best interests of the Ontario public.

PART TWO: THE EXPERT COMMITTEE'S EIGHT PRELIMINARY POLICY RECOMMENDATIONS

The Expert Committee has put forward eight preliminary policy recommendations for reform; understanding them first requires an understanding of the "key terms" formulated by the Committee. We first consider the eight recommendations as an ensemble or totality; we then proceed to review them on an individual basis on more detail.

Advocis' Position on Recommendations 1 to 8 when viewed as a integrated reform proposal.

Advocis believes that any future regulatory reform of financial advisors, including those who hold advanced planning designations, must be based on the indisputable reality that financial advisors play a critically important role for millions of Ontarians and their families. Through the provision of financial planning and investment advice, retirement and estate planning, disability coverage, long-term care and critical illness insurance, advisors help the public prepare for life's events and to secure their financial futures. This role is increasingly more important in an economic climate in which governments, facing their own fiscal constraints, expect Canadians to become increasingly self-reliant.

Given this critical role, Ontarians should be able to trust that their financial advisors are proficient in core advice competencies, up-to-date in their knowledge, and compliant with the highest standards of conduct and ethics. While the majority of advisors meet these expectations, there are inevitably some who do not meet these standards, and due to persistent gaps in Ontario's current regulatory framework, consumers are unnecessarily exposed to risk.

But before any truly effective and comprehensive reform can be undertaken, it must be acknowledged that the daily reality for consumers and advisors is that financial planning is a component of financial advice. The regulatory reality and the practical realities are the same: financial planning is unavoidably and inextricably a part of the larger practice of providing financial advice. Realistically, this means that any regulatory reform in Ontario's financial advice sector will fail to reach all of Ontario's financial consumers unless this foundational reality is formally recognized at the outset of any reform effort.

Advocis believes that advisors need to be held to higher standards and that a form of self-governance is the best way to achieve that end. This is why Advocis has repeatedly called for the Ontario government to introduce some form of professional governance model for financial advisors, and continues to advocate for the introduction of a Delegated Administrative Authority (DAA) for Ontario's advisors.

It is time to end "regulation without representation"

Financial advisors are currently "regulated without representation." While the Expert Committee's approach would maintain advisor oversight in the hands of the MFDA, IIROC, FSCO and so on, so that advisors would continue be regulated by entities that do not consider the advisor-client relationship as merit-worthy of the same level of regulatory scrutiny as is applied to the lawyer-client relationship or the social worker-client one. Indeed, these organizations often do not fully understand what they do. Finally, advisors lack true standing and "voice" in these organizations. For example, neither the MFDA nor IIROC mandate the presence of advisors on their boards of directors.

A DAA would eliminate this massive regulatory hole in Ontario's framework of financial services oversight. Indeed, sooner or later, Ontario will have to do so in the interests of consumers, particularly in furtherance of their increasing need for quality professional advice that can help ensure better investing and retirement outcomes. To better protect the public interest, then, we believe the government should establish a DAA with its board of directors composed of financial advisors and members of the public, among other persons. These two sources of input would be essential to the DAA's ability to set and implement appropriate baseline minimum standards for *all* persons providing retail advice and planning. To recognize those advisors who have obtained additional education, we suggest they be recognized as being specialists in their area of expertise. This would be analogous to what the Law Society of Upper Canada offers: all its members must satisfy baseline standards, but through its Certified Specialist program, it also recognizes those practitioners who are experts in, *inter alia*, criminal law, family law or real estate law.

The Expert Committee owes it to Ontarians to consider *real* consumer protection reform

The Expert Committee noted that "multiple parties emphasized the need to leverage the existing regulatory framework and avoid regulatory duplication that could prove costly for businesses and, ultimately, consumers" and stated that it was "mindful of . . . consideration for regulatory efficiency."[2] It then rejected the idea of a new regulator to oversee individuals and firms not captured by current regulation with this justification:

> In our deliberations, we considered the possibility of recommending a new regulatory body to

[2] Ontario Expert Committee, *Financial Advisory and Financial Planning Policy Alternatives: Preliminary Policy Recommendations of the Expert Committee*, April 5, 2016, p. 5.

> undertake the regulation of Financial Planning by individuals or firms not otherwise regulated. *We believe that the number of individuals and firms that provide Financial Planning services on a stand-alone basis would be too small to warrant the costs associated with a new regulatory body*.[3] (Emphasis added).

This justificatory reasoning of the Expert Committee cannot be applied to the DAA model proposed by Advocis, which is intended to catch *all* financial advisors, and not just those individuals currently not regulated by the OSC, FSCO, or one of the SROs, etc. Indeed, adoption of this reasoning *totally precludes* the Expert Committee from recommending any form of serious and far-reaching reform. This is odd, since the Expert Committee was explicitly tasked with reforming the regulation of financial advisors and planners in Ontario. By virtue of this statement, the Committee is all but bowing out of the most significant part of their task. Obviously it is prudent for the Expert Committee to work within the existing regulatory framework as much as possible and to avoid the addition of further layers of regulation. But the bottom line is that the existing structure does not work for consumers or advisors, and Advocis has a solution which will ensure not additional regulation but smarter, more focused oversight.

The only way to improve consumer protection and properly regulate the advisor-client relationship in a "universal" and "uniform" manner is for the Ontario Ministry of Finance to divest existing regulators of their licensing and conduct oversight of advisors and implement a DAA. The DAA model is endorsed in the *Drummond Report* (2014) as an effective and efficient way to streamline regulation. In fact, the Auditor General of Ontario, in her *Annual Report 2014*, recommended that FSCO should delegate certain administrative and regulatory tasks to a professional organization exclusively for financial advisors:

> If responsibility for oversight of regulated financial sectors were to fall to associations that oversaw industries, FSCO could assume the role of overseeing those associations rather than overseeing individual companies. This would require that FSCO recommend changes to the legislation that governs these professions, but it would allow FSCO to focus its resources on more serious and strategic matters pertaining to the regulated industries...
>
> To ensure that regulatory processes exist commensurate with the size and maturity of the industries... FSCO should explore opportunities to transfer more responsibility for protecting the public interest and enhancing public confidence to new or established self-governing industry associations, with oversight by FSCO. Areas that could be transferred include licensing and registration, qualifications and continuing education, complaint handling and disciplinary

[3] *Ibid.*, p 5.

> activities. In addition, associations could be responsible for establishing industry-sponsored consumer protection funds to provide more confidence in their services by the public.[4]

She further observed that the delegation of regulatory oversight has been used by a number of the "more recognizable" service industries in Ontario, including "Accountants and auditors... Insurance brokers... Investment dealers... Lawyers and paralegals... Mutual fund dealers... Real estate and business brokers." as "examples of self-regulating professional organizations in Ontario."[5]

The inclusion of investment dealers, mutual fund dealers, and insurance brokers is noteworthy. Surely advisors, with their own client service concerns, which are different from those of brokers and dealers, sometimes uniquely so, also deserve their own "self-regulating professional organization." Such an organization should be a DAA for consumer-facing, individual financial service practitioners, such as life agents. It would operate mainly by way of a principles-based approach, although the registration of individual financial advisors would be a rules-based matter for the DAA to conduct and enforce.
A DAA for financial advisors will provide title and scope protection for those persons who meet the requirements. Only these individuals will be able to hold out to the public as financial advisors. It would also require that anyone who meets the definitions and standards must be a member of the DAA. Of course, great care must be taken to ensure that any proposed solution which is put forward by any given stakeholder is not a self-serving proposition which would result in that stakeholder achieving a legally recognized form of regulatory capture; rather, it must have the interest of the industry and consumers as the foundational principle, and must clearly and fairly critique the existing landscape.

We now turn to an evaluation of the Committee's eight recommendations on an individual basis. Several of the recommendations are inextricably linked with one another; these we consider in this sequence, below:

Recommendation 1: Regulation of Financial Planning in Ontario
Recommendation 2: Harmonization
Recommendation 6: Titles and Holding Out
Appendix A – Definitions

[4] Auditor General of Ontario, *2014 Annual Report of the Office of the Auditor General of Ontario*, pp. 152-153.

[5] *Ibid*., p. 152. With regard to the use of a DAA model, it should be noted that the Ontario government has recently elected to delegate the administrative authority existing under the Safety and Consumer Statutes Administrative Act, 1996 to a new DAA, which will be the driver for the province's modernization of how the funeral, transfer service, cemetery and crematorium sectors are regulated. As the government notes, "it is more effective to have a single regulator for the entire sector which will create a one-window approach for both licensees and consumers." In 2016, then, a DAA known as the Bereavement Authority of Ontario will become the single regulator for the bereavement sector, handling licensing and enforcement services.

Appendix A – Definitions: Terminology used in the Expert Committee's report

In the appendix to its report, the Expert Committee sets out the definitions of a number of key terms, including "Financial Product Sales and Advice" and "Financial Planning."[6] (When using the Expert Committee's key terms, this submission will follow the Committee's usage and capitalize them). These definitions are of critical importance, for they establish the perspective through which the Expert Committee views Ontario's regulatory landscape.

The Expert Committee defines "Financial Planning" in exceptionally broad terms, conceptualizing it as "any review and analysis of a person's current financial and personal circumstances, present and future financial needs, priorities and objectives… which can but need not include the establishment of strategies to address and mitigate these matters whether or not a formal financial plan is needed". This definition captures the majority of the work that financial advisors do on a day-to-day basis, and largely parallels how Advocis defines "financial advice" in our Professions Model and Bill 157, *The Financial Advisors Act*.[7]

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[6] For ease of reference, the Expert Committee's key terms and their definitions are reproduced here:

> *Financial Planning* – any review and analysis of a person's: current financial and personal circumstances, present and future financial needs, priorities and objectives, the risks associated with his or her current circumstances, future needs, objectives and priorities which can but need not include the establishment of strategies to address and mitigate these matters whether or not a formal financial plan is prepared.
>
> *Financial Product* – includes a "security" as defined in the Securities Act (Ontario); a contract of insurance, as defined in the Insurance Act (Ontario); and any investment in a mortgage or any mortgage type product, including syndicated mortgages.
>
> *Financial Product Sales and Advice* – an interaction or process involving a consumer and a person or company wherein the person or company, engaging in the business of providing advice, provides an opinion, suggestion, or recommendation to the consumer regarding a decision or course of conduct relating to the consumer's financial affairs, including an opinion, suggestion, or recommendation to buy or sell or hold a Financial Product or provide general financial management or investment advice.
>
> *Conflict* – a situation which has the potential to undermine a person or firm's impartiality including the possibility that an individual or firm places his, her or its own interest above the client's.
>
> *Holding Out* – to represent or give the impression to the general public or a particular person of being qualified or entitled to engage in Financial Product Sales and Advice or Financial Planning, whether explicitly or implicitly by title or action.
>
> *Regulators* – regulatory agencies that have authority by legislation or by a recognition order to regulate Financial Product Sales and Advice and Financial Planning in the province of Ontario.

[7] In Advocis' earlier submission to the Expert Committee of September 21, 2015, we offered the following definitions, which derive from existing regulatory requirements established by FSCO, the MFDA, IIROC, and the OSC:

The report defines "Financial Product Sales and Advice" to be an interaction where, by providing advice, a recommendation is made to a consumer regarding some financial course of action, one that can include a transaction for a Financial Product. According to the analysis of the Expert Committee, Financial Product Sales and Advice is a discrete, transaction-focused event, whereas Financial Planning is something more comprehensive or holistic undertaking. The Expert Committee recommends that the title of "Financial Planner" should be protected in law, and the education, training, credentialing and licensing of individuals involved in Financial Planning should be subjected to one universal set of regulatory standards. Finally, "Financial Product" is defined to include securities, insurance products and mortgages, so the recommendations of the Expert Committee are applicable across the traditional product-based "silos" upon which regulation has traditionally been based.

In its previous submission to the Expert Committee, Advocis began its exposition of a DAA model of retail financial regulation by defining the terms “financial advice,” “financial advisor” and “financial planning.”

> “financial advice” means the process of engaging in the business of advising others with respect to the planning and/or the execution of advice in respect of selecting, purchasing, or selling financial products to meet investment, risk management, or risk mitigation objectives.
>
> “financial advisor” means any person who engages in the business of providing financial advice to others, including the collection and analysis of information about a person or business:
>
> a. to identify needs and risks;
> b. to establish financial objectives;
> c. to establish strategies to address identified needs and risks, and achieve the established financial objectives; and
> d. to continuously monitor the needs and risks and the progress toward achieving the established financial objectives which would include any one or a combination of the following:
>
> 1. cash flow management;
> 2. capital needs assessment;
> 3. education planning;
> 4. retirement planning;
> 5. investment planning;
> 6. taxation and estate planning;
> 7. insurance planning;
> 8. business succession planning; or
> 9. employee benefits planning.
>
> “financial planner” means a financial advisor holding a recognized specialist designation, including:
>
> a. Certified Financial Planner® (CFP®), sponsored by the Financial Planning Standards Council;
> b. Personal Financial Planner (PFP®), sponsored by the Canadian Securities Institute;
> c. Certificate in Financial Planning (Planificateur financier [Pl. fin.] designation), sponsored by Institut québécois de planification financière (IQPF);
> d. Chartered Financial Consultant (CH.F.C.®), sponsored by Advocis, the Financial Advisors Association of Canada;
> e. Chartered Life Underwriter® (CLU®), sponsored by Advocis, the Financial Advisors Association of Canada; and the
> f. Registered Financial Planner® (R.F.P.®), sponsored by the Institute of Advanced Financial Planners.

Our definitions reflect the realities faced by advisors and clients in Ontario, as well as the multiplicity of needs and requirements presented to them by their retail clients.

Not surprisingly, Advocis disagrees with the way that the terms "Financial Planner" and "Financial Planning" have been used throughout the Expert Committee's report in place of "Financial Advisor" and "Financial Advice", respectively. We believe that all financial advisors are involved in financial planning, and that advanced financial planning is a specialization within the field of general financial advice. Therefore, the language used going forward should reflect this reality in order to avoid consumer confusion regarding professional titles and duties. The immediate question is to ask how well these definitions fit with the actual practices they are meant to describe. As we will argue below, the answer, unfortunately, is not very well.

From the consumer perspective, *all* of Ontario's financial advisors engage in some form of financial planning.

Advocis' view is that the necessary beginning point for the Expert Committee – or any other reforming body – be the establishment, preferably by industry consensus, of workable and practicable definitions which reflect the actual work which financial advisors and planner undertake on behalf of their clients. And financial planning is unavoidably and inextricably a part of the larger practice of providing financial advice. This is clear upon even a cursory review of the requirements stipulated in the rules, policies, bulletins and notices of the MFDA, IIROC, OSC and FSCO. We do not assert that all financial advisors are engaged in financial planning at the same high standards as those who have attained specialized designations. But the proposed definition does delineate the basic parameters regarding the minimum actions that a financial advisor must perform and the minimum standards to which he or she must adhere. The definition also affirms that an advisor, whether or not he or she also has a financial planning designation, must meet the *de minimus* standards of the Know Your Client ("KYC") and Know Your Product ("KYP") rules, as well as the various prescribed suitability requirements, all of which are key components of financial planning.

It is crucial to understand that, from the perspective of the consumer, all of the province's financial advisors conduct financial planning, as required under the regulations of the OSC, FSCO, MFDA and IIROC. Within the broad pool of financial advisors, there exist industry-developed designations which enable a financial advisor to further specialize in the more detailed aspects of the various dimensions of advice giving, such as taxation, estate planning, and health insurance, for example.

The reality of Ontario's financial advice sector is reflected in Figure 1. In Ontario, all financial advisors (the largest of the Venn circles) must possess the basic skill level to engaging in client-appropriate financial planning. Within the total advisor population, we see the ongoing development of more stringent specializations with respect to certain sub-fields of the advice process. These sub-groupings reflect specializations which go beyond the benchmark of skills which the average financial advisor would be required to meet. These specializations are useful to many consumers – and at times are necessary for those clients who present to their advisors with more complex advice and planning goals and objectives.

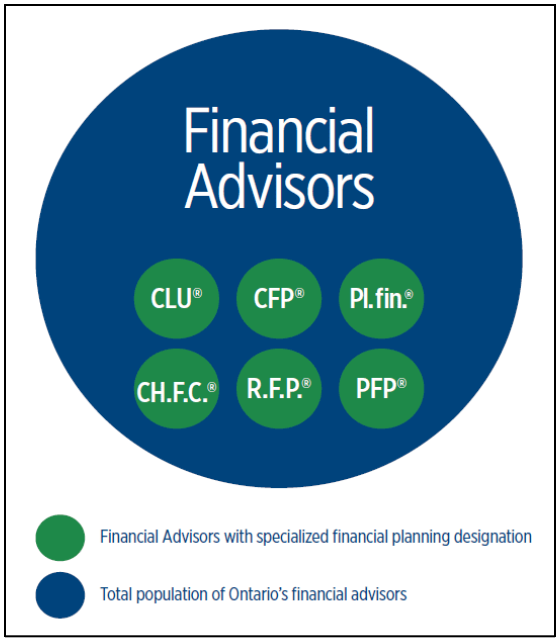

Figure 1. A depiction of the interrelationship between the total population of Ontario's financial advisors and prominent specialist subgroups. For example, advisors who are CLU®, CH.F.C.® or CFP® designation holders are members of specialized groups within the larger population of financial advisors. Overall, the field of financial advice in Ontario is populated with a range of designations, including a number of popular, long-standing financial planning designations.

So, within the family of financial advisors there is the presence and opportunity of smaller subgroups of specialists who wish to operate in advanced areas of planning. Such specialization is common in established professions; indeed, it is analogous to the medical profession, where all doctors must meet a minimum standard to be called a medical doctor or MD. But within the field of MDs we have smaller groups of MDs who have specialized. Every member of the profession is a doctor, but only those who have completed additional training and course work are allowed to use designations which identify their specialization, such as cardiologist and oncologist. To further the analogy, consider a proposal to regulate only the subgroup of advanced specialists, as opposed to the entire group of medical doctors. Such an option would be a wholly inadequate policy response: the risk to consumers would be overwhelming if anyone could hold out as a doctor and operate largely or completely unregulated. Similarly, to regulate only financial advisors who have completed a specialized designation program would be a wholly inadequate policy response, as this too would expose consumers to risk. Yet this is what could result from the adoption of the Expert Committee's proposed definitions.

Advocis' Position on Appendix A – Definitions of key terms

Advocis recommends defining financial advice, financial advisor and financial planner to reflect the realities of the practitioner and the needs of the consumer. Advocis believes that its definitions reflect the actual regulatory and practice-based realities which inform how financial advisors work with their clients, and should therefore set the baseline for any effective reform of consumer-facing intermediaries in the retail financial services sector.

Recommendation 1: Regulation of Financial Planning in Ontario

The Expert Committee recommends that "Financial Planning" in Ontario be regulated as follows:

(a) individuals who or firms that provide Financial Planning services either expressly or implicitly, through Holding Out by way of titles, described services or otherwise, must be regulated;
(b) individuals who and firms that provide Financial Planning and whose Financial Product Sales and Advice activities are regulated by the existing regulatory framework for securities, insurance and mortgage brokering should have any associated Financial Planning activities regulated by their existing regulator or regulators for those who have more than one licence; and
(c) individuals or firms performing Financial Planning activities outside the current regulatory framework should have their Financial Planning activities regulated by the proposed Financial Services Regulatory Authority (FSRA).[8]

The Expert Committee recommends that Financial Planning should be a regulated activity in Ontario, with both individuals and firms being regulated. To accomplish this, the Committee recommends that the title of "Financial Planner" should be protected in law, and the education, training, credentialing and licensing of individuals involved in Financial Planning should be subjected to one universal set of regulatory standards. It also recommends that any other titles or designations should be drawn from a prescribed list compiled by the regulatory authority.

The Expert Committee states that:

> We believe that the better approach is to recommend regulation of Financial Planning as a discreet activity within the existing regulatory framework. In our view, an Ontario-based integrated regulator of financial services, such as the proposed FSRA, is well-suited to

[8] Ontario Expert Committee, *supra* note 2, pp. 4 - 5.

> bring stand-alone providers of Financial Planning services into the regulatory fold and work with other Regulators to achieve the harmonization of standards outlined in the ensuing recommendation.[9]

Advocis agrees with the Expert Committee that financial advice and financial planning should be a regulated activity, but strongly disagrees with the fragmented regulatory framework which would result. The result of adopting the Expert Committee's definitions will be the continuation of in large part of Ontario's fragmented regulatory structure. Sub-clause (b), above, virtually guarantees that much of the regulatory *status quo* will continue in Ontario, as those individuals or firms that are currently registered with an existing regulator will remain regulated by those bodies (i.e., an MFDA-approved person would remain with the MFDA, a life licensee would remain with FSCO, and a dual-licensed advisor would remain subject to both). Only those who conduct Financial Planning but are not currently accountable to a regulator (which would essentially be the small number of financial planners who do not sell any products) would be regulated by the new Financial Services Regulatory Authority ("FSRA"). That framework would mean that advisors and planners would continue to have no actual representation at their own regulator, and the involvement of the FSRA would fragment the advisor's voice even more.

Advocis believes that any solution needs to be holistic in nature, with advisors and planners directly involved in their own regulation; this is how it is done in other professions such as law and medicine. We believe that advisors and planners should be regulated by, and have a role in governing, a new DAA; existing regulators would be consequently divested of their responsibility. Absent this change, it seems all but certain that the problems the Expert Committee has been tasked to address will continue.

What will be the impact on the industry if Recommendation 1 is introduced?

If the Ontario government were to decide to establish a profession for only those few thousand CFP®s and CLU®s in Ontario, then the remaining tens of thousands of financial advisors who are not holders of an "approved" planning designation (in this hypothetical case, either a CFP® or a CLU®), would not be permitted to act as financial planners. The result? By law the overwhelming majority of Ontario's advisors would be forbidden from providing their clients with planning services — including the critical financial planning services which they are presently required to perform under the current licensing requirements of the MFDA, IIROC, OSC and FSCO. In fact, continuing to provide clients with those planning services required for the purchase of a life policy or mutual fund would result in these non-designation holders trespassing on the newly circumscribed scope of the new professional activity of financial planning.

Yet this hypothetical policy may in fact be the outcome of the Expert Committees preliminary policy recommendations – in essence, the creation of a "planning" profession for only those individuals who

[9] *Ibid.*, p. 5.

hold a particular designation(s), in spite of the fact that this would exclude from engaging in financial planning tens of thousands of advisors who, in the course of working directly with millions of Ontarians, provide them with financial advice which is inclusive of financial planning. The establishment of a "planning only" regulatory model would also require a legislative paradigm shift, one which would necessitate the wholesale redrafting of thousands of pages of existing laws and regulations, bulletins and guidelines, rules and policy statements, all of which require that all of Ontario's (and indeed those throughout Canada) financial advisors engage in some level of financial planning in the interests of consumer protection. A "planning only" profession will fail to address any of the numerous and pressing concerns related to consumer protection, exacerbate current levels of confusion and complexity experienced by consumers, and add another layer of regulation. Most problematically, a "planning only" policy would in effect remove the critical financial planning components to which today's life agent or mutual fund licensee must adhere, thereby exposing millions of Ontarians to immediate and ongoing risk, and redirecting those consumers who can afford it to engage the services of the favoured designation holder. Yet what the province needs is to simplify and clarify matters for consumers, government agencies, and industry stakeholders alike.

Advocis' Position on Recommendation 1:
Advocis recommends the introduction of a mandatory membership requirement in a DAA, so as to immediately produce unified oversight of retail-facing advisors.

<u>Recommendation 2</u>: <u>Harmonization</u>

With regard to the harmonization of standards, the Expert Committee "recommends that the education, training, credentialing and licensing of individuals engaged in the provision of Financial Planning be harmonized and subject to one universal set of regulatory standards."[10]

Advocis believes that there is an urgent need to ensure a uniformity in the education, training and ethical development of all advisors in Ontario. Accordingly, we agree with the general thesis that all of the province's advisors should be subjected to a single, uniform minimum set of industry knowledge and competency standards and substantive continuing education requirements.

Proficiency standards, professional ethics and continuing education are cornerstones of professionalism. That's why in our earlier submission we proposed undertaking a realistic commitment to inculcating ethical norms in individual advisors and an ethical culture in their firms through an industry-wide, universal code of professional conduct, a mandatory errors and omissions insurance requirement, and a publicly accessible comprehensive registry of Ontario's financial advisors. Under a DAA model, the DAA

[10] *Ibid*., p. 5.

would establish initial proficiency standards for financial advisors, and would administer, monitor and enforce continuing education requirements designed to ensure that all financial advisors maintain a high standard of proficiency. The DAA would be required to actively administer their codes of conduct, so that the public is assured that the DAA's member advisors understand and fulfil the ethical obligations they owe to their clients.

Advocis' Position on Recommendation 2: Harmonization.
A mandatory membership requirement in a DAA would immediately produce unified oversight of retail-facing advisors. Advocis therefore recommends the establishment of a mandatory minimum baseline of skills, education and other competencies which all financial advisors, including financial planners, would be obliged to meet. Again, we believe the best way attain what the Expert Committee describes as a "harmonized" and "universal" requirement is through the introduction of a global, pan-sectoral framework which captures all of Ontario's financial advisors into a single professional body, instead of continuing to leave them dispersed across various regulatory, self-regulatory and trade bodies, such as the OSC, FSCO, IIROC, the MFDA, the CLHIA, and so on. The FSRA (or other regulators) could introduce or amend licensing and registration requirements with comparative speed. Mandatory membership in a DAA for all of the province's financial advisors would make it easy for Ontario to ensure that individuals who hold themselves out as financial advisors are licensed. Licensing is currently split between three regulators: FSCO, the MFDA and IIROC. Ensuring that licensing is handled by a single entity would yield immediate efficiencies, including in the creation of the central registry envisioned in Recommendation 7. Thus, under the proposed DAA, the consumer's assurance that his or her advisor has met or exceeded the initial proficiency standards would derive from the fact that every person in Ontario who is licensed or registered to sell financial products has met the initial requirements for membership in the DAA. The DAA would be able to develop categories and subcategories for membership, as conceptualized in Figure 1, which would recognize the areas of specialization reflected, for example, in designations such as the CFP® and the CLU®.

<u>Recommendation 6</u>: <u>Titles and Holding Out</u>

The Expert Committee recommends that "the use of titles by individuals and firms engaged in the provision of Financial Product Sales and Advice and/or Financial Planning be prescribed in order to reduce consumer confusion." As examples of the confusing proliferation of titles consumers currently face, the Committee references the use of "financial advisor", "wealth advisor", "retirement planner", and "wealth coach." To realize this goal, the Committee recommends that:

- a circumscribed list of approved titles that are descriptive of the regulated activities be created. These would be the only titles permitted to be used by individuals and firms in their Financial Product Sales and Advice and/or Financial Planning activities;
- restricted use of the title "Financial Planner";
- only those designations, qualifications, and credentials approved by the regulators (as well as professional and academic qualifications, and those) be permitted to be used; and
- persons engaged in providing Financial Product Sales and Advice and/or Financial Planning be prohibited from using corporate positions or titles.[11]

It is of crucial importance that the reform not be *only* about the use and misuse of job titles. Such reform would be merely cosmetic, and of little lasting value to Ontarians. Rather, reform in this area must encompass both the title and the scope and function of the work. Advocis agrees that protections must be put in place to ensure that Ontario's consumers know that they are dealing with proficient professionals who are appropriately registered and regulated. Indeed, virtually all stakeholders are in agreement that the multiplicity of titles presently used by individuals employed in Ontario's financial services industry is a chief source of consumer confusion. At present in Ontario, anyone may hold out as a financial advisor without obtaining any education or taking an examination. This absence of examination and qualification standards causes problems for both financial advisors and Ontario consumers.

What titles, and who may hold out?

The basic principle should be that an advisor cannot hold him- or herself out to the public in a manner that deceives or misleads – or could reasonably be expected to deceive or mislead – a client or prospective client with regard to the advisor's proficiency, qualifications, and product or service offering. Care should be taken to not prohibit those titles, designations and other credentials which clearly indicate to the public that the advisor has specialized knowledge or expertise in an area gained through education and/or experience.

The role of the DAA

With regard to advisor designations, the DAA would identify those designations that meet the defined expectations of those holding out as having completed an advanced designation program in relation of financial planning, such as a CLU® or CFP®. Advocis has of course long been committed to the provision of high-quality designations for financial advisors which will ensure that consumers are working with a person who has met sufficiently advanced proficiency standards.

Individuals who elect to hold themselves out as competent practitioners in areas of professional specialization, such as financial planning, would be required to maintain in good standing the necessary

[11] *Ibid*., p. 8.

recognized designations. The designation programs would be provided by organizations which the DAA has vetted and determined that their designation program meets the province's standards for specialization. This mandatory review would help address the problem associated with the alphabet soup of accreditations, certificates and designations that currently exist and are misleading to the public. It would also allow for those legitimate designation programs which currently exist to continue to provide the specialized education products which advisors and their clients want.

A DAA which established a "certified specialist" program would satisfy both the government's objective of protecting all Ontarians who receive financial advice with baseline standards, while providing the motivation for advisors to continue their education and achieve a specialization as a key competitive advantage when holding out in the marketplace.

Advocis' Position on Recommendation 6: Holding Out

Advocis recommends that the terms "financial advisor" and "financial planner" be defined in law, as follows:

"financial advisor" means any person who engages in the business of providing financial advice to others, including the collection and analysis of information about a person or business:

a. to identify needs and risks;
b. to establish financial objectives;
c. to establish strategies to address identified needs and risks, and achieve the established financial objectives; and
d. to continuously monitor the needs and risks and the progress toward achieving the established financial objectives which would include any one or a combination of the following:

1. cash flow management;
2. capital needs assessment;
3. education planning;
4. retirement planning;
5. investment planning;
6. taxation and estate planning;
7. insurance planning;
8. business succession planning; or
9. employee benefits planning.

"financial planner" means a financial advisor holding a recognized specialist designation, including:

a. Certified Financial Planner® (CFP®), sponsored by the Financial Planning Standards Council;
b. Personal Financial Planner (PFP®), sponsored by the Canadian Securities Institute;
c. Certificate in Financial Planning (Planificateur financier [Pl. fin.] designation), sponsored by Institut québécois de planification financière (IQPF);
d. Chartered Financial Consultant (CH.F.C.®), sponsored by Advocis, the Financial Advisors

Association of Canada;

e. Chartered Life Underwriter® (CLU®), sponsored by Advocis, the Financial Advisors Association of Canada; and the

f. Registered Financial Planner® (R.F.P.®), sponsored by the Institute of Advanced Financial Planners.

As noted above, Advocis recommends that the terms "financial advisor" and "financial planner" be defined in law, and that a number of today's leading designations be granted initial proficiency recognition by a DAA; one consequence of this grant of recognition would be that they possess a regulatory "approved status" for the purposes of holding out to Ontarians. These designations would include planning designations identified immediately above.

The ability to identify one's skills via a concise description makes for a useful signalling mechanism to consumers. IIROC and the MFDA have taken considerable strides to reduce the "alphabet soup" phenomenon through policies and guidance on financial designations and titles which seek to promote greater transparency for financial consumers, including less sophisticated investors, who are more vulnerable to confusing or unsavoury holding-out practices, It may be the case that these efforts should be allowed to progress before any prohibitive action is taken by the Expert Committee.

Finally, we would note that privileging one designation over another is, in its effects on advisors and consumers, tantamount to a regulatory taking, since such an action instantly discounts the value of all other competing designations. Instead, the regulatory goal should be to establish a minimum threshold, not a ceiling. By recognizing the current leading designations which meet a *de minimus* standard, a baseline of consumer protection in the market for financial advice is established.

Recommendation 3: Statutory Best Interest Duty
Recommendation 4: Exceptions

The Expert Committee recommends that "a Statutory Best Interest Duty (SBID) be adopted and applied to all individuals who and firms that provide Financial Product Sales and Advice and/or Financial Planning in Ontario."[12] The duty is defined as an "explicit obligation designed to ensure that clients' interests are put first and conflicts are avoided."[13]

[12] *Ibid*., p. 6.
[13] *Ibid*., p. 6.

The only exceptions to the proposed duty would be in cases where: (1) the individual or firm is already subject to a statutory best interest duty by virtue of its licensing and registration requirements, as in the case of portfolio managers; (2) the individual or firm is already subject to a professional legal standard of care and fiduciary duty, and the advice being provided is solely incidental to person or firm's principal business or profession, as in the case of lawyers and accountants; or (3) the individual or firm is a mere "order taker" – that is, no financial advice is provided to the customer, and the individual or firm is exempt from suitability requirements, as in the case of discount brokers.[14]

A. <u>The scope and application of the Statutory Best Interest Duty</u>

1. ***Broadly-worded definitions significantly widen the ambit of the duty.*** The scope of the proposed duty will be exceptionally wide-ranging: in addition to its broad definitions of Financial Product Sales and Advice and Financial Planning, the Expert Committee defines "Financial Product" as follows:

> Financial Product – includes "security," as defined in the *Securities Act* (Ontario), as well as a contract of insurance, as defined in the *Insurance Act* (Ontario); and any investment in a mortgage or any mortgage type product, including syndicated mortgages.

It is not clear if the open-ended nature of this definition – which is non-exhaustive, due to the use of the word "includes" – is intentional and meant to signal the possibility that other items could be added to the definition, perhaps by the proposed FSRA. At any rate, it clearly includes all securities and life insurance contracts within its ambit.

2. ***Definition of "conflict" would drastically curtail the industry's existing conflict management and compensation practices***. Here it should be noted that the Expert Committee has defined "conflict" as "a situation which has the potential to undermine a person or firm's impartiality including the possibility that an individual or firm places his, her or its own interest above the client's."[15] This conflict need not be material or actual; the mere possibility of the undermining of impartiality. This is an extremely difficult understanding of "conflict" to introduce into financial law. It stretches what it means to act in the client's best interest to the point where one cannot act in the client's interest at all, unless one is merely drafting a plan for a client who must then find someone – but whom? – to sell him the relevant products. It is impossible to see how an advisor can sell a security to a consumer and receive some form of third party compensation, or even sell a consumer a security which is produced and distributed by the company for whom the advisor works.

[14] *Ibid*., p. 7.
[15] *Ibid*., p. 12.

In fact, it is difficult to see how this definition of conflict can be conceptually aligned with the nature of the investment process. For example, receiving a commission or payment on a fee-for-service basis for a speculative and risky investment which fails to generate a return or even loses its principal could mean that the advisor or dealer did place his interest above that of the client. This privileging of the dealer's interest above that of the client occurs at the point of sale of the product, or when the advice to make the investment is rendered.

In short, the definitions as drafted by the Expert Committee so dramatically alter what it means to act in the "best interest" of a client that the very term "best interest" as understood and articulated by IIROC and other regulatory bodies could only be seen by the proposed FSRA as entirely inadequate.

It should be recalled that the CSA, in its December 2012 Consultation Paper 33-403, *The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, noted that a best interest duty could be tailored to incorporate existing industry practices regarding the management of conflicts:

> A statutory best interest standard does not have to impose an unqualified common law fiduciary duty on all advisers and dealers in respect of all facets of the client relationship. Distinctions can be made among the constituent elements of a fiduciary duty and addressed in different ways to meet the needs of all stakeholders. That is to say, the elements of a statutory fiduciary duty can be qualified to accommodate specific circumstances including the particular circumstances and business model of the adviser or dealer. *It could be made explicit, for example, that conflicts of interest can be addressed as currently provided in Securities Legislation (*including *NI 31-103)*. (Emphasis added).[16]

The Expert Committee would have been well-advised to balance the client's best interests with a pragmatic recognition of long-standing industry practices regarding conflict management.

3. ***Uncertainty about whether the Statutory Best Interest Duty is intended to operate on an ongoing basis.*** Another issue of concern is the temporal application of the best interest duty: how long would the advisor's duty to the client persist? The Expert Committee states, in relation to "know-your-client and suitability requirements," that "the focus of the suitability standards is limited to the sale of a Financial Product." This is not true, as the MFDA and IIROC have ongoing suitability obligations. But the fact that the Expert Committee characterizes ongoing suitability requirements in this fashion – i.e., as non-existent

[16] Canadian Securities Administrators, Consultation Paper 33-403: *The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness Of Introducing A Statutory Best Interest Duty When Advice Is Provided To Retail Client*s, October 25, 2012, 35 OSCB 9558, at p. 9586.

– forces one to wonder if the Expert Committee wants to see the Statutory Best Interest Duty extend beyond the sale of the product and operate on some form of ongoing or annual basis. Would existing annual suitability requirements of the MFDA, for example, be replaced by new annual best interest standards?

The Committee also states that "we wish to restrict the imposition of a SBID [Statutory Best Interest Duty] to activities and recommendations that have the potential to influence a consumer's financial decisions." Does this mean that a financial plan completed 11 months ago, and not yet updated, as no material changes have occurred in the client's life, still has attached to it a best interest duty?

B. <u>The form and content of the Statutory Best Interest Duty</u>

1. ***Codification will not guarantee harmonization.*** The Expert Committee states that the Statutory Best Interest Duty should be based on a uniform and codified standard of care. However, given that the Expert Committee wishes to apply the duty to the insurance and investment sectors, it seems necessary to point out that codification does not guarantee uniformity. As the Committee notes, while "financial advice generally is subject to know-your-client and suitability requirements . . . [which] vary across sectors."[17] This is an undeniable empirical reality which suggests that the sought-after "uniform" standard of care will itself vary across those same sectors. The "raw material" which produces the content of that standard of care is nothing other than the practice-based reality of advising and planning as it occurs in those sectors – it is the practical interaction of advisor and client "in the field." It is this that ultimately determined the nature of the industry's existing KYC and KYP requirements. One must expect the same determinative forces that set KYC requirements in the insurance and securities sectors to do the same when setting the standard of care for the best interest duty. Any best interest or fiduciary standard – even a codified one – is of necessity based in and fleshed out by the "facts of the ground." This jurisprudential reality demonstrates the limits of the Expert Committee's expectation that "applying a SBID would make clear the legal duty of care and significantly reduce, if not eliminate, confusion."[18]

2. ***Adjudication will likely determine the ultimate content of any statute-based best interest obligation.*** The Expert Committee says that the common law fiduciary duty is too expensive and time-intensive. Advocis agrees. But it is unrealistic to believe that the Expert Committee's Statutory Best Interest Duty won't be litigated in the same manner as the common law fiduciary duty has been in Ontario's courts. Even if it is only adjudicated before an FSRA tribunal, it will almost certainly take on many of the same features of the common law duty. Over time case law will accrue, and the doctrine of *stare decisis* will lead to the emergence of principles which will guide the elucidation of the duty – and those principles will very likely

[17] Ontario Expert Committee, *supr*a note 2, p. 6.
[18] *Ibid*., p. 6.

be similar to those which have been articulated in our common law. This raises the question of just what is to be gained by trying to supplement or eliminate the current common law duty with the proposed statutory one.

C. <u>Potential impact of the proposed Statutory Best Interest Duty</u>

1. ***A thorough re-categorization of the plaintiff class***. A statutory best interest duty would displace the common law duty and act as a blunt instrument, forcing advisors to treat all clients as if they are complete novices. Moreover, the reverse onus would mean that plaintiffs would be treated as victims of a fiduciary's malfeasance; the advisor or dealer firm would have to prove that there was no violation of the best interest obligation.

2. ***Uncertainty over the common law duty and the administration of the proposed new duty***. Presumably the Expert Committee's Statutory Best Interest Duty would be administered by the proposed FSRA in a FSRA tribunal. If so, then it may be assumed that the FSRA would operate in the same way as the Law Society of Upper Canada, which prosecutes lawyers for fiduciary breaches of their rules of professional conduct. Presumably, this would also mean that a client could still be able to prosecute in civil litigation an advisor for breach of his common law fiduciary duty.

3. ***Embedding the retrospective evaluation of advice and transactions, many of which are inherently uncertain, into the regulatory process.*** It would invite a high degree of second-guessing in hindsight as to whether a decision was in the "best" interest of a client, with the likely outcome being that the determination of what is "best" will quickly be boiled down to the one objective *ex ante* objective criteria available from this *ex post* perspective: a determination of which product among a group of suitable products was the least costly to the consumer. While advisors know that price should be one of many aspects to consider, under a statutory best interest duty, making a qualitative judgment of a product's other attributes could result in legal liability. By making all advisor-client relationships presumptively fiduciary, a statutory best interest duty would likely increase the volume of litigation brought against advisors and dealers (including nuisance claims), create enormous new compliance obligations that could overwhelm the industry and, finally, cause significant uncertainty regarding the interpretation of the duty. As a result, financial advice would become less accessible to consumers, which runs counter to the public policy objective of promoting personal financial independence and retirement readiness.

4. ***Uncertainty regarding whether the proposed Statutory Best Interest Duty imposes a fiduciary obligation***.

Statements made in recent consultations indicate the Statutory Best Interest Duty is a fiduciary one

The Expert Committee is determined to bring in a statutory best interest duty, but it has recently suggested that it may impose a standard short of a fiduciary duty. This statement strikes us a possibly being more rhetorical than conceptual in nature – and perhaps offered as an attempt to reduce the level of concern among advisors, brokers and dealers:

1. The exemptions from the Statutory Best Interest Duty contained in Recommendation 4 seem to be based on an equivalency between the Statutory Best Interest Duty itself and the fiduciary duty on lawyers and the statutory fiduciary duty on portfolio managers; and

2. Consider, as well, the statements of the CSA in its 2012 *Consultation Paper*: "We believe that imposing a statutory duty on an adviser or dealer to 'act in the best interests' of clients constitutes imposing a fiduciary duty. . . . Because acting in a client's "best interests" is at the heart of a fiduciary duty, we will generally refer in this Consultation Paper to a fiduciary duty as a "best interest" standard or duty."[19]

Present use of a best interest obligation to manage conflicts of interest

Both the MFDA and IIROC have similar rules on the management of conflicts of interest. Let us review IIROC's "best interest" requirements, which are found in IIROC Dealer Member Rule 42, a principle-based rule which is periodically supplemented by guidance.[20] According to the rule and accompanying guidance, IIROC members must address conflicts of interest that do, or could, arise: all existing or potential material conflicts of interest between a Dealer Member or an Approved Person and a client must be addressed "in a fair, equitable and transparent manner and considering the best interests of the client or clients." "Any existing or potential material conflict of interest that cannot be addressed in that manner must be avoided." [21]

In a recent commentary on Rule 42, IIROC is at pains to stress how member firms and their representatives are to manage conflicts of interest *vis-à-vis* the "best interest of the client":

> This principle is also specifically reflected in our rule that requires a firm's *representatives* to address material conflicts of interest – whether existing or potential – in a manner that is *consistent with* the best interest of the client. Recognizing that *firms* must balance the interests of multiple clients simultaneously, our rule requires them to address such conflicts in a manner that *considers* the best interest of the client.[22] (Emphases in original).

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[19] Canadian Securities Administrators, Consultation Paper 33-403: *The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness Of Introducing A Statutory Best Interest Duty When Advice Is Provided To Retail Client*s, October 25, 2012, 35 OSCB 9558, at p. 9562.

[20] IIROC Guidance Notice 12-0108, "Client Relationship Model – Guidance," March 26, 2012.

[21] IIROC Guidance Notice 16-0068, "Managing Conflicts in the Best Interest of the Client," April 6, 2016.

[22] *Ibid*.

The obligation that the registrant "address" the conflict "in a manner that considers the best interest of the client" means to do so "in a manner that is *consistent with* the best interest of the client."[23] This is significant because "consistency" does not automatically mean that the IIROC member, to act in the best interest of the client, must always and automatically act *solely* in the client's best interest. Rule 42 is therefore not an absolute — in other words, it is not a full-blown fiduciary obligation. Indeed, in response to a comment that Rule 42's reference to the "best interests of the client" may be interpreted as creating a fiduciary duty, IIROC stated that:

> IIROC does not believe that the phrase "best interests of the client" on its own creates a fiduciary duty relating to existing or potential material conflicts of interest, and it is not IIROC's intention to do so. Whether or not a fiduciary duty exists in an account relationship depends on the facts of each case, including, among other things, the services being provided to the client and the degree to which the client relies on the firm/adviser in making investment decisions. While the standard of conduct established by the proposal is not as high as the fiduciary standard, it is intended to strengthen investor protection by clarifying IIROC's expectations on how existing or potential material conflicts of interest are to be addressed as between the Approved Person and the client, as well as between the Dealer Member and clients generally.[24]

In regard to Rule 42, the CSA offers this interpretation:

> Interestingly, subsection 42.2(2) of IIROC Dealer Member Rule 42 states that an "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*." (Italics added) Subsection 42.2(3) states that "[a]ny 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." (Italics added) Although IIROC has stated that its intention is not to create a fiduciary duty, the conflict of interest rule applicable to

[23] *Ibid*.

[24] "IIROC response to comments on Client Relationship Model Rules and amendments to IIROC Dealer Member Rules 200 and 1300," March 26, 2012. Online at http://www.iiroc.ca/Documents/2012/A6F10441-3A89-4BFD-8BB1-D9B7C7119D88_en.pdf.

Approved Persons suggests a higher standard than the rule applicable to the Dealer Member (which only requires "considering" the client's best interest).[25]

The IIROC rule requires only that the Dealer Member "consider" the best interests of the client in addressing conflicts of interest. So, while Rule 42 does not create a fiduciary duty, both the CSA and IIROC believes that it does impose a high standard, one intended to "strengthen investor protection."

Is there any conceptual room between today's best interest duty on registrants and the Expert Committee's "less-than-a-full-fiduciary-standard" best interest duty?

We see, then, that while IIROC Rule 42 certainly is comprehensive, it is not as onerous as the Expert Committee's proposed Statutory Best Interest Duty promises to be. Given the Expert Committee is suggesting that its Statutory Best Interest Duty is not a fiduciary one, and that it is more onerous than IIROC Rule 42, one is left to wonder just what sort of "less-than-a-fiduciary-standard" best interest duty the Expert Committee thinks it can implement.

The Expert Committee's proposed best interest duty simply states that "conflicts are avoided" – the duty is unrestricted by IIROC's use of the adjectival "material" modifier. And the Expert Committee defines "conflict" as "a situation which has the potential to undermine a person or firm's impartiality including the possibility that an individual or firm places his, her or its own interest above the client's." This is much more stringent than the IIROC Rule 42 duty to act in a manner consistent with the client's best interests.

In short, there does not seem to be much room between, say, IIROC Rule 42 and a true fiduciary standard. If it is not a fiduciary standard, then the Expert Committee should be clear that a defence of contributory negligence is available.

D. Current fiduciary law and Advocis' position

We reiterate our position from our February 2013 submission[26]: a fiduciary relationship demands the highest standard of care in law, requiring the fiduciary to act solely in the beneficiary's interests, without regard to one's own. It is only appropriate where there is a significant imbalance of power between the parties: the beneficiary of the duty is characterized as vulnerable, there is significant information asymmetry and the fiduciary acts as a caretaker on the client's behalf.

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[25] Canadian Securities Administrators, Consultation Paper 33-403: *The Standard of Conduct for Advisers and Dealers*, p. 9569, at note 55.

[26] At http://www.advocis.ca/regulatory-affairs/RA-submissions/2013/Advocis-Response-to-CSA-Consultation-Paper.pdf.

The Supreme Court of Canada has stated that fiduciary obligations must be reserved for situations that are truly in need of the special protection that equity affords. These situations have been clearly set out by courts, through the articulation of key principles in case law by the nation's leading jurists. This common law approach strikes the right balance – it recognizes that retail investors in the securities marketplace are not homogenous and it gives clarity to the situations which invoke a fiduciary duty, all while protecting the most vulnerable that are in greatest need of its protections.

It is the highest standard of care in law and one that is normally reserved for situations of vulnerability and information asymmetry, such as between a doctor and patient or lawyer and client. Briefly, though, a context-based best interest duty already exists in Canadian law, and it is flexible enough to recognize that since clients are not homogenous when it comes to their financial sophistication, there are various models through which advisors serve these clients. Some clients may grant discretionary authority to their advisor, while others may see their advisor as a sounding board to discuss strategies. The existing principles-based common law duty looks at the nature of the relationship between the advisor and client to determine whether a best interest duty is appropriate.

While this recommendation may sound reasonable on its face, a best interest duty has severe legal ramifications. Accordingly, we urge the OSC to be cautious in using the phrase "best interest": we understand the populist allure of saying, colloquially, that an advisor should act in a client's best interests – no layperson could argue with a statement like that on its face. However, as you are aware, the legal interpretation of a best interest standard is not so simple. We all wish to improve the industry, including the enhancement of consumer protection – but we believe the way forward is through the professionalization of the advisory industry, with higher baseline and ongoing standards, rather than an overarching statutory duty.[27]

Given the foregoing, Advocis is firmly against the imposition of a statutory best interest duty. The existing common law best interest duty continues to serve Ontarians as financial consumers. Its guiding principles have been refined by decades of case law, so it is consequently able to accommodate the diverse spectrum of clients across the financial advisory and planning universe. A statutory best interest duty could very realistically set off a "race to the bottom" where a product's price is the sole determinative factor in determining what the best choice is for a client.

[27] Advocis' Professions Model (http://www.advocis.ca/raisethebar/) was launched in 2013, with the goal of increasing professional standards for financial advisors and planners. Since then, much debate has taken place about how the advisory sector should be reformed in the Province of Ontario. This includes the formation of an Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives. Advocis remains an active participant in the ongoing dialogue.

Moreover, we disagree with the Expert Committee's assertion that there is an absence of an explicit obligation for financial advisors to act in their client's best interest. Such an obligation appears in Advocis' *Code of Professional Conduct* and in the Financial Planning Standards Council's *Standards of Professional Responsibility*. Like IIROC, the MFDA also imposes a best interest obligation. MFDA Rule 2.1.4 *Conflicts of Interest* states that the Member and the Approved Person must address conflicts through the exercise of responsible business judgement; in doing so, they shall be influenced only by the best interests of the client.

Advocis stands by its *Code of Professional Conduct*: our members voluntarily hold themselves to a higher best interest standard. But we simply cannot support a statutory best interest duty that would be interpreted by the OSC, MFDA, IIROC, FSCO, dealers, brokers, the CLHIA, etc. – entities that do not understand modern advisors. Our *Code of Professional Conduct* is interpreted and administered by members of the profession – as in the case of any profession, it is the professionals within it who best understand how the fiduciary concept must be applied to the practices at which they work. This is how the fiduciary concept is given life with lawyers, doctors, accountants, architects and so on. It is manifestly unfair and unworthy of the professional's status to apply a statutory best interest duty to a professional group while failing to involve them in their own regulation; indeed, there is no other major occupation that operates in this way. So we will support a statutory best interest duty if advisors are recognized as professionals, meaning that they have true input in their professional regulation – through a DAA. In short, our issue is not with statutory best interest duty – rather, it's our opposition to a statutory best interest duty that is interpreted and applied by regulators that are not connected with the work of advisors. And this is why Ontario's recent Bill 157 proposed a progressive regulatory model that would have established an advisor-run body dedicated to the oversight of *all* financial advisors. This SRO would focus intensively on the advisor-client relationship – indeed, both the MFDA and IIROC bring a similar intensity of focus and scrutiny to mutual fund and securities dealers.

Advocis' Position on Recommendations 3 and 4: A Statutory Best Interest Duty and Exceptions to it.
Advocis recommends another way forward for a best interest duty – by placing it within a Code of Professional Conduct which is administered by an industry-wide DAA. Under Advocis' proposed DAA model, all financial advisors would be required to subscribe to their DAA's code of professional conduct, and abide by their DAA's rules of professional conduct in all of their dealings. To reiterate: Advocis does not oppose a statutory best interest duty *per se*, and in fact continues to express its support for the common law fiduciary duty. It is a question of who and how that best interest standard will be interpreted and applied. For decades, Advocis members have voluntarily adhered to a *Code of Professional Conduct* that includes acting in the client's best interest. Advocis proudly continues to advocate for an industry in which all financial advisors are held to a best interest

duty, but we cannot and support a best interest duty that is applied and interpreted by a regulatory authority which does not include financial advisors in its governance structure. To move to a best interest standard and leave the oversight to existing regulators will not work. The role of the financial advisor has now evolved to the point that the existing regulatory structure cannot support the specialized work provided to clients by the advisor. A best interest standard can only be promulgated, interpreted and implemented with significant input from the advisors and their clients.

A significant feature – indeed, perhaps *the* defining feature – of the "fiduciary concept" is its moral ambition, which lies in the expectation of the client of true good faith on the part of the intermediary. In this light, the ultimate focus of the fiduciary duty is trained on the fiduciary's motives and actions in fulfilling the client's instructions and advancing his overall financial interests, and not merely on the state of the client's accounts at any given point in time. Embedding a best interest obligation in the code of conduct of a DAA will make for a more robustly interpreted and applied obligation in Ontario's financial services sector – which is of course an outcome very much in any client's best interest.

Recommendation 5: Referral Arrangements – Disclosure of Referral Fees

The Expert Committee recommends "that no individual who or firm that provides Financial Product Sales and Advice or Financial Planning be permitted to pay a referral fee to a third party for the referral of a customer or prospective customer who is to be provided with Financial Planning or Financial Product Sales and Advice, unless the other person or firm receiving the referral fee is regulated as a provider of Financial Product Sales and Advice or Financial Planning and owes a best interest duty to consumers."[28] The Committee further says that "there must also be full transparency with respect to the referral arrangement, including compensation."[29]

What is the underlying purpose of Recommendation 5?

It is not clear what is driving the EC's recommendation that referrals be made only if the "person or firm receiving the referral fee is regulated as a provider of Financial Product Sales and Advice or Financial Planning" and, moreover, "owes a best interest duty to consumers."[30] One can understand why the Expert Committee would want the person or firm to whom the client is referred to be under a best interest duty, if only to ensure that there is no effort to contract out of the proposed Statutory Best Interest Obligations. For its part, the Expert Committee states that the rationale for Recommendation 5 is "to ensure that consumers who seek Financial Product Sales and Advice and/or Financial Planning can be assured that they are receiving service from individuals who have the appropriate credentials and

[28] Ontario Expert Committee, *supra* note 2, p. 7.

[29] *Ibid.*, p. 7.

[30] *Ibid.*

licensing."[31] But if the concern is about verifying the presence of the proper licencing and credentials, then there is no need to bring a best interest duty, statutory or otherwise, into the requirement. Simply specifying that the individual or firm to whom a consumer is referred must be a registrant in good standing with the relevant regulators should be sufficient to address any fears in regard to inadequacy of licensing or credentials. Indeed, the proposed central registry of Recommendation 7 could be used to quickly satisfy this obligation. All of this tends to suggest that the real aim of the proposal is ensure the presence of the Statutory Best Interest Duty in referral arrangements. But, as we will see below, bringing that obligation into the referral fee disclosure requirement is both unnecessary and likely to create confusion.

How would the Statutory Best Interest Duty interact with Recommendation 5?

In its rationale for Recommendation 5, the Committee states that it wants to ensure that "the duty of best interest remains intact."[32] This suggests that the Committee fears that some parties will attempt to contract around a best interest duty by referring the client to a colleague at the same firm (or to a related firm that is part of a larger organization). However, the current requirements governing referral fees do not let registrants contract out of their disclosure obligations in this manner, and if the person or firm to whom the client is referred has a best interest duty, then there is no concern about the client being transferred to an intermediary who owes a *lesser* duty of care to the client. So the concern is only with the party which originates the referral. But under Recommendations 1 and 6 this person or firm cannot hold out to the public unless it is already under the mandatory Statutory Best Interest Duty – unless the person or firm is exempted from that duty by operation of Recommendation 4. If the person or firm qualifies for one of the exemptions, then it is either under another form of fiduciary or best interest duty, or it is a mere "order-taker" – and surely the Expert Committee does not wish or need to introduce Recommendation 5 merely to prevent discount brokerages from sending clients on referrals.

Ongoing responsibility: Referral disclosure requirements do not end after the referral is completed: the registrant appointed in the referral agreement has an ongoing duty to promptly inform any affected client when there is a change in the disclosed information. Recordkeeping requirements are intended in part to help ensure that firms properly supervise their representatives and monitor compliance with referral agreements. Under the proposed recommendation, would a failure by a registered individual or firm to properly inform a client when there is a change in the referral agreement be considered a breach of a best interest duty?

Due diligence: In Ontario a securities registrant bears responsibility for ensuring that the person to whom their client or prospective client is referred is appropriately qualified to provide the services. Is this

[31] *Ibid.*

[32] *Ibid.*, p. 8.

requirement now a fiduciary one? Suppose the advisor refers his client to a lawyer for some complicated wills and estates work. If the lawyer claims to be experienced in wills and estates, is this claim sufficient for the advisor to refer the client and receive a referral payment? What degree of due diligence is required of the advisor with regard to the lawyer's claim of sufficient skills and acumen?

<u>The length of the best interest duty's "supply chain"</u>: there must be a reasonable limit on the best interest duty in the conduct of advisor referrals. Is it possible that the Expert Committee's proposal could be interpreted to mean that a Statutory Best Interest Duty is owed to the retail client by all intermediaries in the advice chain? This could entail a significant reinterpretation of prevailing fiduciary law in Canada, in which fiduciary duties are, in general, directly between the provider of the service and the client.

What, then, is the harm associated with referral fees that the Expert Committee is trying to remedy?

Let us setting aside for a moment the wish of Expert Committee to "preserve" the "intact" presence of the Statutory Best Interest Duty in the referral process. It is worth noting that the Expert Committee did not indicate the consumer harm or risk which Recommendation 5 is meant to address.

Ontario's existing regulation of referrals is sufficient to the task

At present, Ontario advisors have a reasonably clear set of rules for referring and receiving referrals in exchange for compensation. In general, the advisor must make comprehensive disclosure to the client to ensure transparency, and provide written disclosure of potential conflicts of interest. An advisor's firm also needs to be a party to any referral agreement entered into by one of their registered representatives, and must maintain the relevant documentary record.

On the insurance side, the *Ontario Insurance Act* (Regulation 347) requires life agents to provide clients with a written disclosure statement which identifies their license information, the firms and insurers they represent, how they are paid, and any third parties that the agent may receive compensation from – e.g., a referral from a third party, bonuses, and so on. This document also provides the client with information on how to file a complaint.

On the securities side, financial advisors and dealers must disclose to their clients all relevant details about their referral arrangements, regardless of whether or not the arrangements are connected to their firms' regulated activities. There is a duty to disclose to the client, in written format, each referral arrangement. This must be provided to the client at the earlier of the opening of the client's account or the provision of any services to him. This disclosure must set out, to the extent possible, the amount of the fee, the method for calculating the fee, and all material terms of the referral agreement. Violating these obligations can result in serious penalties, including revocation of a registration. Moreover, Phase II of the Client Relationship Model (CRM2), has continued to enhance these disclosure requirements. A review of CRM2's requirements on referral fees suggests that few, if any, regulatory gaps remain in this area.

Given CRM2's comprehensive referral fee requirements, is further reform actually needed?

CRM2 requires disclosure of referral fees to mutual fund investors, and provides comprehensive and detailed guidance on how dealers should handle their referral disclosure requirements when referring clients to, for example, portfolio managers or other firms. This guidance even captures transactions which cut across the industry's SROs. CRM2's scrupulous approach to referral fees includes these instances:

Referral by MFDA dealer to IIROC dealer—unsolicited: Suppose, for instance, that a client of a Mutual Fund Dealers Association (MFDA) member firm is referred to and Industry Regulatory Organization of Canada (IIROC) member, so that he can purchase or sell a security which the MFDA Member is not licensed to trade. CRM2 makes it clear that the client and the originating MFDA firm can rely on the IIROC firm to provide proper disclosure of referral fees, and that this disclosure be part of the annual CRM2 documentation. This reliance obtains whether or not the MFDA firm was solicited by the IIROC firm.

MFDA dealer to portfolio manager—dealer retains client: Similarly, suppose an MFDA member firm refers a client to a portfolio manager, while still retaining the individual a client. Again, the MFDA member firm may rely on the portfolio manager to disclose to the client the referral fees – provided the dealer satisfies itself of the adequacy of the disclosure made in the portfolio manager's report to the client. Under CRM2, adequate disclosure means reporting the name of the MFDA member firm and the specific amount of the referral fee paid by the portfolio manager to the MFDA member.

MFDA dealer refers client numerous times to an IIROC dealer and/or portfolio manager—client has multiple accounts: In addition, to avoid an undue compliance burden on advisors and dealers, and to minimize client confusion, CRM2 provides for sensible, straightforward disclosure in potentially complex situations. For example, in the case where an MFDA firm cannot satisfy itself that the portfolio manager or IIROC firm will provide sufficient disclosure of referral fees, and the client has multiple accounts with the MFDA firm, the mutual fund dealer does not have to provide referral fee disclosure on each annual *Report on Charges and Other Compensation* it must deliver to the client. Referral fees may be disclosed within, or as an addendum to, any one of the client's annual *Reports on Charges and Other Compensation*.

Given Ontario's already comprehensive treatment of fee disclosure, and the express inclusion of fee disclosure rules in the CRM2 framework and annual reports, it is not at all clear that Recommendation 5 is needed.

To what activities would the proposed referral disclosure requirement apply?

At present, financial advisors and dealers must disclose to their clients all relevant details about their referral arrangements, *regardless* of whether or not the arrangements are connected to their firms' regulated activities. It is not clear if the Expert Committee's proposed recommendation on referral fees applies only to the "Financial Planning or Financial Product Sales and Advice" provided to the consumer, or if it extends to other, ancillary services, even if unrelated to the financial services industry.

To conclude: it is not clear that this is an area where consumers are being ill-served. On the face of it, the Recommendation 5 seems like an effort to further regulate advisor compensation. In terms of consumer outcomes, the proposal may make it more difficult for consumers to be referred by their advisors to legitimate subject matter experts, such as tax or estate specialists.

Advocis' Position on Recommendation 5: Referral
Advocis recommends that this proposal be abandoned unless or until the Expert Committee is able to adduce some empirical evidence of consumer harm which demonstrates the need to go beyond the existing rules of IIROC, the MFDA and FSCO.

Recommendation 7: A Central Registry

The Expert Committee recommends "that a single, free, comprehensive central registry be created and maintained, with adequate resources to provide a one-stop source of information for consumers regarding the licensing and registration status, credentials and disciplinary history of individuals who and firms that provide Financial Product Sales and Advice and/or Financial Planning to Ontarians."[33]

Advocis agrees that Ontarians deserve a one-stop, industry-wide mechanism for verifying a financial advisor's registration status, licensing, professional and educational qualifications and credentials, and disciplinary history information. Advocis believes that Ontarians should have access to a central registry of information which contains the complaint or discipline history of individuals and other intermediaries which engage in financial planning and the provision of financial advice. Ensuring ease of public access to information on financial advisors is a crucial element of any protection scheme for financial consumers.

Accordingly, under Advocis' DAA proposal, advisors would be required to fully participate in a public registry of financial advisors, which would be accessible on the internet and through other appropriate modes of public inquiry. The public registry would enable any member of the public to conveniently access information about an individual's qualifications, registration/licensing status, and professional conduct as a financial advisor. Such a registry would include a history of all sustained complaints and disciplinary action, as well as information on any confirmed breaches of any section of the DAA's code of professional conduct.

[33] *Ibid.* p. 9.

We would urge the Expert Committee to take note of several problems associated with the administration of such a registry. Consider, as a working example, the Financial Industry Regulatory Authority (FINRA), which is the SRO for broker-dealers in the United States. On behalf of state securities regulators, FINRA maintains the Central Registration Depository (CRD), the central database containing records for all firms and individuals involved in the securities industry in the United States. The CRD in turn provides the information for FINRA's public access tool, BrokerCheck, which is described on its website as follows:

FINRA oversees the people and firms that sell stocks, bonds, mutual funds and other securities. Simply type in your current or prospective broker's name to see employment history, certifications, and licenses—as well as regulatory actions, violations or complaints you might want to know about. You also can get information about your broker's firm. There's no reason not to check.[34]

In addition to providing up-to-date and accurate information on an advisor's record and disciplinary history, including documented malfeasance, BrokerCheck also publishes accusations, settlements, and even misdemeanours which may go back decades and be unrelated to the financial services sector. Some problem areas with BrokerCheck include:

<u>All complaints form part of the advisor's publicly-accessible history</u>: if a complaint is formally submitted to FINRA in writing, it will appear on the advisor's BrokerCheck record. As one observer notes: "All it takes is for an unhappy client (or an unhappy former boyfriend or girlfriend for that matter) can allege that an adviser promised her that IBM would double in price over the next two months."[35] The formal response in BrokerCheck may state that the accusation was denied, or without merit, but as a formal allegation it stays on the advisor's BrokerCheck record.[36] In addition, BrokerCheck will publish as part of an advisor's record complaints which did not related directly to the advisor, but rather to his firm or dealer.

<u>Settlements of convenience in response to potentially dubious lawsuits</u>: Whether it is true or not, the U.S. civil litigation system is viewed by many observers as being susceptible to the machinations of plaintiffs' lawyers who will sue a broker-dealer in order to realize a quick settlement; advisors' "employees are often motivated to settle these frivolous cases in order to avoid the expense of litigation… [but] that adviser is then forever marked with that settlement, even though the language clearly states that the allegation was without merit and settled for convenience."[37]

[34] At http://brokercheck.finra.org/.
[35] Danny Sarch, "Why Finra needs to fix BrokerCheck now," *Investment News*, June 3, 2016.
[36] *Ibid*.
[37] *Ibid.*

No limitation on the reporting of misdemeanours: Brokercheck will also publish any misdemeanour felonies, some of which may not be pertinent to gaining an understanding of advisor's skills, competencies and professional ethics. For example, an arrest for possession of a controlled substance when one was in one's teens and which is now three decades old will be reported on BrokerCheck.

Advocis' Position on Recommendation 7: A Central Registry

Advocis recommends Ontarians deserve a one-stop, industry-wide mechanism for verifying a financial advisor's registration status, licensing, professional and educational qualifications and credentials, and disciplinary history information. Advocis fully supports the publication of sustained complaints against an advisor in a central public registry. But care should be taken to some of the glitches that have arisen in the United States with BrokerCheck.

Ideally, every effort should be made to adapt existing tracking systems and databases – including those used by the SROs, the OSC, and FSCO – into functioning as conduits which feed into a single consumer-friendly registry which operates on an interprovincial level.

Recommendation 8: Financial Literacy and Investor Education

Advocis wholly endorses the Expert Committee's recommendation that "financial literacy and investor education of Ontarians be supported and actively encouraged in Ontario by government, regulators, public and private schools (through their respective curriculum bodies and school boards), non-profit organizations and the financial services industry."[38] Indeed, Advocis recently partnered with Junior Achievement Canada in order to advance the financial knowledge of Canadian youth. Advocis members visited elementary and high school classrooms across Canada to help deliver financial educational programs to students. Last year, Advocis volunteers participated in and supported an initiative of the charity Prosper Canada and the City of Toronto to offer a free financial coaching program to low-income residents. The Mpower Money Coaching pilot program relies on 50 volunteer financial advisors to assist 100 Torontonians in acquiring much-needed financial knowledge and skills, improve their credit scores, develop and meet personal financial goals, etc.

In terms of financial literacy and coaching, behavioural economics explains why so many individuals, although they possess a working knowledge of the basics of investing and retirement planning, continue to make poor financial decisions. Behavioural economics offers numerous insights into household financial management, and has produced an evidence-based conceptual framework for understanding the causes and cures of inconsistent or irrational financial behaviour by consumers. And behavioural

[38] Ontario Expert Committee, *supra* note 2, p. 9.

economics also indicates that the advisor is well-positioned to be an effective guide to the consumer, "nudging" her toward desirable outcomes.[39] Indeed, the advisor can function as the transformative link between knowledge and action. In the role of the provider advice and assistance in making financial decisions, the advisor can help the client adapt to and understand the tremendous growth of information, technology, and regulation in the retail financial sector. Indeed, the flood of change already outpaces the ability of many Ontarians to "stay current," and advisors should see the challenge of assisting clients in staying up-to-date as a professional one.

Mere availability of information and more disclosure cannot, by themselves, make Canadians more financially literate. However, advisors can make general retirement, insurance and investment information, as well as mandatory disclosures, such as that required under CRM2, both understandable and actionable for clients. More generally, advisors can help ensure that clients better leverage existing informational and investment resources and adopt better financial habits in their day-to-day lives. One example of how advisors can help make their clients more financially aware and responsible may be seen in the growing level of consumers' awareness of the importance of risk tolerance. A recent survey by the Canadian Securities Administrators – the *2016 CSA Investor Education Study* – revealed a marked increase in those consumers who said they reviewed their level of risk tolerance in the last year, with 61 per cent reporting they did so – up from the 49 per cent in 2012. The study found that changes in the economy (38 per cent) and advice from a financial adviser (36 per cent) to be the top two reasons why investors who normally do not review their risk tolerance did so in the last year. Another 17 per cent reviewed their risk tolerance because of a major life change.[40]

In addition, the survey confirms a continuing and steady increase, since 2006, in the percentage of Canadians who work with a financial adviser: from 43 per cent in 2006, that cohort rose to 56 per cent this year. In addition, when it comes to researching investments, most investors rely primarily on their adviser for information. Roughly 70% of investors used their adviser as a source when they looking for investing information. Concomitant with this increased use of advisors is a stable level of investor knowledge: in both 2012 and 2016, the surveys show that six-out-of-10 Canadians could correctly answer a majority of seven questions intended to measure investment knowledge. In addition, consumer

[39] The term "nudge" was defined and popularized by Cass Sunstein and Richard Thaler in their monograph *Nudge: Improving Decisions about Health, Wealth, and Happiness*. New Haven & London: Yale University Press, 2008: a nudge "is any aspect of the choice architecture that alters people's behavior in a predictable way without forbidding any options or changing their economic incentives" (p. 6). For the United Kingdom's experience with "nudge-based" policy in financial services, see Greg B. Davies, "Beyond Nudge: Building a UK Savings and Investment Culture," EngageInsight Creative Thinking, December 22, 2015.

[40] This is the fourth survey on investment knowledge, investor behaviour and incidence of investment fraud among Canadians. Previous surveys were conducted in 2006, 2009 and 2012. The 2016 study also included new questions around barriers to informed investing behaviour and access to investing information.

awareness of provincial securities regulators improved slightly, up from 39 per cent in 2012 to 42 per cent this year.[41]

Advocis' Position on Recommendation 8: Financial Literacy – A Role for Advisors
Advocis recommends the development of an office which can measure the progress of the numerous financial literacy efforts underway in Ontario, and, indeed, across Canada. Published research studies in other jurisdictions indicate that "financial coaching" can be a highly effective tool which leads to measurable improvements in financial literacy and hence financial well-being over time. The time has come to begin to determine which methods produced the best results with those groups who need help the most. Regulators should introduce "nudge"-style regulatory forms which emphasize the need for consultation with a professional advisor, as is now done with certain CSA exempt market forms.

Part Three: The Expert Committee's List of Issues for Further Consideration

The Expert Committee recommends that the Ontario government give further consideration to three additional issues – all of which, the Committee notes, fall outside of its mandate. The three issues related to the unfortunate fact that in Ontario, there is too often no clear line of redress for a financial services consumer who has a legitimate complaint. To launch and pursue a complaint, the aggrieved consumer must first gain some understanding of the particular regulatory regime that governs the product or advice he received. Nowhere is Ontario's regulatory apparatus more fragmented than at the level of the consumer. Thus the Expert Committee has identified the following as areas deserving of further study:

1. a simplified complaint and restitution mechanism for consumers;
2. a simplified approach to the investigation, prosecution and adjudication of consumer complaints related to regulatory offences in the provision of Financial Planning and Financial Product Sales and Advice; and
3. a consumer-friendly process for recovery of financial losses.

Many stakeholders have urged the Expert Committee to improve investor redress, which includes access to effective dispute resolution mechanisms and binding decision-making, and the ability to obtain compensation in a fair and timely manner. Advocis agrees. The ability of a fair and impartial arbiter or tribunal to render and implement binding decisions is an essential aspect of an effective financial services regulation. Ontario's financial consumers need a single point of entry into the complaint process; the current labyrinth of arbitration, courts, and ombuds leave too many individuals confused and frustrated.

[41] *Ibid.*

Advocis has long advocated for the need to introduce a true system of professional accountability for financial advisors, one which is integrated across all consumer sectors in Ontario's financial markets. A DAA would be empowered to suspend or revoke membership, or impose various conditions on membership for unprofessional conduct, including violations of regulatory requirements, failure to cooperate with regulators, and criminal and regulatory offences. Actions or omissions which impugn or bring into disrepute the advisor's professional integrity or competence, or that of the profession as a whole, and their suitability to offer financial advice to the public, would be reviewable. The evidence set out below suggests that registrants who are members of an SRO commit fraud or other forms of financial malfeasance at a lower rate than non-SRO registrants.

Reduce fraudulent activity by requiring all consumer-facing intermediaries to be registrants: The Canadian Foundation for Advancement of Investor Rights (FAIR Canada), has issued two reports in the last four years which examine advisor malfeasance. It outlined a series of recommendations in an August 2014 report, including the idea that Canadian regulatory agencies must collaborate more effectively, especially in the tracking of fraud complaints, that regulators should publicize the results of their findings, and that governments and regulators in provincial capitals and in Ottawa should implement a national whistleblower program. In examining investment fraud in Canada, the definition of investment fraud was limited to fraud involving securities that directly affect individual retail investors, such as Ponzi schemes and boiler rooms. The report reviewed all of the fraud cases that were concluded by the CSA in 2012. The CSA's *2012 Enforcement Repor*t was the first to include a specific, stand-alone category for fraud. Upon FAIR's review of these cases, it was stated that the "overwhelming majority of the cases (fifteen out of eighteen) involved perpetrators who were not registered."[42]

Reduce investment fraud by requiring DAA membership for all consumer-facing intermediaries: In February 2011, FAIR Canada released *A Report on a Decade of Financial Scandals*, which reviewed fifteen of the largest and most high profile securities-related scandals from 1999 through the end of 2009. This report emphasized the fact that "the Canadian securities regulatory system is complex and fragmented. There are thirteen provincial and territorial securities regulators and two national SROs... With this bewildering array of regulators, investigation agencies and prosecutors, no one agency has ultimate responsibility for combating investment fraud."[43] It also stated that five of the 15 cases reviewed involved firms and individuals *not registered* with securities regulators. About 22% of the Total Loss can be traced back to non-registered individuals and firms.[44] More interestingly, while "approximately 78% of the Total Loss was

[42] FAIR Canada, *A Report on a Canadian Strategy to Combat Investment Fraud* (August 2014), p. 20. Online at http://faircanada.ca/wp-content/ uploads/2014/08/FINAL-A-Canadian-Strategy-to-Combat-Investment-Fraud-August-2014-0810.pdf.

[43] FAIR Canada, *A Report on a Decade of Financial Scandals* (February 2012), p. 2. Online at http://faircanada.ca/wp-content/uploads/2011/01/Financial-scandals-paper-SW-711-pm_Final-0222.pdf.

[44] *Ibid*., p. 19.

attributable to registered firms or individuals," only "some 17% of the Total Loss involved registered firms or individuals who were also subject to the supervision of an SRO. It would therefore appear that registrants that are directly regulated by a provincial securities commission (but not an SRO) represent a much greater risk of investment fraud losses by investors than registrants that are also SRO members."[45]

The DAA model is a viable and effective means to ensure promotion of the public interest: A regulatory requirement that advisors must be in good standing with a DAA would prevent unscrupulous individuals from simply moving to a different financial sector and seeking licensing or registration. The resulting regulatory umbrella created by this DAA model would close current gaps in the enforcement and disciplinary reach of regulators, by ensuring that individuals who violate industry requirements in any one sector would not be permitted to continue activity in the industry without proper review. The DAA would have discretion with regard to the investigation of complaints and the initiation of professional discipline. It should be a not-for-profit entity dedicated to financial advisor professionalism in the public interest. It is essential that the DAA be entirely independent from financial institutions, as well as product manufacturers and distributors. In terms of its governance, the DAA would be mandated to have a number of public directors on its Board, and also on any board committee responsible for professional conduct and discipline.

Advocis' Position on The Expert Committee's Concerns on Consumer Complaints and Redress
Advocis recommends the creation of a DAA which would assume the oversight currently residing with the MFDA, IIROC and FSCO in relation to the conduct and competency of advisors. It should be empowered to initiate proceedings and suspend or revoke membership or impose other conditions, including fines and penalties for non-payment of fees, for failure to fulfill continuing education requirements, and for suspension or termination of licensing or registration by a regulator in other jurisdictions.

Conclusions and Looking Ahead

Throughout its long history, Advocis has been committed to proficiency standards for all financial advisors. This is consistent with our commitment to our clients — as set out in our enabling federal legislation — and in our Latin motto, *non solis nobis* — "not for ourselves alone." Ontarians *deserve* to know that all advisors are subjected to a single, uniform set of regulatory standards. Advocis has been at the forefront of the movement to professionalize financial advisors and planners for some time. Bill 157, *The Financial Advisors Act*, 2014, which passed second reading and garnered all-party support, was a progressive piece of legislation, and we believe that the Bill should become a focus of these consultations. Further, as we publicly stated on June 2, 2016, to the Expert Committee, we believe the Committee

[45] *Ibid*.

should endorse Bill 157 in principle and that it should become a central focus of the next stage of the Committee's consultative process. The time for professionalization and a degree of self-governance for financial advisors is now. The time for patchwork solutions is past. The existing regulatory umbrella under which advisors and their clients find themselves is failing both the advisory industry and Ontario's financial consumers. True consumer protection means recognizing the holistic nature of financial advice and regulating the advisor-client relationship on a universal, cross-sectoral basis. This Bill 157 clearly would do.

This is why Advocis' definitions of "financial advisor," "financial planning" and "financial advice" simply reflect the daily realities of the advisor and consumer, and would enable a single professional body to oversee, in spite of their diversity, all of Ontario's financial advisors, even those who are advanced specialists. Indeed, this form of oversight seems the most efficient, as to do otherwise would require adding additional regulatory layers and complexity. Moreover, another layer of regulation will not solve the problem of regulatory arbitrage and will leave unaddressed the gaps caused by the silos which separate the insurance and securities sectors at the advisor-client level. Advocis believes that a truly industry-wide effort to regulate *all* financial advisors will enable the industry to move beyond the *status quo* and thereby avoid such well-publicized instances of egregious criminal conduct, which of course understandably erodes public trust in our advice industry and, to an extent, in our capital markets. Just as importantly, an industry-wide DAA will eliminate less-reported by equally problematic regulatory hazards, such as regulatory arbitrage and capture.

Promoting professionalism in all advice-based, retail-focused relationships between intermediaries and consumers in Ontario's financial services sector may in fact be the most effective way to inculcate an enhanced commitment to ethical and professional conduct. Excluding financial advisors — whether in title or in scope of practice, or both — from any future reform efforts will virtually guarantee its failure. As we have repeatedly stated: Ontarians deserve better. To see how we can give Ontarians the regulatory system they are entitled to, it is first necessary to understand in more detail the current system, which we believe is an impasse of sorts — one which prevents the introduction of smaller, smarter and more targeted regulation with a consumer focus.

A DAA model would work in the best interests of Ontario's financial consumers by ensuring that *all* advisors meet necessary minimum professional standards. In contrast to the truly *universal* approach of a DAA stands the argument forwarded by other industry groups which seeks to regulate only a particular advanced planning designation. Unfortunately, such a reform would leave most Ontarians still exposed to unnecessary risks while, in effect, creating a narrowly-constituted professional group of advisors who alone are permitted to provide financial planning advice. Such an approach will inevitably restrict consumer access to this subgroup of now-privileged designation holders to the wealthier segments of society.

Advocis would be pleased to offer further comments or assistance on this matter. To discuss any of the issues that we have raised, please contact the undersigned, or email Ed Skwarek, Vice President of Regulatory Affairs and Public Affairs at eskwarek@advocis.ca.

Sincerely,

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