

June 27, 2007

British Columbia Securities Commission  
Alberta Securities Commission  
Saskatchewan Financial Services Commission  
Manitoba Securities Commission  
Ontario Securities Commission  
Autorite des marches financiers  
New Brunswick Securities Commission  
Registrar of Securities, Prince Edward Island  
Nova Scotia Securities Commission  
Superintendent of Securities, Newfoundland and Labrador  
Registrar of Securities, Northwest Territories  
Registrar of Securities, Yukon Territories  
Registrar of Securities, Nunavut

Dear Sirs/Mesdames:

**Re: Canadian Securities Administrators' Proposed  
National Instrument 31-103 Registration Requirements**


Thank you for the opportunity to comment on the Canadian Securities Administrators' (CSA's) Proposed National Instrument 31-103 Registration Requirements (the Proposed Rule).

Advocis, the Financial Advisors Association of Canada, is Canada's oldest and largest voluntary professional membership association of financial advisors representing life and health insurance licensees, and mutual fund and securities registrants across the country.

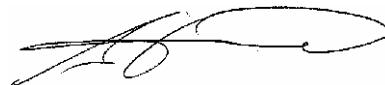
While the majority of Advocis members are regulated under a provincial insurance regulatory regime, they are also regulated by provincial securities commissions/regulators. As the CSA's Proposed Rule directly impacts our members, we attach our comments for your consideration.

We look forward to working with you to ensure the CSA's final Rule reflects our mutual objectives. Please do not hesitate to contact us if you have any questions regarding our submission.

Yours truly,



**Roger McMillan, CFP, CLU, CH.F.C.**  
**Chair,**  
**National Board of Directors, Advocis**



**Steve Howard, CA**  
**President and CEO**  
**Advocis**



# Proposed National Instrument 31-103 Registration Requirements:

Advocis' Submission to the  
Canadian Securities Administrators  
(CSA)

June 27, 2007

**Table of Contents**

**Page**

Executive Summary ..... ii

Section A -- Introduction ..... 1

Section B -- General Concerns ..... 3

Section C -- Specific Comments ..... 4

    Part 1 -- Fit and Proper Requirements..... 4

    Part 2 -- Conduct Rules ..... 5

    Part 3 -- Conflicts ..... 9

Section D -- Conclusion ..... 10

## Executive Summary

### **Advocis:**

- supports the CSA's objective of ensuring that registration requirements provide protection to investors from unfair, improper or fraudulent practices.
- believes that the Proposed Rule has been largely drafted to accommodate *traditional business structures* in which the relationship between a securities firm and its sales representatives is that of employer and employee.
- would like to work with the CSA to find workable registration categories within the Proposed Rule that addresses the concerns of *non-traditional business structures* such as independent owner-operators who are typically dual-licensed financial advisors who sell insurance and mutual fund products.
- is currently exploring two particular models that we expect to finalize shortly and will be presenting to the CSA for consideration, and would appreciate the CSA's confirmation that it is willing to consider including a placeholder in its Proposed Rule to allow for this possibility.
- is concerned with the CSA's policy development process, in particular that the CSA would draft a Proposed Rule:
  - without broadly consulting with industry stakeholders during the early stages of the policy development process, particularly organizations like Advocis whose members represent a significant segment of the financial services industry;
  - that is broad in scope and captures all market participants, including those who, for the most part, do not participate directly in the Canadian capital markets (raising of capital function) and are already regulated by provincial securities regulators;
  - that provides no robust cost/benefit analysis of bringing non-direct capital market participants and financial planners under the ambit of the Rule; and
  - that imposes prescriptive rules on all market participants without considering alternative approaches on how to best reduce the incidences of "bad behaviour" by a few individuals.
- believes that the CSA's prescriptive rules-based approach to regulation and the layering-on of additional rules and regulations will not prevent misconduct in the financial markets nor will it ensure consumer protection.
- believes that the Conduct Rules, which prescribe the way in which professional financial advisors interact with their clients, impose an inappropriate external framework on the relationship.
- strongly supports consumer protection, and believes that it can be more effectively achieved through principles-based regulation, an approach currently being adopted by the Financial Services Authority (FSA), the UK's integrated regulator of financial services.
- believes that there are significant opportunities for regulatory cross-pillar harmonization (between the securities and insurance sectors), particularly in the area of market conduct, and would therefore like to explore with the CSA possible exemptions from the application of the proposed conduct rules (similar to the exemptions granted to the SROs), to the extent that insurance-regulated financial advisors are already in compliance.
- urges the CSA to consider our comments and recommendations, and amend the Proposed Rule to reflect the needs of our members.

## **SECTION A -- INTRODUCTION**

### **Regulatory Perspective**

Advocis supports the CSA's objective of ensuring that registration requirements provide protection to investors from unfair, improper or fraudulent practices, as well as the CSA's intent to harmonize, streamline and modernize the registration regime across Canada. Moreover, Advocis is a strong supporter of consumer protection and believes that consumers are generally best served in competitive market environments that provide consumers with the most choice.

From a regulatory perspective, we understand the appeal of a comprehensive rule that i) captures all market participants who engage in the business of dealing in securities, ii) provides prescriptive rules that outline the obligations and expectations of market participants, and iii) can be administered relatively easily by ensuring that it applies to all participants (with a few exceptions), and puts the onus of compliance on market participants to ensure that they conduct themselves in a fit and proper manner.

### **Small-Business Perspective**

From a small-business perspective, Advocis has serious concerns with the CSA's proposed Rule for many of the same reasons regulators may desire it. In our view, the rule should i) be targeted to a specific segment of the market to address a particular problem or issue that has been clearly defined and rigorously analyzed, ii) provide regulatory guidance (in the form of principles-based regulation) that focuses on outcomes and high-level rules as a means of achieving regulatory objectives, and iii) place more emphasis on investigation and enforcement of regulatory policies and rules and punish "bad behaviour" of a few individuals rather than create overly burdensome regulations on those who are already compliant.

### **Acceptable Business Structures - Small-Business vs. Large Fully-Integrated Firms**

We believe that the proposed Rule has been largely drafted to accommodate *traditional business structures* in which the relationship between a securities firm and its sales representatives is that of employer and employee. Traditional business structures are typical of large fully-integrated financial institutions such as banks and investment dealers who trade in securities and have the means to ensure that they are in compliance with comprehensive and complex securities regulations and rules from a supervisory standpoint.

The majority of our members are self-employed independent financial advisors, dual-licensed for life and health insurance and mutual funds, are not direct participants of the capital markets (raising of capital), and for the most part, are regulated by provincial insurance regulators. In fact, the CSA has indicated in past regulatory initiatives that these *non-traditional business structures* (i.e., independent contractors), like those Advocis represents, cannot be reconciled with the existing [regulatory] regimes or accommodated when modifications are made to the regimes.

### **Addressing the Needs of Small-Business Non-traditional Structures**

Advocis rejects this view that non-traditional structures cannot fit within the existing regulatory framework. While our small-business members may, in some cases, have *non-traditional* business structures and may present a regulatory challenge to the CSA, they nonetheless represent a legitimate and significant segment of Canada's financial services industry. As such, they deserve to be recognized and accommodated by regulators so that they can continue to carry on their businesses and provide valued financial services advice to millions of Canadians in a cost effective and efficient manner. We believe that failing to address the regulatory needs of

small-business financial advisors is tantamount to restricting the financial services business to large vertically integrated financial institutions and securities dealers with the potential impact of reducing the choice of delivery options to consumers.

Advocis would like to work with the CSA to find workable registration categories within the Proposed Rule that addresses the concerns of non-traditional business structures such as independent owner-operators who are typically dual-licensed financial advisors who sell insurance and mutual fund products.

### **Providing Flexibility to Accommodate Independent Owner-Operators and Expanding the Rule's Restricted Portfolio Manager Registration Category**

Specifically, in keeping with the CSA's objective to reduce the number of registration categories for dealers and advisors, we believe there is an opportunity to develop a more flexible introducing/carrying dealer structure under the Proposed Rule's Mutual Fund Dealer registration category and to expand the Restricted Portfolio Manager definition to accommodate the interests and business models of financial advisors in today's market place.

We are currently exploring two particular models (including a variation of the Independent Owner-Operator (IOO) model that may be familiar to some CSA representatives) that we expect to finalize shortly and will be presenting to the CSA for consideration, ideally before the next version of the Proposed Rule is issued, presumably later this year. In the interim, we would appreciate the CSA's confirmation that it is willing to consider including a placeholder in its Proposed Rule to allow for this possibility.

While we note that the Self-regulatory Organizations (SROs), namely the Mutual Fund Dealers Association (MFDA) and the Investment Dealers Association (IDA) set by-laws, policies and rules for their members (indirectly impacting our members by virtue of being Approved Persons of the dealer), they do not represent the interests of financial advisors.

Consequently, while many of our members (as Approved Persons of SRO dealers) would be exempt from certain provisions of the Proposed Rule, particularly many of the conduct rules, they are still subject to complying with the MFDA and IDA rules that are written for dealers, whose interests are often very different from those of advisors.

Advocis believes direct consultation with financial advisors on the Proposed Rule would be more beneficial than relying on discussions with the SROs in developing policy proposals, especially in the early stages of the policy development stage. Financial advisors are most often the closest link to the investor and have a unique perspective on consumers' needs.

### **Advocis Members and Their Objectives**

In order to gain a thorough understanding of our positions regarding the Proposed Rule, we believe it is crucial to first understand the nature and business structure of financial advisors who Advocis represents.

Advocis members are in many instances owner-operators of small and medium-sized businesses who provide professional financial advice to millions of Canadians. Our objective is to assist individuals, families, and businesses in achieving their financial objectives.

Many of our members have become securities registrants after they have established an advisory practice in other financial activities, such as life insurance agents. In addition, our membership includes financial planners who have developed similar practices based on mutual funds alone.

Our core activities include providing generally accepted professional designations, high standards of professionalism through the enforcement of a Code of Professional Conduct, and participating in the development of public policy and regulation affecting financial advisors and their clients before all levels of government across Canada.

While Advocis supports the CSA's objective of ensuring that registration requirements provide protection to investors from unfair, improper or fraudulent practices, as well as their intent to harmonize, streamline and modernize the registration regime across Canada, we offer our perspective on how these goals can be more effectively achieved.

Notwithstanding our Specific Comments below on the various provisions of the Proposed Rule, Advocis has the following general concerns with the CSA's policy development process.

## **SECTION B -- GENERAL CONCERNS**

In our view, perhaps the most disconcerting aspect of the Proposed Rule is the CSA's policy development process. We are seriously concerned that the CSA would draft a Proposed Rule:

- without broadly consulting with industry stakeholders during the early stages of the policy development process, particularly organizations like Advocis whose members represent a significant segment of the financial services industry, and particularly on the Conduct Rules that are of significant concern to many market participants.
- that is broad in scope and captures all market participants, including those who, for the most part, do not participate directly in the Canadian capital markets (raising of capital function) and are already regulated by provincial insurance regulators.
- that does not recognize the need to address concerns of market participants who are dual-licensed to sell life and health insurance and mutual funds, and are subject to two provincial regulatory regimes (insurance and securities), while in many cases they are dealing with the same consumer, offering them comprehensive financial advice and products.
- that forces small operators into a regulatory regime that is more suited for traditional business structures consisting of employees/agents/dealers of large financial institutions who are primarily engaged in the Canadian capital markets and investment banking activities.
- that relies on the view points of the Self-Regulatory Organizations (SROs), namely the Mutual Fund Dealers Association (MFDA) and the Investment Dealers Association (IDA), whose members are dealer firms, not financial advisors.
- that imposes increased regulatory burdens and costs on Advocis members who have been operating relatively "problem free" under the insurance regulatory regime while still operating in the best interest of consumers and with the highest level of professionalism – including professional accreditations and adherence to a professional code of conduct.
- that provides no robust cost/benefit analysis of bringing non-direct capital market participants and financial planners under the ambit of the Rule.
- that imposes prescriptive rules on all market participants without considering alternative approaches to how to best reduce the incidences of "bad behaviour" by a few individuals.

- that is not principles-based and flexible in its approach like that being used successfully by provincial insurance regulators and recently adopted by the Financial Services Authority (FSA), the UK's integrated regulator for financial services to address market misconduct and enhance consumer protection.

## **SECTION C -- SPECIFIC COMMENTS**

### **Part 1 -- Fit and Proper Requirements (Part 4 of Rule)**

Advocis agrees with the CSA that there should be fit and proper requirements to ensure the suitability of individuals or firms for registration. However, while we support the CSA's three cornerstone concept: proficiency, integrity, and solvency, we believe that their respective qualification requirements could be modified to better accommodate various market participants.

In general, Advocis believes that one of the most effective ways to protect consumers is to ensure that the registrant is a recognized financial services professional. Advocis takes the view that professional financial advice is delivered by an accredited financial advisor who:

- has a professional designation,
- adheres to a professional code of conduct,
- maintains membership in a recognized professional body,
- subscribes to practice standards,
- acquires meaningful continuing education credits, and
- maintains adequate errors and omissions (E&O) insurance coverage to protect both the consumer and the financial advisor.

#### **Proficiency**

We understand that under the Registration Reform initiative, the CSA is considering proposing changes to the registration requirements or proficiency standards that would no longer allow provincial jurisdictions like British Columbia to formally recognize i) "financial planning" as a distinct activity or ii) the designations obtained for the purpose of holding out as a qualified "financial planner".

Advocis believes strongly that one of the most effective ways to protect consumers is to ensure that they receive professional financial services advice delivered by an accredited financial advisor who has a professional designation. We support jurisdictions like BC that recognize the expertise of an advisor and the higher proficiency standards of those who hold out as a financial planner.

To the extent that the CSA is considering changing the proficiency standards of registrants, we would be interested in meeting with the CSA to discuss this important issue to ensure that high proficiency standards are maintained.

#### **Solvency**

In terms of the CSA's proposed solvency requirements, we believe that the capital requirements create unnecessary barriers to entry, and note that other professions do not have to provide \$50,000 to begin practicing. Advocis believes that the proposed Rule's insurance requirements are sufficient to address issues or concerns with respect to solvency.



## **Part 2 – Conduct Rules (Part 5 of Rule)**

As noted above, Advocis has concerns with the CSA's prescriptive rules-based approach to regulation as we believe that the layering-on of additional rules and regulations will not prevent misconduct in the financial markets nor will it ensure consumer protection. In particular, Advocis has serious concerns with the Conduct Rules, which prescribe rules to guide the way in which professional financial advisors interact with their clients.

Moreover, not only do the Conduct Rules contain key guiding elements of the *Client Relationship Model (CRM)*, which are of concern to our members, but we note that the CSA also intends to implement core client relationship principles through the MFDA and IDA. The combination of these two initiatives will have a profound impact on the regulatory obligations of financial advisors.

In general, Advocis believes that prescribing rules regarding the relationship between financial advisors and consumers is inappropriate and creates an external framework for the regulation of advice-givers in their relationship with consumers of financial advice.

Advocis is of the view that regulators must defer to expert standard-setting institutions to validate the specific knowledge and skills necessary to deliver professional financial advice to the public. For example, professional codes of conduct and best practices within a principles-based regulatory framework more effectively promote the priority of the client's interest, which need not be prescribed in regulation.

Regulators must be made aware that the current SRO rules-based suitability framework needs to be amended to address the needs of consumers in an increasingly complex investment world. SROs and their dealers have become increasingly prescriptive on suitability issues that can often restrict the ability of advisors in offering a full range of investment options to suit their clients' needs. As we note above, MFDA/IDA rules are written for dealers, whose interests are often very different from those of advisors. A principles-based regulatory regime would give advisors the flexibility they need as professionals to better meet the financial needs of their clients.

### **Principles-based Approach to Regulation Adopted by Regulators**

#### ***i) Financial Services Authority (FSA)***

Advocis strongly supports consumer protection, and believes that it can be more effectively achieved through principles-based regulation, an approach currently being adopted by the Financial Services Authority (FSA), the UK's integrated regulator of financial services.

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

Advocis concurs with the FSA's position, and believes that prescriptive rules that do not directly ensure enhanced consumer protection impose additional regulatory burdens and costs on our small-business members. These added costs make it more difficult for our members to compete in the highly competitive financial services sector, potentially resulting in fewer advisors in Canada and ultimately less choice for consumers.

Below is an excerpt of the FSA's rationale for adopting a principles-based approach:

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

## **ii) British Columbia**

Advocis believes that the British Columbia Government continues to demonstrate its commitment to results-based regulation that costs less, is more effective in protecting investors, and promotes competitiveness and innovation. We believe that B.C. has gone further than any other province to advance sensible regulations that are "friendly" to the consumer/investor and create a workable operating environment for existing registrants.

In addition, the BC Securities Commission (BCSC) has a similar approach to regulation. As it notes in its Service Plan, 2007-2010:

***Regulation inevitably imposes costs through regulatory fees, compliance costs, and restrictions on business activity. Investors ultimately pay these costs, so regulatory interventions should generate the greatest investor protection and market integrity benefits for the least cost... Rules are often not the best choice of tool, because they tend to be the most intrusive and most costly alternative... However, if a rule is necessary, it should have these attributes:***

- ***The focus should be on outcomes ..., rather than merely prescribe a process on the assumption that the resulting process will achieve the outcome.***
- ***The scope of the rule should be limited to what is necessary to achieve the desired outcome.***
- ***The rule should be clear and simple.***

While Advocis supports the notion of greater harmonization among regulators across Canada, it regrets that regulatory initiatives undertaken by specific regulators such as B.C. have not received greater consideration by its provincial counterparts in the Proposed Rule.

## **iii) Provincial Insurance Regulators**

In addition, we note that a principles-based approach to regulation is being implemented successfully in Canada by provincial insurance regulators.

By way of example, recent regulatory initiatives in the Canadian insurance sector illustrate how principles-based regulation, with the support and efforts of the industry, can be effective in promoting widespread compliance of regulatory requirements. Following a comprehensive review of insurance practices over the past two years, Canada's insurance regulators under the auspices of the Canadian Council of Insurance Regulators and Canadian Insurance Supervisory Regulatory Organizations recommended a principles-based approach to enhance and harmonize best practices across the industry and in all jurisdictions to deal with the issue of managing potential conflicts of interest. The market conduct areas examined by the insurance regulators include similar aspects of the advisor-client relationship that the CSA is contemplating under the conduct rules (Client Relationship Model) for securities representatives.

Advocis would be pleased to outline for the CSA the initiatives that the insurance industry has been undertaking to ensure that intermediaries adhere to regulatory requirements so that consumers are adequately protected.

## **Regulatory Cross-Pillar Harmonization**

Moreover, with the convergence of the financial services industry, namely in the insurance and securities sectors, we believe that there are significant opportunities for regulatory cross-pillar harmonization, particularly in the area of market conduct. As many of our members are financial advisors that in many cases hold multiple licenses to distribute securities, mutual funds, and insurance products and services, they are subject to two provincial regulatory regimes (insurance and securities). At a time when regulators are looking for ways to modernize and streamline regulation, we would like to see regulatory efficiencies and cross-pillar harmonization that is principles-based and not administratively costly or burdensome for financial advisors.

With respect to the Conduct Rules in general, Advocis notes that under provincial insurance regulation, its members comply with many of the same market conduct/client relationship rules, such as suitability and conflicts of interest that are prescribed in the Proposed Rule (albeit under a principles-based regulatory platform). Therefore, in an effort to avoid duplication and unnecessary and costly compliance burdens on many of our members, we would like to explore with the CSA possible exemptions from the application of the proposed conduct rules (similar to the exemptions granted to the SROs), to the extent that insurance-regulated financial advisors are already in compliance.

We have identified below our comments and specific concerns with respect to certain provisions of the CSA proposed conduct rules.

### **1. Account Opening and Know-Your-Client (KYC):**

**5.4 -- Suitability:** We recognize the KYC/suitability obligation that financial advisors have to their clients. However, we believe that the suitability obligation is defined by the business relationship contracted between the buyer and seller of the financial services or products and should not be prescribed by the CSA or an SRO.

Many of Advocis' members who are financial advisors typically use a *Letter of Undertaking* to define the scope of the advisor's role in the client/advisor relationship and an *Investment Policy Statement* that captures the agreed points of reference by which the investor's objectives are to be implemented and achieved. We believe that an *investment policy statement* tailored to a client's specific needs and risk tolerance is a more effective means for determining investment portfolio suitability than the typical KYC checklist.

**Advocis Recommendation:** We believe that an *investment policy statement* should also be recognized by the CSA as an acceptable means for determining a client's investment portfolio suitability, as an alternative to a prescriptive KYC checklist.

**5.6 -- Leverage Disclosure:** We believe that a client should be made aware that leverage is not a short-term strategy prior to engaging in such an investment strategy.

**Advocis Recommendation:** The written leverage disclosure statement provided to the client should include a duration comment indicating that leverage should only be considered as part of a long-term investment strategy.

## 2. Relationship Disclosure

### 5.10 -- Providing a Relationship Disclosure Document (RDD):

Advocis supports meaningful disclosure to retail investors that is easily understood, relevant to the transaction, mitigates real or potential conflicts of interest and will help investors make more informed decisions with respect to the risks associated with financial products.

To help its members achieve this objective, Advocis includes in its Best Practices manual an *Advisor Disclosure Reference Document* and an interactive disclosure and suitability tool that guides advisors in complying with regulatory disclosure requirements for all client transactions. This document is an example of how principles-based regulation can and should work. Insurance regulators turned to the industry to define the parameters around appropriately implementing conflict of interest principles. The *Advisor Disclosure Reference Document*, a six-point disclosure guideline, was developed by all key stakeholders in the life and health insurance industry, and as such had buy-in from all market participants before it was disseminated to companies, brokers and agents across Canada. This approach, in our view, supports widespread compliance.

We believe that clients are currently being overwhelmed with paper and requests for signatures and other requirements. In our view, the RDD is much too prescriptive and is inflexible for the current financial services marketplace. In addition, much of the information required for the RDD is currently provided for in the *client engagement letter*.

**Advocis Recommendation:** To the extent that the content of the RDD is generally already provided for in the *client engagement letter*, we believe that the same information need not be duplicated in an RDD. The content of the RDD and/or *client engagement letter* should be determined by the contracting parties, not prescribed by the CSA or SRO.

## 3. Compliance

As cited above in our response, Advocis believes that the Proposed Rule will generally impose certain unnecessary regulatory burdens on our members who do not directly participate in the Canadian capital markets, and it should therefore be amended to allow for CSA exemptions recognizing cross-pillar harmonization where appropriate. Under such a framework, we would have no specific concerns with the conduct rules' proposed compliance requirements, particularly as they are not new, are intended to be principles-based, and provide non-SRO firms flexibility to demonstrate to regulators that they have an effective compliance system.

## 4. Complaint Handling

Advocis is a strong proponent of the need for consumer dispute resolution mechanisms so that consumers may have their complaints adequately addressed or obtain information about the regulatory process.

Advocis believes that the complaint-handling rule seems reasonable and we do not have any specific concerns with the requirements. We support the CSA's position that recognizes that different complaint resolution mechanisms are available depending on the sector in which the registrant is licensed. In addition, Advocis strongly encourages its members to obtain errors and omissions insurance to help resolve professional liability complaints.

## ***Enforcement***

As the vast majority of complaints that are settled involve misappropriation of client funds and fraud, we believe that the bodies established to deal with dispute resolution should have the necessary resources to investigate complaints and significant enforcement powers to ensure that rules and principles are taken seriously. Advocis believes that those who perpetrate such crimes against consumers should be appropriately punished. Moreover, we believe that the CSA should consider including a referral mechanism in the Proposed Rule whereby those individuals could be referred to an appropriate criminal justice system.

### **Part 3 – Conflicts (Part 6 of Rule):**

#### **1. Conflicts of Interest**

Advocis recognizes the need for a mechanism to manage potential conflicts of interest and enhance consumer confidence in the market. Advocis also recognizes the challenges regulators must have in dealing with this issue given the various interests involved and the different ways they could be assessed and balanced.

The proposed Rule sets out an over-arching principle that requires registrants to identify and deal with conflicts, including prescriptive requirements outlining the manner in which they must be addressed. While the rule is comprehensive, it is also complex and onerous, requiring firms to establish internal systems to evaluate the balance struck between competing interests. Advocis believes that a principles-based approach would be simpler and more effective.

The ultimate objective in developing conflict of interest provisions is to ensure that the interests of the client are best served. The insurance industry is also dealing with the same issue and regulators have adopted broad-based principles as a means of managing potential conflicts of interest, which include meaningful disclosure of conflicts of interest and product suitability. Under this approach, if the broker or agent can effectively demonstrate that the product recommendation is suitable to the client, and has made appropriate disclosures, then any actual or potential conflict of interest arising from compensation, ownership or financial relationships is likely to have been effectively managed.

We encourage the CSA to consider a less prescriptive and complex approach in developing conflict of interest rules, and we would be interested in discussing in more detail alternative approaches that the insurance regulators have adopted.

#### **2. Referral Arrangements**

While Advocis supports the intent of the Rule in its attempt to address and reduce the various issues that are associated with referral arrangements, we note that it is very prescriptive in its requirements and puts the onus solely on registrants to ensure that clients are protected.

It is our understanding that the new referral arrangement rules are, in part, a response to the emergence of more sophisticated and complex financial products and the desire for advisors to have significant knowledge of these products and to ensure clients are equally aware. Indeed, there are risks inherent in new products, which can be magnified if disclosure from advisors to clients regarding risk, fees or conflicts is inadequate in circumstances where financial advisors have not followed the appropriate rules and regulations in dealing with their clients, including knowledge of products in referral arrangements.

Notwithstanding, significant efforts must also be made to appropriately assess the form and structure of new financial vehicles in terms of their viability and sustainability before they go to market. While additional effort needs to be focused on compliance activities and investor education to enhance the level and quality of information disclosed to investors and to improve their understanding of this information when making their investment decisions, significant effort must also be placed in reviewing and vetting financial products before investors are exposed to them. Only then will any additional obligations of financial advisors relating to referral arrangements be of benefit to investors from a consumer protection standpoint.

We believe that the Proposed Rule does not go far enough to address how the CSA plans to reduce the incidence of fraudulent products entering the marketplace. We believe that the Rule should also outline how the CSA will take steps to ensure that investment products are appropriately vetted to prevent unsuitable and fraudulent products from entering the market, before they are inadvertently sold or referred by financial advisors.

## **SECTION D -- CONCLUSION**

We thank the CSA for the opportunity to provide our comments on this important rule. We urge the CSA to consider our concerns and recommendations, and amend the Proposed Rule to reflect the needs of our members. Advocis members represent a significant part of the financial services sector in Canada, and they wish to continue to conduct their businesses within registration categories that are acceptable to both Advocis members and the CSA. It is our goal that our members work within a regulatory framework that meets the objectives of all market participants and securities regulators without imposing undue hardship on advisors who are in compliance with securities rules.

\* \* \* \* \*