



Advocis
390 Queens Quay West, Suite 209
Toronto, Ontario
M5V 3A2
T 416.444.5251
1.800.563.5822
F 416.444.8031
www.advocis.ca

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Richard J. Corner
Vice President, Regulatory Policy
Investment Dealers Association of Canada
121 King Street West, Suite 1600
Toronto, ON
M5H 3T9

Dear Mr. Corner:

RE: Implementation of the Client Relationship Model

We are writing on behalf of Advocis, The Financial Advisors Association of Canada, to provide you with our comments on the Investment Dealers Association of Canada (IDA) proposed rule changes to implement the core principles of the Client Relationship Model (CRM). Advocis strongly supports consumer protection and has been working with federal and provincial regulatory authorities on various initiatives in this regard. While the IDA states that it has explored principles where necessary and appropriate, we believe the approach taken in the proposed rule changes has the effect of adding another layer of requirements and increasing compliance costs for advisors with little proven investor protection benefits.

Advocis is a national professional association that is committed to preparing, promoting and protecting financial advisors in the public interest. We do this by providing a professional platform including career support, designations, best practices direction, education, timely information and professional liability insurance. This strengthens the relationship of trust and respect between financial advisors and their clients, the public, and government. Advocis is Canada's largest association of financial advisors, representing life and health insurance licensees, and mutual fund and securities registrants across the country for over a century. Our members are individuals, the majority of whom carry on business as either sole proprietors or independent, small businesses. A smaller proportion of Advocis members operate under employee-employer arrangements of financial services firms. We represent advisors at all stages of the business cycle, ranging from new entrants to the industry through to mature practices led by leaders in the industry serving a significant client base.

General comments

Advocis has a keen interest in the Canadian Securities Administrators (CSA) Registration Reform Project intended to harmonize, streamline and modernize the registration regime across Canada, which is being implemented through *Proposed National Instrument 31-103 Registration Requirements*. While this massive reform initiative is well intended, we are troubled by some

aspects of the proposed conduct rules to introduce the Client Relationship Model, which form an integral part of this reform initiative.

The proposed conduct rules have arisen out of the Fair Dealing Model proposal, which was introduced originally in 2004 by the Ontario Securities Commission. The proposal came under heavy criticism at that time as being too complex, introducing a substantial number of new rules, and demonstrating little benefit to consumers. While this regulatory proposal has been recently renamed the Client Relationship Model, and is being implemented by the two recognized self-regulatory organizations (SROs), namely the IDA under this set of proposals and the Mutual Fund Dealers Association of Canada (MFDA), its objective is the same as previous iterations – creating an enhanced regulatory regime to guide financial advisors’ activities and interaction with consumers, which for the most part remains rules-based.

It is our understanding that the purpose of the Client Relationship model is to clarify requirements relating to how registrants deal with clients (including enhanced documentation provided to clients), such as the general duty to act honestly, fairly and in good faith; managing conflicts of interest; and duty to assess suitability of investments. We fail to understand why securities commissions and the IDA are moving towards what appears to be a more prescriptive regulatory system in these specific areas of market conduct, where broad principles, in our view, would be much more appropriate. While the IDA’s proposed rule changes contemplate the implementation of some core principles, these are not broadly articulated and come with detailed specifications tantamount to creating more rules.

Advocis is of the view that prescribing rules regarding the relationship between financial advisors and consumers imposes an external framework for the regulation of advice givers, and that the definition of the skills and specific knowledge necessary to deliver professional financial advice to the public should be left to expert standard-setting institutions and professional associations. We believe that viable alternatives exist to the approach currently being contemplated under the Client Relationship Model. Layering more rules and regulations governing how advisors interact with their clients is contrary to a principles-based approach to regulation. Given the already significant degree of prescriptive regulation found in provincial Securities Acts and in the current IDA rule book, a principles-based approach to regulation needs to be seriously considered at this juncture. In our view, the IDA has not clearly identified a particular problem that it is trying to address, nor has it provided any clear evidence or rationale for this initiative. It is not clear to us how the proposed conduct rules, in addition to what already exists in the regulatory framework, will enhance consumer protection or prevent misconduct.

Any new requirements should be principles-based by focusing on the outcomes that requires firms and their representative to achieve rather than on the process or actions firms and advisors must take. This would provide both firms and advisors with the flexibility they need to find the most efficient way to achieve the desired outcomes. A focused approach on protecting the consumer should be based on the commensurate consumer risks and corresponding benefit of added regulation, among other specific factors.

Greater emphasis should be placed on investigation and enforcement of regulatory policies and rules, and punishing “bad behaviour” of a few individuals rather than creating overly burdensome regulations on those who are already compliant. As a significant number of complaints that are settled involve misappropriation of client funds and fraud, we believe that the bodies established to resolve these issues should have the necessary recourse 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.

Placing greater emphasis on developing rules that cause greater burdens for compliant advisors is not in the public's best interest. SROs and their dealer members have become increasingly prescriptive on such issues as suitability that can often restrict the ability of advisors in offering a full range of investment options to meet their clients' needs. The IDA rules are written for dealers, whose interests are often very different from those of advisors. For example, the SROs are proposing that every dealer provide its retail clients with essential details of the relationship they are entering into with the client as part of new requirements for relationship disclosure. However, it is the advisor that forges and maintains the relationship with the client based on trust and personal suitability. A principles-based regulatory approach would give flexibility to advisors in better meeting the financial needs of their clients as financial professionals.

Principles successfully being applied in other sectors and jurisdictions

A high level of proficiency and standards regarding the principles of client–advisor interaction can best be achieved through a professional platform in the delivery of financial advice, which encompasses professional designations, professional codes of conduct through best practice standards, meaningful continuing education and professional liability insurance. These principles already form a major part of the regulatory regime in the life and health insurance industry and are applied by comprehensive financial advisors that offer both insurance and investment solutions to their clients. Our members ensure that they are acting in the best interests of their clients. A principles-based approach to regulation serves to strengthen those standards.

Recent regulatory initiatives in the Canadian life and health insurance sector illustrate how principles-based regulation, with the support and efforts of the industry, is making a significant contribution to widespread compliance of regulatory requirements. Following a comprehensive review of insurance practices over the past few years, Canada's insurance regulators under the auspices of the Canadian Council of Insurance Regulators and Canadian Insurance Services Regulatory Organizations recommended a principles-based approach to enhance and harmonize best practices across the industry and in all jurisdictions to deal with the issue of managing conflicts of interest. The market conduct areas examined by the insurance regulators include similar aspects of the advisor-client relationship that the IDA is attempting to implement under the Client Relationship Model for securities representatives. The broad principles that insurance regulators have tasked the industry to implement are:

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

The industry has responded favourably to these principles and has been working diligently to implement these through a comprehensive and cooperative strategy at the company, agency and individual advisor levels. We would be pleased to outline for you in more detail the initiatives that the insurance industry has been undertaking to ensure that consumers are being adequately protected while supporting intermediaries in adhering to regulatory obligations.

As an organization representing financial advisors that in many cases hold multiple licenses to distribute securities, mutual funds, and insurance products and services, we are of the view that harmonization of regulation must not simply be achieved across Canadian jurisdictions but

across financial services as well. Only then can we achieve a truly consistent, harmonized and modern regulatory system in the financial services sector.

Moreover, Advocis strongly believes that stronger consumer protection can be more effectively achieved through principles-based regulation along the lines of that 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. According to the FSA:

Past experience suggests to us that prescriptive standards have been unable to prevent misconduct. The ever-expanding rule books of our predecessor bodies and our consolidated Handbook, designed to prevent misdemeanor, have not stopped further 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.

Flawed policy development process

Perhaps the most troubling aspect of this reform initiative is the policy development process outlined in your proposal document. According to the document, the first and only time financial advisors were given an opportunity to comment on the proposed conduct rules came in August 2007, three years after the SROs began working on the current version of the Client Relationship Model under the auspices of the CSA Registration Reform Project, once the Ontario Securities Commission had turned over its efforts to bring about the Fair Dealing Model. We do not believe that this forms a constructive consultative process, since it is in the early stages of conceptualizing new policy directions where stakeholder input is the most valuable. Furthermore, early interaction with stakeholders most affected by regulatory proposals can save considerable time and effort within an iterative process, since there would be greater buy-in to the overall approach at the early stages of policy development.

Even more troublesome is the fact that consumers, the intended beneficiaries of the new rules from an investor protection standpoint, have not been formally engaged on the new disclosure requirements. While there was intent to conduct a cost-benefit analysis of the proposals with investors, it did not proceed because of failure to reach an agreement on the intended cost-benefit survey work between regulators, the SROs and industry groups. Advocis was not part of these discussions.

Financial advisors are the intermediaries that deal directly with consumers, so we strongly believe that any initiative that will change the way we are permitted to interact with our clients should have our input directly. We wish to be actively involved in developing, reviewing and commenting on proposals regarding major rule changes such as those contemplated in the implementation of the Client Relationship Model, which will undoubtedly have a significant impact on our members and the entire advisor community. Getting the approach right in the early stages of policy development is crucial if regulators' objectives are to ensure that the

industry embraces specific regulatory proposals being contemplated, and the outcome of consumer protection is to be achieved.


We urge the IDA to consider alternative approaches to achieve its objectives, and to conduct further research on these issues including a robust cost-benefit analysis to ensure that the conduct rule changes contemplated are not imposing unnecessary compliance burden with no demonstrated benefits in the way of enhanced or necessary consumer protection. Regulatory changes of this magnitude should not go forward without this critical analysis clearly illustrating that investor protection benefits significantly outweigh added compliance costs to market participants.

Advocis appreciates this opportunity to provide comments on these important rule changes. We urge the IDA to consider our concerns, and amend its proposals in favour of broad principles. Advocis members represent a significant part of the financial services sector in Canada. It is our goal that our members continue to conduct their businesses 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 current securities regulations.

Sincerely,



Steve Howard, CA
President and CEO
Advocis



Teresa Black Hughes CFP, CLU, RFP, FMA, CIM
Chair
National Board of Directors, Advocis

c.c. Jean St-Gelais, Président et directeur général, Autorité des marchés financières
William Rice, Chair, Alberta Securities Commission
Doug Hyndman, Chair, British Columbia Securities Commission
David Wild, Chair, Financial Services Commission of Saskatchewan
Donald Murray, Chair, Manitoba Securities Commission
David Wilson, Chair, Ontario Securities Commission
Donne Smith, Chair, New Brunswick Securities Commission
H. Leslie O'Brien, Chair, Nova Scotia Securities Commission
Winston Morris, Superintendent of Securities, Newfoundland and Labrador
Mark Gallant, Registrar of Securities, Prince Edward Island