Independent Financial Brokers of Canada
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October 19, 2018

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission of New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:
The Secretary
Ontario Securities Commission
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Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
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Submitted by email:
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Dear Sirs and Mesdames:

Subject: Request for Comments on Proposed Reforms to Enhance the Client-Registrant Relationship

Independent Financial Brokers of Canada (IFB) welcomes the opportunity to provide comments on the proposed reforms to National Instrument 31-103 and Companion Policy 31-103CP on behalf of its approximately 3,500 members across Canada.

IFB is a national, voluntary, not-for-profit association incorporated for over 35 years. IFB members are licensed financial advisors who operate on a self-employed and independent basis. IFB does not

represent employees of financial institutions, or career advisors of proprietary firms. Most IFB members operate small to medium sized financial practices in their local communities. They provide personalized advice, mostly funded on a commission basis, and offer clients a reasonable cost-effective choice beyond their local bank branch. The majority are regulated by the MFDA or IIROC, as well as their respective provincial life insurance regulators. Many also provide clients, either through their own firm or through their referral networks, with complementary services such as financial planning, group benefits, estate planning, mortgages, exempt products, and deposit brokering.

IFB has responded to, and actively participated in, the many previous consultations and roundtables held by the CSA, and some CSA members. We bring issues to the conversation that are specifically focused on potential impacts to clients of the small businesses and firms IFB members operate, thereby giving regulators a different perspective than that of large organizations and trade associations.

At the outset, IFB commends the CSA for having reached agreement on a harmonized set of reforms to enhance the relationships between investors, advisors and firms, and that this has been expanded to apply to all securities registrants, not just to mutual funds. Many IFB members are licensed in multiple jurisdictions and it was a major concern of IFB's that if the CSA could not arrive at a harmonized approach, registrants conducting business in multiple jurisdictions would face a fragmented regulatory system that would not serve investors, or the industry, well.

Initial Observations

We note, as we have on many previous occasions, that it is becoming increasingly difficult for small and medium sized financial service providers to compete with large integrated financial firms, largely due to increasingly high compliance costs. This shift is borne out in the number of mergers, acquisitions or exits from the market of smaller firms. According to MFDA statistics, the number of firms regulated by the MFDA has declined from a high of 250 in the early 2000s, to 91 as of July 31, 2018. Regulators must recognize how a dearth of personalized advice from smaller, independent firms will reduce choice for consumers who want to seek an alternative to obtaining advice from large financial institutions.

At the same time, regulatory bodies expand. As an example, the MFDA – despite widespread input from stakeholders that it not do so – continues to develop an in-house CE framework for its upcoming mandatory requirement. Most stakeholders support a CE requirement as a means of improving advisor proficiency. However, this could have been accomplished in an efficient and inexpensive way had the MFDA simply moved forward with the requirement and allowed industry and retail education providers respond with course materials. Many advisors are already subject to other mandatory professional requirements for CE, and these existing platforms could have been leveraged. Instead, we have a framework still under development, with no implementation date, and being pursued on a cost recovery basis with, no doubt, a need for more staff.

While the cost and delays are concerning, perhaps more concerning is that, despite the increased focus on client-centric reforms and advisor proficiency, the MFDA - the national SRO for Canadians' most popular choice of investment- is delaying implementation of a proficiency requirement. We urge the

CSA to consider the cost, timing and implementation of the CE program as part of these other initiatives intended to improve investor protection.

IFB has observed that the Companion Policy 31-103CP contains a considerable level of detail not contained in the Instrument itself. At times, the CP uses language which appears to be more indicative of mandatory regulatory requirements than guidance. It would be helpful for all registrants, and would further clarify the CSA's expectations, by either removing the language in the CP which implies a mandatory requirement, or move those sections of the CP into NI31-103.

Below are our comments on the specific proposals set forth by the CSA.

Section 3.4.1 Firm's obligation to provide training
IFB agrees that representatives should be proficient in the securities they sell, and remain current with their compliance obligations under securities regulation. Under the product training requirement, however, registrants would be required to receive training on all securities available through the firm.

Some firms are likely to offer a wide range of products, not all of which may be of interest to every advisor or suitable for their clients. An expansive product-related requirement could quickly become cumbersome – even overwhelming - for firms and advisors and, therefore, unlikely to achieve the intended result. Additional guidance on the acceptability of incorporating existing informational tools, such as the Fund Facts, prospectus documents, etc., would be helpful in reducing the impact of developing product related education programs.

In our view, the requirement for advisors to receive specific training on the updated compliance expectations, including conflicts of interest, KYC, KYP and suitability, consistent with putting the client's interest first, will be well-received by many advisors. Advisors are at the forefront of the client relationship and should be kept well-informed of changing regulatory expectations.

The MFDA is proposing to introduce a compliance course as part of the mandatory CE framework noted above. This should be recognized in the CSA proposal.

IFB is an education provider and supports the ability for registered firms to outsource training. This will promote a cost-effective and competitive marketplace.

Section 13.2 Know Your Client
IFB has noted in previous consultations the challenges advisors can face in keeping client files updated. Specifically, IFB members can deal with clients who, for personal or confidential reasons, do not want to undergo a complete risk assessment, or refuse to provide detailed information, or do not respond to repeated attempts by the advisor to contact them with important information. These circumstances can create regulatory risk for the advisor. Depending on the advice sought or product purchased, clients want to have some flexibility in deciding on the amount of detail they must divulge.

As a result, IFB has highlighted the need for a solution that addresses the shared responsibility of clients in keeping their information up-to-date, and that recognizes that clients should have a voice in determining how much information wish to share. Advisors who encounter such situations would be required to obtain documented client consent, which would then be re-visited by the advisor on a regular basis, similar to the triggering events identified by the CSA for updated KYCs. IFB recommends the CSA acknowledge the responsibility that clients share in developing and maintaining their account information in the proposals.

The CSA guidance is very detailed on the factors to be used in determining the client's risk profile, and financial circumstances (including deposits/holdings kept outside of the firm, and anticipated and unexpected expenditures). This may require comprehensive financial planning analysis, which may be beyond the competency of the advisor. Similarly, the requirement to identify alternative investment actions more likely to achieve the client's investment objectives and returns could result in advisors acting outside their license, leaving them open to disciplinary action and fines, or even litigation. The impacts of these proposals should be reconsidered in this light.

Section 13.2.1 Know Your Product (new)

Generally, IFB supports the inclusion of a specific KYP requirement. The new KYP rule requires that a firm only make an investment available once it understands the security and how it compares to similar products, then approve it and monitor it on an ongoing basis. Advisors also have KYP requirements to take reasonable steps to understand the security, its costs (initial and ongoing) and the impact of costs on the client.

However, the CSA expands upon this and sets out its expectation that the new KYP requirements will result in improvements "including a higher provision of lower cost, better performing securities to clients". We are concerned with the emphasis placed on cost as a defining factor to achieving acceptable KYP, and suitability determination. While cost is an important factor, lower cost does not always equate to better performance, or a more suitable product choice, and ignores the many benefits an advisory relationship can have for clients. Our concern is that advisors will feel pressured to recommend only the lowest cost alternative.

The Canadian Council of Insurance Regulators and Canadian Insurance Supervisory Regulatory Organizations recently published their *Guidance Conduct of Insurance Business and Fair Treatment of Customers (FTC)*[1] which sets out the regulatory expectation that all parties involved in the sale and manufacturing of an insurance product will incorporate FTC principles into all stages of the life-cycle of the product. The Guideline shares the CSA's client-centric focus. Of particular note is the expectation in the product design stage that "*policies, procedures and controls be put in place that enable the Insurer to…target the Consumers for whose needs the product is likely to be appropriate, while preventing or limiting, access by Consumers for whom the product is likely to be inappropriate".*

[1] https://www.ccir-ccrra.org/Documents/View/3378

Of further note is guidance from an IOSCO survey[2]. While it related to structured products, it has relevance in its observation that "*many regulators have in the past focused their attention on the point-of-sale, while regulators in some jurisdictions (for example in the UK and the EU more broadly) are increasingly introducing more focus on product design. Investor outcomes…may be improved through setting requirements for firms earlier in the value chain…with fewer incidents of products reaching the wrong investors or being poorly designed.*" These approaches underscore how applying KYP principles earlier in the product design stage could be another regulatory tool the CSA could build on.

13.3 Suitability Determination

The CSA proposes a new requirement that the client's interest must be put first when making an investment action, and that registrants must take a portfolio approach to client holdings, as part of their suitability determination. In doing so, advisors must consider the KYC and KYP information across all accounts held at the firm and outside of the firm.

This latter requirement will be particularly problematic for advisors, as it is likely that many clients will object to such financial disclosures for reasons related to privacy, or will find it unduly invasive. We also question whether this is a useful exercise, as it is unlikely the information could be kept updated in any meaningful way, and may even mislead clients into thinking that the underlying investment strategies in each account share a common outcome. Based on this, IFB recommends this be removed or, at a minimum, that clients have the ability to indicate their refusal in writing, thereby relieving the advisor from this part of the suitability obligation.

The move from assessing suitability on a trade-by-trade basis (as per MFDA requirements now) to a portfolio basis will be costly, and a significant change for MFDA dealers and representatives, likely requiring a lengthy transition period.

Section 13.4 Conflicts of interest (COIs)

IFB supports disclosure and transparency in client relationships, including informing clients of, and properly managing, conflicts of interest. The financial advice that a client seeks from an advisor can range from little or no input, to discretionary account management. Any standard governing conflicts of interest should reflect that advice can be scaled depending on the needs and wants of the client.

IFB agrees with the need for firms and advisors to take appropriate measures to identify, mitigate and manage conflicts of interest in favour of the client. Further, we agree with the expansion of COIs to apply to all securities products, rather than only to mutual funds. We are, however, concerned that the breadth of what has been proposed will lead advisors and firms to reduce the services or products offered to investors, more out of concern of potential regulatory action than the seriousness of the conflict.

For example, the current proposal abandons the concept of a material conflict, and expands the rules around assessing, documenting and disclosing to the client all conflicts, including those that are "reasonably foreseeable". Further clarity is needed on what "reasonably foreseeable" means and how

[2] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD434.pdf

advisors and firms will be held accountable for having met the test at the time, yet likely only adjudicated with the benefit of hindsight, in the event of a client complaint or regulatory audit.

The presence of a conflict of interest does not mean it will result in adverse consequences for the client. We believe there is risk that advisors will feel pressured to reduce the scope of the products they recommend, and to recommend products based on the lowest cost to the investor. Today, clients have the option of choosing to obtain (and pay for) advice or invest on their own.

IFB supports disclosure of conflicts of interest, including compensation, to investors. Investors should have the ability to judge whether the fees they pay – embedded or not - make sense relative to the services they receive. However, under these proposals, we see it likely that the market will shift toward recommending lower cost ETFs, over mutual funds, and to increasing the use of fee-based arrangements, where clients will be required to pay the fee upfront. It should be acknowledged that fee-based arrangements are not without conflicts of their own. Many clients prefer the commission structure and would find it uncomfortable to negotiate a fee-based arrangement, or have no awareness on which to judge what a reasonable fee might be.

Most consumers seek the services of a financial advisor to help them set realistic financial goals and guide them through the various investment options available. Advisors, as licensed professionals, rely on their knowledge of the client, the client's risk tolerance, and the financial marketplace to deliver appropriate advice, and apply this to the products they recommend. The concept of risk-based investing seems to have been replaced with prescriptive requirements that seek to guarantee positive outcomes for clients, which is an unrealistic expectation for any investor. Investing is, by its nature, a risk-based activity.

In practical terms, the CRM2 disclosure related to client accounts, fees, and performance has created opportunities for clients to initiate further discussion on these issues, thereby bolstering the disclosures already required at account opening, and on an ongoing basis. In addition, the CSA has a study underway to measure and research the impact of the most recent mutual fund Point of Sale changes and changes arising from CRM2. It may be prudent for the CSA to consider the findings of this study before introducing more detailed changes at this time.

i) 13.7 and 13.8 Referral Arrangements

The proposals in 13.8(1) would limit registrants from paying a referral fee to a non-registrant. IFB believes this is unduly restrictive. Many advisors rely on referrals to build their business, and to add value and convenience to their clients by expanding the scope of services clients can access through them. Common examples might include a referral to an accredited financial planner, life insurance agent, lawyer, accountant, etc. The MFDA and IIROC already have extensive rules that regulate disclosure and acceptable referral arrangements to ensure the client is aware and approves of the arrangement.

IFB thinks a better solution is to permit referrals between those who are otherwise subject to regulatory or professional oversight, rather than limiting referrals to another securities registrant. The OSC has

expressed concern that some firms use internal referral systems that may result in payments to unregistered individuals leading to unregulated oversight. Our concern, however, is that the impact of these proposals will go well beyond the OSC's target groups.

IFB believes the unintended negative consequences of the referral proposal will be disproportionately felt by the many small registered firms and sole proprietorships who contribute valuable financial expertise to individuals and families in communities across Canada, and whose clients rely on this expertise. These advisor firms may be forced out of business to address an issue that has no relevance to their business model, nor are the target of the OSC concern.

We submit that our solution could leave room for regulators to restrict arrangements within corporate financial groups, but still permit duly-licensed advisors to provide access to the more holistic services that other professionals provide and that clients increasingly demand.

CSA Questions:

Does prohibiting a registrant from paying a referral fee to a non-registrant limit investors' access to securities-related services?

Yes. We believe the impact of this will be especially significant for small firms and sole proprietorships, like those most IFB members own. These rules will be yet another factor that will push independent firms out of the market and leave investors with little choice but to obtain their advice and access to wider services from their bank and bank-owned channels.

We also note that limiting referrals to another registrant means clients will be limited to those who provide investment advice, when referral arrangements often provide a 'team' approach to deal with a range of client needs. The vast majority of advisors have their client's best interests at heart and want to see them succeed in whatever stage of life (wealth accumulation, saving for their children's education, retiring with sufficient funds) or business they are in.

We encourage the CSA to find ways to deal with its specific concerns arising from referral arrangements in vertically integrated firms, while not disadvantaging investors who are benefiting from the wider access to professional advice.

Would narrowing section 13.8.1 (Limitation on referral fees) to permit only the payment of a nominal one-time referral fee enhance investor protection?

No. Limiting permission to a one-time referral fee ignores the ongoing nature of most advised relationships, as does the restriction on the allowable referral period. Most clients who are referred to another professional, for example for insurance, financial planning or tax planning purposes, will receive advice and services on a regular or ongoing basis. We agree that clients must be aware of the referral and agree to it, and it must be in the best interest of the client. Clients are free to exit the arrangement with either party if it does not meet their expectations or needs.

As noted above, we encourage the CSA to address its concerns regarding the referral arrangements in vertically integrated firms specifically, rather than taking such a broadly restrictive approach.

ii) Sale of proprietary products

IFB welcomes the CSA proposal to prohibit monetary or non-monetary benefits that bias individual recommendations of proprietary products over non-proprietary products. We also support clear disclosure to clients when advisors recommend the purchase of proprietary investments, and the requirement for the advisor to assess the competitiveness of proprietary products against non-proprietary products.

IFB has often stated in previous submissions that the sales incentives and conflicts present in the sale of proprietary products and in large integrated financial firms must be recognized and controlled for. This has been the subject of the FCAC investigation and subsequent report that uncovered widespread sales pressures and practices in Canadian banks.

Indeed, New Zealand's Financial Markets Authority observed in its 2015 "Report on Sales and Advice" that: *Vertically integrated distribution models, where a business is the provider, manager and distributor of a product, can exacerbate conflicts of interest. Remuneration and incentive arrangements can also reinforce conflicts of interest, particularly when sales staff are remunerated on a volume basis or through certain bonus structures*.

iii) Boards of Directors

The CSA considers it a conflict of interest for registered individuals to serve on a board of directors, and one that regulators consider when assessing an individual's initial, or continuing, fitness for registration. As well, firms are required to consider such director positions when approving an outside business activity (OBA).

IFB is a federally incorporated, not for profit professional association governed by a volunteer board of directors, drawn from its members in good standing. IFB is not a registered firm, but members who serve on the Board may be securities registrants. As registrants, IFB members are required to disclose Board service as an outside business activity to their firm.

IFB draws attention to this section because, going forward, firms are likely to take an increasingly cautious stance when dealing with any perceived conflict of interest, regardless of the materiality. This could lead firms to not approve the OBA of an IFB Board member, where that member is also a registrant. Conversely, serving on the Board may be viewed by registrants, who are IFB members, as an activity that puts their registration at risk. Either of these results would be detrimental to IFB, while not in any way addressing the intent behind the CSA position: consumer protection.

To address this, IFB proposes that there be an exemption from the COI rules for such directorships or, <u>at a minimum</u>, that a condition be added that regulators and firms cannot unreasonably withhold approval.

Section 13: Misleading Communications
IFB agrees that representatives should hold out to the public in a manner that accurately reflects their proficiency, and is not misleading or potentially deceiving. IFB members are subject to the holding out guidance that already exists through MFDA and IIROC Rules, including the requirement that firms pre-approve the use of an advisor's title, and monitor the advisor's internet and social media presence. Life insurance licensees are subject to similar provisions.

We are pleased that the CSA is restricting the use of corporate officer titles, except where the individual is a corporate officer, as determined by corporate law. We agree that corporate titles based solely on sales revenues have mislead investors into wrongly believing that these individuals hold senior, influential positions in the firm or product manufacturer, which they often do not.

We encourage the CSA to make its review of titles and designations a priority. It is an important consumer protection issue - particularly for vulnerable or inexperienced investors who may unduly rely on advice from a registrant who appears to have a specific or senior level of expertise which they do not, in fact, hold. Conversely, the proposals should not discourage advisors from taking steps to broaden their skills, education, proficiency, or undertake training to address a specific area of interest.

IFB supports the proposals that firms align their services and products with how they hold out to the public, and specifically that a firm cannot hold out as independent if it is not, or that it operates in a fiduciary type of capacity if it does not. This will improve transparency for the investing public, and promote more informed decision-making by clients.

Section 14: Relationship Disclosure Information
In Section 14, the CSA has proposed increased disclosure arising out of a concern that registrants do not provide investors sufficient disclosure when they use proprietary products.

IFB fully supports restrictions on firms which offer proprietary products from holding out as independent, and improving investor clarity when a proprietary product is recommended. Firms should make clear any restrictions on the products and accounts they offer, so that consumers have a better understanding of the services the firm offers, before they become clients or deciding if they want to remain clients.

Concluding remarks
Overall, we recognize that the CSA has presented a comprehensive and thoughtful set of client-focused reforms intended to lead to better outcomes for investors. We agree that some of the proposals will strengthen transparency and reduce confusion for clients. However, IFB shares the concern of others that the rigor of some proposals may be difficult for firms and registrants to apply in actual practice. Further clarification of regulatory expectations, including defined terms and standardizing of terminology in NI31-103 and 31-103CP will be needed.

Investors and regulators cannot realistically expect bullet-proof outcomes that will always lead to positive investment returns. Investing, by its very nature, is risky. The presence of risk cannot be

forgotten or ignored. Firms and advisors must be able to have some level of comfort that they have satisfied regulatory expectations based on the information that is available to them *at the time the advice was given*, and that they will not be held to a different conclusion in hindsight – in effect creating a 'safe harbour'.

We also see the potential for market consequences, including a reduction in the number of firms (particularly smaller firms), and a narrowing of product shelves. Critics of the current framework often maintain that 'the industry will adapt'. Canada's financial services industry is already heavily concentrated amongst a few very large players. Further concentration, and less access to independent advice, will not improve investor outcomes. Going forward, as the industry adjusts to the proposed changes, investors may have to bear higher costs. The result of which may be to discourage investors from seeking investment advice altogether or turn to channels where no advice is provided.

IFB thanks the CSA for the opportunity to provide these comments on behalf of IFB members.

Please contact the undersigned or Susan Allemang, Director Policy & Regulatory Affairs (email: sallemang@ifbc.ca) should you wish to discuss or have questions.

Yours truly,

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