

May 29, 2012

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Dear Mr. Day:

**Re: Ontario Securities Commission Draft Statement of Priorities for Fiscal 2012/13**

Thank you for the opportunity to comment on the Ontario Securities Commission's (OSC's) Draft Statement of Priorities for Fiscal 2012/2013 (the "Draft SOP").

**Executive Summary of Advocis' main comments on the Draft SOP**

- **shareholder participation and proxy voting:** Advocis supports the OSC's goals of improving shareholder participation and the efficiency of proxy voting. This will benefit retail investors and improve the political economy of the province for the benefit of all Ontarians.
- **exempt market products and capital raising:** Advocis is concerned about individual investor access with regard to certain exempt market products, as well as preserving access to capital for Ontario's small- to mid-sized firms and ensuring access for sophisticated and accredited investors to suitable exempt market products.
- **the cost of ownership of mutual funds:** Advocis is pleased that the OSC is taking a research-based analytical approach to this issue. Advocis' position is that mutual funds offer Canadian consumers access to affordable financial advice that is included in the cost of fund ownership. We anticipate that the publication of an OSC discussion paper will help to correct misconceptions and underscore the value of access to professional financial advice and other advantages that mutual fund investing offers to consumers.
- **review of closed-end funds:** Given that many closed-end funds now convert

into a open-ended funds with the issuers placing additional units, this review is both timely and necessary. Advocis specifically suggests that investors contemplating purchasing either a closed-end fund or an open-end fund would be best served by an OSC requirement that closed-end funds create fund facts sheets similar to those now distributed by open-end mutual fund dealers.

- **risk-based compliance oversight:** Advocis welcomes the OSC's emphasis on risk-based compliance oversight. We believe that the commitment of financial advisors to the promotion of proficiency, professionalism and accountability through associations such as Advocis, can only help the OSC and other financial market regulators and SROs across Canada to build public confidence and trust.
- **stronger enforcement mechanisms and quasi-criminal prosecutions:** Advocis believes that this commitment will prove effective in terms of deterring before the fact non-compliant and criminal conduct by bad actors. Advocis also believes that a more judicious use of existing quasi-criminal enforcement powers will prove a better regulatory tool for OSC staff, investors and the public at large than the long-delayed effort to review and possibly introduce a blanket "catch-all" statutory-based fiduciary duty. Advocis suggests that the OSC make a priority of ensuring the prosecution of individuals and corporations suspected of repeat offences.
- **creation of an Office of the Investor:** Advocis believes that the decision to establish an Office of the Investor may further increase the financial literacy of Ontario investors, and help foster interest and trust in our capital markets. We would suggest that the OSC revise the description of the mandate of the Office of the Investor, to include "financial advisors," so that the phrase reads "... work with investor advocacy groups, financial advisors and regulators to enhance OSC understanding of investor issues."
- **re-evaluation of the adviser-client relationship to consider whether an explicit statutory fiduciary duty should apply to advisers and dealers:** Advocis is well-positioned to judge the impact of a statutory based fiduciary duty on advisors and their clients. A fiduciary duty already exists in Ontario at common law, and Advocis members are already required to act in the best interests of their clients. The imposition of a fiduciary duty by statute will simply shift the onus from the plaintiff from having to prove the existence of a fiduciary duty to the defendant advisor having to disprove its existence. Neither Ontario — nor the rest of Canada — have had the problems which have led other jurisdictions to consider some form of fiduciary obligation. The result is that Ontario should be careful about changing a fiduciary regime that both currently — and historically — has functioned very well. Absent compelling evidence that the current common law fiduciary regime is not effective, and that the costs of replacing it with a statute-based fiduciary regime, won't do more harm than good, Advocis counsels against such a radical change.
- **the development of alternative, tailored disclosure documents:** Advocis welcomes the OSC's intention to re-examine risk disclosure in the Fund Facts

document and in disclosure documents generally. Advisors play a crucial role in explaining these documents to clients.

- **publishing rules that ensure investors receive from their dealers/advisers reports on the ongoing costs and performance of their investments:** Given that investment products and strategies are evolving rapidly, Advocis believes that the OSC should recognize that more and more consumers are turning to professionals for assistance when making financial decisions given the increased complexity of a more diverse marketplace. These Ontarians wish to rely on the advisor-client relationship, and not on the disclosure of information they may not understand and are disinclined to read. The OSC should ensure that any new rules deemed to be necessary are drafted so that consumer choice and needs are respected and responded to effectively.
- **the need to protect investors with regard to complex products:** New financial instruments and structured products have implications for retail investors. Complex new products make it all the more important for investors to have access to knowledgeable professional financial advisors. We believe capable professional advice is crucial to ensuring that investors understand the risks and suitability of such products and are able to make informed choices.

### **Advocis: Who We Are**

Advocis, The Financial Advisors Association of Canada, is the oldest and largest voluntary professional membership association of financial advisors in Canada. Through its predecessor associations, Advocis proudly continues a century of uninterrupted history of serving Canadian financial advisors, their clients, and the nation.

With over 11,000 members organized in 40 chapters across Canada, and almost 6,200 in Ontario, Advocis serves the financial interests of millions of Canadians.

As a voluntary organization, Advocis is committed to professionalism among financial advisors. Advocis members adhere to an established professional Code of Conduct, uphold standards of best practice, participate in ongoing continuing education programs, maintain appropriate levels of professional liability insurance, and put their clients' interests first.

Across Canada, no organization's members spend more time working one-on-one on financial matters with individual Canadians than us. Advocis advisors are committed to educating clients about financial issues that are directly relevant to them, their families and their future. Almost all Advocis members are regulated under provincial securities commissions. As the OSC is a key regulatory body for securities intermediaries and dealers and oversees powers delegated to recognized self-regulatory organizations, its priorities and activities directly affect a significant number of Advocis members. Our following specific comments of the OSC's goals reflect the priorities of Advocis' members and their clients.

### **The OSC's Key Regulatory Priorities For 2012–2013**

Four of the OSC's five regulatory goals for 2012–2013 remain essentially the same as in

previous years. A new, fifth goal represents a response to systemic risk concerns which have emerged following the global financial crisis in 2008.

Overall, Advocis shares the OSC's stated commitments to investor protection, improved transparency and better enforcement.

The OSC's 2012-2013 Statement of Priorities properly assess the new global nature of securities. Of particular interest is the OSC's observation that:

[c]apital markets have changed fundamentally in recent years. We have experienced sharp increases in the breadth of activity as well as changes in the nature of business models and the complexity of products. Securities, insurance and banking products have become more interchangeable and global markets more interconnected than ever before.

Without question, product convergence between the banking, insurance and securities sectors has accelerated and steps must be taken to ensure that like products are regulated in a like manner. On this issue, Advocis argues that a more principles-based approach to regulation will provide the necessary flexibility needed to ensure more consistent regulation of products. This argument can be cast as a harmonization of rules between sectors to ensure a level playing field. However, this should not be interpreted as requiring securities-type regulation for banking or insurance products, anymore that it should be viewed as a call for insurance or banking-type regulation of the securities sector. Each of the financial sectors is unique. We believe that a principles-based approach to regulation will allow regulators to achieve their desired policy goals without the introduction of unintended consequences. Regulators must be careful that regulation of the financial sectors in Canada does not result in product arbitrage – where compliance costs (which are ultimately passed on to the client) for a particular product in one sector increases to the point where a like product in another sector is selected in its stead.

Advocis believes that a commitment to principles-based regulation (“PBR”) in the securities, insurance, and banking sectors will ensure that the proper outcomes, such as consumer protection, will be achieved in a manner that will not result in product arbitrage.

The Hockin Report, with which Advocis was actively involved, adopted many of the recommendations made with respect to the adoption of PBR for securities regulation.<sup>1</sup> Advocis believes that many of the recommendations made are worth reviewing today in relation to the OSC's own priorities.

### **Principles/Outcomes-based Regulation**

The Hockin Report recommends PBR as a new way forward in regulating the Canadian capital markets. A full understanding of the PBR process leads to the conclusion that it is a stronger and smarter form of regulation than what currently exists:

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<sup>1</sup> Expert Panel on Securities Regulation in Canada. Chaired by The Honourable Thomas Hockin, P.C. *Final Report and Recommendations*. January 12, 2009. Accessible at [www.expertpanel.ca/eng/reports/index.html](http://www.expertpanel.ca/eng/reports/index.html).

- it's stronger because avoidance of a rule or policy based on a merely technical interpretation becomes nearly impossible;
- it's stronger because avoidance is met with more effective enforcement; and
- it's stronger and smarter because the regulated community has a greater interest and role to play in developing rules and ensuring that rogue industry participants are brought into line, as the regulation that is produced through PBR has a stronger market focus and is good business policy.

In a PBR environment, the animating idea is for the regulated industry itself to participate in and design the detailed rules and procedures that will permit the standards set by the principles to be achieved.

The shift to PBR in no way hails the end to regulatory oversight; rather, it is recognition of government's resource limitations in providing the specialized experience and knowledge that industry can provide. It places increased responsibility on the regulated community itself to provide solutions that are consistent with the general principles established by the regulator.

The guiding core of regulatory principles that should direct action on the part of regulators, trade associations, and professional bodies are:

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

Three key elements of PBR are:

- broad-based standards in preference to detailed rules;
- outcomes-based regulation; and
- acceptance of increased responsibility by trade associations and professional bodies in establishing suitable practices to meet the general principles established by the regulator.

As identified by the OSC, product convergence is not a passing fad. Instead, it's a market shift that in large part is driven by changing demographics and the natural operation of the market to address consumer needs. Accordingly, the role of regulators should be to ensure that the proper principles-based rules are established which will allow the market to develop naturally, as opposed to establishing rules that will artificially shape the market. This in no way suggests a weakening of consumer protection – any deficiencies in consumer protection would be viewed as a market failure that requires regulatory intervention.

To the point of consumer protection, we also note your observation that:

[t]here continue to be instances where retail and institutional investors have been sold products that were not adequately explained, were not suitable and did not meet their needs. These problems resulted in investor harm and have shone a spotlight on the inadequacies of the existing disclosure regimes and on the need for financial advisors to appropriately inform investors to enable them to make good investment decisions.

We are aware of international instances where great retail investor harm has resulted from fraud and mis-selling. Both the United Kingdom and Australia offer glaring examples of such malfeasance. However, at the retail level in Canada, we have not experienced similar issues. Further, we would note that the frauds perpetrated on Canadians have largely been by individuals who are not securities or insurance registrants. Take, for example, the high-profile case of Earl Jones, who purported to be a financial advisor, gained the trust of a number of consumers, and robbed them of their savings. This is why Advocis fully supports consumer protection and enhanced recognition of the importance of having a professional financial advisor who belongs to a professional association and is required to carry professional liability insurance to help with investment needs.

Advocis believes that a clear distinction must be made between what has happened in foreign jurisdictions to ensure Canada does not unnecessarily introduce rules that will adversely impact the ability of Ontarians to gain access to a qualified financial advisor. We are of the view that the lack of regulation of the use of the job title "financial advisor" has greatly contributed to the consumer risk. Currently, anyone in Canada can call him- or herself a financial advisor regardless of his or her level of training, financial acumen, and other relevant skills.

Rather than importing regulatory solutions from other jurisdictions, Advocis is of the view that enormous strides can be made to improve consumer protection by ensuring that anyone who holds out as a financial advisor must have the appropriate education, approved credentials, and be governed by a code of professional conduct. We support the need for a more consistent level of professionalism for all who hold out as financial advisors. We also support the creation of a database that would be easily accessible for consumers, so they can be assured that the person they are dealing with is in fact a licensed financial advisor; this measure would go a long way in addressed the risks posed by the "Earl Jones" type of fraudster.

Please find below an item-by-item list of the OSC's goals and initiative and Advocis' comments on them.

### **Goal #1 – Deliver Responsive Regulation**

- **"The OSC strives to identify the important issues and deal with them in a timely way. The OSC will continue to be proactive in pursuing regulatory standards that discourage or pre-empt regulatory arbitrage, maintain or improve market confidence, reduce financial crime and safeguard investors. Expanding OSC research and analytical capabilities in support of policy making and operational decisions will better inform policy development."**

Advocis supports this goal. Improving shareholder participation and the efficacy and efficiency of proxy voting are goals which benefit retail investors and improve the political economy of the province for the benefit of all Ontarians. Advocis suggests that some tracking or monitoring system be put in place for an annual review of the OSC's efforts to achieve greater operational and policy efficiencies in these areas.

- **Improve the proxy voting system by:**
  - **conducting an empirical analysis to review concerns raised about the accountability, transparency and efficiency of the voting system**
  - **facilitating discussions amongst market participants on improving the functioning of the proxy system, taking into account the needs and concerns of retail investors, and**
  - **working with the CSA to review the role of proxy advisers in our capital markets by soliciting feedback from issuers, investors and other market participants.”**

In terms of proxy voting, Advocis would urge the OSC to consult with stakeholders to help ensure unintended consequences do not arise as a result of reforms in this area, particularly for advisors and their clients. For example, in the fund context, the shares held by the fund company must be voted in the best interests of the beneficial owners (the unitholders) by the legal owner. With respect to securities lending practices, under *National Instrument 81-102*, fund companies can lend securities. The issue Advocis wishes to raise is whether there is a mechanism in place to determine if a fund has lent a significant portion of a particular holding to an entity, for the explicit use of the borrowing entity to exercise its vote on a target entity the acquisition of which would run counter to the interests of the unitholders or the investment objectives and strategy of the fund as set out in the prospectus. This could become an issue in a takeover bid where the interests of the unitholders (the beneficial owners) may run contrary to the interests of the fund company or portfolio managers for the fund.

Lending the securities to an entity which then votes the shares in a way that is contrary to the investment objectives and strategy of a fund could facilitate circumvention by a fund manager or portfolio manager of fiduciary obligations owed to the unitholders.

The impact on advisors and consumers could take many forms. One can imagine an investor complaining that his advisor told him that he is investing in an ethical fund company which will not be involved in the raising of capital for companies selling nicotine products. Later the investor discovers that the fund company loaned securities to help drive a takeover of a company that is undervalued in North America but is now poised to explode in value because it has signed a contract with a foreign cigarette company. The incensed investor in the ethical fund now feels that the fund manager deliberately evaded the spirit of agreed-upon constraints, making the investor the unwitting participant in the acquisition of an undervalued target for the sole purpose of reaping profit from a “proscribed” activity. In the result the investor feels his personal investing values were trampled upon and that his advisor failed him. He now wants legal redress against the advisor, who failed to explain this possibility – however remote – to him.

- **“Undertake comparative research on capital raising regimes in other jurisdictions, including gathering economic data focussing specifically on approaches to**

**raising capital for start-up and small businesses. This work will include consultation with issuers, investors, dealers, academics and others.”**

Advocis welcomes the OSC's commitment to study the approaches taken in other jurisdictions' to capital-raising. We look forward to participating in the consultation. Advocis would caution that a commitment to review the regulatory activity of other jurisdictions should not become the prelude to a relaxing of the OSC's own regulatory standards.

- **“Consider and consult on alternate capital raising exemptions in Ontario in addition to the accredited investor and \$150,000 exemption.”**

Advocis is concerned about individual investor protection with regard to certain exempt market products, as well as preserving access to capital for Ontario's small- to mid-sized firms and ensuring continued access for sophisticated and accredited investors to suitable exempt market products. The OSC, along with other CSA members, have initiated consultations with respect to the accredited investor and minimum amount exemptions. In these consultations Advocis has stressed the importance of professional advisors and their key role in providing advice to clients on suitable exempt market products.

For the minimum amount exemption, Advocis recently submitted to the CSA that the current \$150,000 threshold be retained and indexed for inflation. As well, Advocis submitted that the threshold amount be dropped to \$20,000 when the exempt market product is distributed through a financial advisor who is registered with an exempt market dealer and the product is managed by a registered portfolio manager and comes with an Offering Memorandum. For the accredited investor, Advocis again submitted that the current threshold amounts be retained and indexed for inflation.

Advocis also argued that a second, separate accredited investor test should be introduced. This test would require that the exempt market investment be distributed through a financial advisor who is registered with an exempt market dealer and comes with an Offering Memorandum. With these qualifications met, the current accredited investor exemption's income and asset thresholds could be reduced by 50%. The result of these proposed alternative minimum amount and accredited investor exemptions would be a significant reduction in the risk of an individual making an inappropriate exempt market investment, while simultaneously enhancing the range of investment opportunities available to individuals and improving access to capital for companies.

Advocis also argued that, prior to the purchase of a product pursuant to our proposed additional minimum amount and accredited investor exemptions, an individual investor should be required to sign a risk acknowledgement form. The use of such a risk factor disclosure document will provide regulators with further assurance that the investor has understood the risks, and provides the dealer with a degree of extra protection in regard to possible allegations of misconduct.

Given the growing complexity of exempt market products, Advocis proposed a requirement that all registrants participating in the exempt market pass an approved exempt markets course. This would help ensure that a basic standard of proficiency is met by key parties to an exempt market transaction.

Given the foregoing, Advocis would urge the OSC be mindful of the need of new and small- to mid-sized companies to be able to access capital through the exempt market. It is estimated that \$83.9 billion was raised in the exempt market in 2010 alone. Advocis therefore believes that informed retail investors who deal with exempt market registrants and sign a risk acknowledgment form should still be able to invest in various exempt market products.

Advocis was pleased to see that the OSC's Investor Advisory Panel (IAP) recommended, like Advocis, the introduction of a risk acknowledgement form for exempt market investors. The IAP concluded that financial advisors play a crucial role in the exempt market, noting that "financial advisors may be in the best position to assess the investment/experience and recommend suitable investments."<sup>2</sup> Advocis hopes the OSC shares this conclusion of its IAP and looks forward to participating in consultations on requirements for participation in the exempt market and alternative capital-raising exemptions.

- **“Conduct research and analysis, and publish a discussion paper on the cost of ownership of mutual funds in Canada, identifying investor protection and public interest issues.”**

Advocis looks forward to the opportunity to participate in consultations regarding the cost of ownership of mutual funds in Canada from the perspective of investor protection and the public interest. Advocis is pleased that the OSC is taking a research-based analytical approach to this issue, which is something of a “red flag” on the emotional level for many stakeholders, and – contrary to the position of many industry observers – exceptionally complex on the conceptual level.

Accordingly, Advocis suggests that the OSC consult widely with all stakeholders and engage in an extensive fact-gathering process. Only after the marshalling of all relevant evidence should the OSC begin the determination of the issues regarding the cost of ownership, and after that identify and delineate all possible policy responses. At the end of the analytic process, if a new policy response from the OSC is required, Advocis urges the OSC to take the least prescriptive option available in achieving the desired policy outcome.

Advocis' position is that mutual funds offer Canadian consumers access to affordable financial advice that is included in the cost of fund ownership. Unfortunately, there are misconceptions about the relative cost of owning mutual funds in Canada in comparison to the cost in the United States. We anticipate that the publication of an OSC discussion paper will help to correct misconceptions and underscore the value of access to professional financial advice and other advantages that mutual fund investing offers to consumers.

Much of the confusion and comment on the issue of mutual fund ownership costs in Canada is based on comparisons to the U.S. mutual fund market. As a prelude to any OSC-commissioned study, Advocis would note that when comparing the costs of owning

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<sup>2</sup> February 29, 2012 letter from OSC Investor Advisory Panel c/o Anita I. Anand to John Stevenson, Secretary, Ontario Securities Commission. “Re: CSA Staff Consultation Note 45-401 – Review of Minimum Amount and Accredited Investor Exemptions – Public Consultation, p. 7

mutual funds in Canada and the U.S., it is important to focus on the total cost of ownership over the lifetime of the asset, rather than the reported expense ratio, which only captures some of the costs associated with owning the fund. In September 2010, Mackenzie Financial produced a report comparing these total costs of actively managed, commission-based mutual funds in the two countries.<sup>3</sup> The report concluded that when comparing the total cost of ownership for actively-managed, advisor-driven mutual funds ("full service" funds) at the retail investor level, the amount paid by Canadians and Americans is comparable, at approximately 2.4% for equities and balanced funds and 1.7% for fixed income funds.<sup>4</sup>

The Mackenzie Financial study concluded that for actively-managed, advice-driven mutual funds, the Canadian and U.S. retail investor pays comparable fees. Advocis recognizes that there are differences in the distribution channels used by mutual fund companies in Canada and the U.S. In particular, a large portion of the U.S. mutual fund market is the direct/discount broker segment. However, this channel operates without the presence of the trusted advisor who can provide his professional fund skills and experience to the individual retail investor. Advocis believes that the value of advice and counsel, while difficult to quantify, provided by professional financial advisors to clients wishing to select investment options from the universe of mutual funds more than pays for itself, for those committed to a mid- to long-term investment horizon.<sup>5</sup>

- **“Re-evaluate the regulatory and operational requirements associated with closed-end funds (non-redeemable investment funds) by assessing the rationale for rules that differ from the rules governing the more common open-end mutual funds. This work will include consultations with issuers and investors with a view to publishing new rules for comment.”**

Given that many closed-end funds now convert into open-ended funds with the issuer placing additional units, this review is both timely and necessary. As many Advocis members hold IIROC registrations and deal with both closed-end funds and mutual funds, Advocis supports a re-assessment of the underlying rationale for the regulation governing closed-end funds – and why they differ from the rules governing the open-end mutual funds – since a detailed review of the relevant rules and underlying policies has not been done for many years.

Advocis suggests that the intent of any such review should be to remove redundant rules and put into place a PBR-type of regime for closed-end funds. In the absence of a clear regulatory benefit to requirements specific to closed-end funds, then by all means those requirements should be modified to reflect current regulatory principles, or even eliminated.

Advocis specifically suggests that investors contemplating purchasing either a closed-end fund or an open-end fund would be best served by an OSC requirement that closed-

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<sup>3</sup> Mackenzie Financial, *Canadian Mutual Fund Ownership Costs: Competitive Relative to the U.S.* September 2010. Accessible at [www.mackenziefinancial.com/en/pdf/mackenzie\\_coo\\_report.pdf](http://www.mackenziefinancial.com/en/pdf/mackenzie_coo_report.pdf).

<sup>4</sup> *Ibid.*, pp. 10 -11.

<sup>5</sup> See Claude Montmarquette, “An Economic Analysis of Value of Advice in Canada.” Center for Interuniversity Research and Analysis on Organizations. (Forthcoming).

end funds create fund facts sheets similar to those now distributed by open-end mutual fund dealers.

- **“Undertake research and analysis of increasingly complex financial products and investment strategies and collaborate closely with other regulators and exchanges to ensure regulatory approaches towards investment products are consistent and opportunities for regulatory arbitrage minimized.”**

Advocis supports the OSC's recent efforts to properly research and analyze increasingly complex financial products and investment strategies. Further harmonization of regulatory approaches, provided it is in the consumer interest, is to be lauded, but such harmonization should also recognize the differences that exist in products distributed in different sectors of Ontario's financial markets.

Sophisticated exempt market products, leveraged ETFs and other complex instruments are too often beyond the understanding of retail investors, and often come with unrealistic expectations. Advocis believes that financial advisors have an important role in the distribution of these products by ensuring that all suitability requirements are met. In short, financial advisors who belong to a professional association with a code of conduct and minimum ongoing CE requirements can and do prevent retail investors from adopting imprudent investment strategies and making inappropriate investment product selections.

Product convergence between the securities, banking, and insurance sectors is an ongoing and indeed an increasing trend. We recognize that there are legitimate differences in how the banking, insurance and securities sectors operate, and, consequently, a one-size-fits-all approach to regulation is inadequate.

Advocis also shares the OSC's concerns on regulatory arbitrage, and supports efforts to ensure that regulatory approaches to investment products are consistent across Canadian jurisdictions and, insofar as it is feasible, with the efforts of international regulators as well. That's why Advocis advocates for a principles-based approach to regulation. PBR provides the flexibility needed to accommodate the unique features of each sector. As an active member of the Joint Forum of Market Regulators, the OSC should continue to bolster its efforts to identify core regulatory principles common to the insurance and securities sectors, highlight differences in market, regulatory and supervisory practices across those sectors, and counter in a principles-based manner existing regulatory inefficiencies, opportunities for regulatory arbitrage, and excessive regulatory costs.

## **Goal #2 – Deliver Effective Enforcement and Compliance**

- **“Conduct compliance reviews of website and marketing disclosures by smaller issuers.”**

[AND]

- **“Further develop and implement a more effective, risk-based and proactive approach to both issuer regulation and compliance oversight.”**

Advocis welcomes the OSC's emphasis on risk-based compliance oversight. The reputation of Canada's capital markets continues to suffer, due to the perception, however erroneous, that enforcement is inefficient and ineffective. The ability in some instances of a small number of individuals to evade timely retribution undermines the good reputation of thousands of financial advisors, and undermines investors' trust in our financial system.

With regard to issue of a risk-based, proactive approach to regulation and compliance, Advocis submits that a properly calibrated risk-based approach entails the targeting of high-risk issues and actors and is a suitable, perhaps necessary, strategy for a regulator faced with a regulatory universe of complicated issues. A risk-based approach allows for the proper allocation of limited regulatory resources. Advocis feels that the current regulatory approach is too often to implement regulation that is designed to deal with the small handful of the industry's bad actors in a manner that places the vast majority of good actors under increasingly burdensome regulatory requirements. This only adds to compliance costs and creates a business environment characterized by excessive transaction costs. Advocis feels that the proper targeting of bad actors and prudent use of existing enforcement tools will negate the need for additional regulation. Such "blanket style" regulation all too often results in the regulator using the most costly and restrictive mode of regulation, with new and more onerous requirements which inflicts unnecessary costs on good advisors – and their clients.

We believe that the commitment of financial advisors to the promotion of proficiency, professionalism and accountability through associations such as Advocis, can only help the OSC and other financial market regulators and SROs across Canada to build public confidence and trust.

Advocis submits that conducting compliance reviews of website and marketing disclosures should be done in a manner consistent with a risk-based approach to securities regulation. In the interests of greater investor protection and the conservation of regulatory resources, Advocis would like to know if the OSC has compiled an evidentiary basis for its position that smaller issuers are more likely to violate standards. As part of its advocacy for PBR, Advocis supports evidence-based initiatives regarding compliance reviews. If that is the case in this particular instance, the OSC should be commended: by identifying high-risk market participants and subjecting them to specific compliance review, the OSC is prudently working within a PBR-based ambit, and not engaging in unnecessary regulatory activity which lacks an evidentiary basis.

- **“Promote vigorous and timely enforcement action by reducing timelines for completing investigations and initiating regulatory proceedings.”**

Like all stakeholders, Advocis supports this goal of reduced timelines and urges the OSC to set measurable targets and track its progress towards this goal. Advocis would like to see, if possible, more detailed information on enforcement issues, beyond basic timeline data such as the average number of months from intake to commencement of a proceeding, by including more quantitative and qualitative data, such as a breakdown of proceedings by category, the number and type of substantive issues raised by each proceeding, and the posting on a quarterly basis of information such as this in an easy-to-understand format for Ontarians.

- **“Increase the use of stronger enforcement mechanisms and increase quasi-criminal prosecutions.”**

Advocis believes that the OSC's commitment to using stronger enforcement mechanisms and increasing quasi-criminal prosecutions will prove effective in terms of deterring before the fact non-compliant and criminal conduct by bad actors and also reinvigorate public confidence in the ongoing fairness of Ontario's capital markets.

Advocis also believes that a more judicious use of existing quasi-criminal enforcement powers will prove a better regulatory tool for OSC staff, investors and the public at large than the long-delayed effort to review and possibly introduce a blanket “catch-all” statutory-based fiduciary duty.

Under the *Securities Act*, the OSC has the authority to lay quasi-criminal charges against individuals or companies in the Ontario Court of Justice for alleged violations of the *Act*. Advocis was pleased to see that in April 2011, the Ontario Court of Justice made its first finding of guilt for fraud in quasi-criminal proceedings brought by the OSC, and in fiscal 2010–11, the Court imposed jail sentences on two individuals in proceedings launched by the OSC in regard to violations of cease trade orders. Advocis would suggest that the OSC make a priority of ensuring the prosecution of individuals and corporations suspected of repeat offences. Jail sentences for repeat violators of Ontario's securities law will be a strong deterrent to those actors who would harm Ontario's investors and undermine the efficacy and fairness of Ontario's capital markets.

### **Goal #3 – Deliver Strong Investor Protection**

- **“Key initiatives the OSC plans to undertake to champion investor protection are as follows.”**

The OSC has given itself a full schedule: we see, *inter alia*, a re-commitment to release a paper on the advisor's fiduciary duties to clients in its last statement of priorities, further work on the new Fund Facts documents and the development of similar disclosure requirements for other types of investment funds, further examination of investment products and prospectus exemptions in the exempt market, the establishment of an Office of the Investor, and so on.

Advocis submits that with such a broad regulatory focus, concrete issues, such as effective risk disclosure in Fund Facts, may get lost. As the OSC is the government's primary protector of investors' interests, Advocis is concerned that individual investors are not able to judge for themselves if the OSC is actually fulfilling its annual commitments to investor protection. Advocis believes that the general investing public does not have the inclination to parse its way through the OSC's Annual Review in order to determine which priorities were partially or fully attained, and which weren't.

More specifically, Advocis believes that the annual process of drafting, receiving stakeholder comment and then issuing a final Statement of Priorities would benefit from a formal review mechanism. We envisage an annual stand-alone document which provides an explicit accounting of the steps taken by the OSC to fulfill that fiscal year's Statement of Priorities, compared to what it stated it will seek accomplish. The Office of

the Investor could be a suitable channel for disseminating this information to the Ontario consumer.

**“The OSC will create an Office of the Investor to establish a stronger investor focus and understanding. This Office will:**

- **deepen the OSC’s understanding of investor issues**
- **act as the focus for investor concerns and ensure investor issues are considered in policy and operational activities within the OSC**
- **work with the OSC Research and Data Analysis Group to conduct specific research into investor issues and the implications for regulatory responses**
- **work with investor advocacy groups and regulators to enhance OSC understanding of investor issues**
- **work with the Investor Advisory Panel to support its mandate, and**
- **work with the Investor Education Fund to support its efforts.”**

Advocis believes that the decision by the OSC to establish an Office of the Investor has the potential to further increase the financial literacy of the average individual investor in Ontario, and help foster interest and trust in our capital markets. It is important that retail investors have a forum which can work collaboratively with the Investor Advisor Panel and the Investor Education Fund.

Working with advocacy groups, including Advocis, regulators and SROs will help the Office of the Investor promote public confidence in the markets – provided it is given the mandate and resources to forcefully address those issues that negatively affect market integrity in the eyes of retail investors.

As well, publication of the results of the research and activities of this Office will no doubt be of real benefit to all stakeholders. Given the amount of time Advocis members spend with Ontarians seeking financial advice, we feel confident in saying that the Office will help improve the public’s perception of the OSC's roles and responsibilities.

We would suggest that the OSC revise the description of the mandate of the Office of the Investor, by adding the words “financial advisors,” so that the phrase quoted above reads “... work with investor advocacy groups, financial advisors and regulators to enhance OSC understanding of investor issues.”

We believe that associations that represent financial advisors, such as Advocis, have a significant role to play in representing the interests of investors, and should have a voice along with other consumer advocates in helping the OSC to fulfill its investor protection mandate.

- **“Re-evaluate the adviser-client relationship to consider whether an explicit statutory fiduciary duty or other standards should apply to all advisers and dealers in Ontario. The research underway will be completed, and a paper on the adviser’s duty to clients will be prepared and published in consultation with the CSA.”**

Advocis is well-positioned to judge the impact of a statutory based fiduciary duty on

advisors and their clients. Advocis members are required to act in the best interests of their clients.

Moreover, Advocis also operates the Advocis Protective Association or APA – in effect, an advisor-designed insurance company for providing an errors and omissions insurance policies for both Advocis members and non-member advisors. Advocis is likely in the rare situation of being one of the few commentators to the OSC on this issue which operates its own E&O plan for advisors. We would therefore urge the OSC to undertake in conjunction with its long-awaited research on fiduciary obligations a companion study on the potential impact on providers of professional liability insurance to advisors which would flow from the introduction of a statute-based fiduciary duty. We would also urge that the companion insurance study be completed prior to moving this issue any further forward.

The imposition of a fiduciary duty by statute will simply shift the onus from the plaintiff from having to prove the existence of a fiduciary duty to the defendant advisor having to *disprove* the existence of such a duty. By shifting the onus to the advisor to disprove that he or she was under a fiduciary duty, and assuming that all clients are fiduciaries, the result could be expensive litigation. Such a shift in onus seems inconsistent with the OSC's commitments in other areas to focus on fact-based evidence and data collection as a necessary prelude to effective regulation.

Advocis believes that obligations arising out of the relationship between clients and advisors should be built around enforcing existing rules and common law. Radical departures from existing rules and standards should not be undertaken lightly and we welcome the consultation document that the OSC will be releasing shortly.

A blanket fiduciary standard which assumes all clients are dependent upon and vulnerable to the advice provided by their advisors, regardless of the client's financial acumen and the character of the impugned action, would be a drastic departure from the standard practices of financial services professionals, drive up the costs of financial advice for average Canadians, override fiduciary jurisprudence established through the common law, and prove highly disruptive to virtually all types of investment services provided by intermediaries to all classes of investors.

Advocis is concerned that a fiduciary duty prescribed by statute would not recognize the essential fact that the work financial advisors perform is both broad and varied. Advocis believes that the common law's principled and balanced approach to fiduciary duties – as developed by Canadian courts – and complemented by professional rules of conduct applicable to the advisor, will continue to protect the public's interest.

Under such a regime, trying to establish a common set of expectations on which a client and advisor can agree will prove exceptionally difficult, and in some cases, simply impossible. The truth is that advisors are already under fiduciary duty where warranted by the facts. Advocis urges the OSC not to import a statute-based fiduciary duty simply because of current trends in foreign jurisdictions. The regulatory regimes of the U.K. and Australia, for example, have had to face a variety of challenges in recent years. Not all of these challenges match those currently faced by the OSC, and what may be an appropriate rationale in terms of establishing fiduciary obligations in these jurisdictions is by no means present in or applicable to Ontario. Indeed, if one wished to base the need

for a fiduciary duty on recent regulatory experience, then one must conclude that Ontario's rules and regulatory environment have been effective in averting problems similar to the U.K, the U.S. and Australia. Advocis, like the OSC, believes that scarce regulatory resources should not be spent in the pursuit of merely doing as other regulators have done, in the absence of a real and identified problem existing on Ontario that can *only* be addressed through such radical changes. Unlike Ontario's recent experience, in the U.K. and Australia the public was exposed to widespread fraud in an unparalleled degree.

No statutory fiduciary duty will eliminate fraud, Ponzi schemes, unregistered representatives and unregistered products – the very concerns on which the OSC should focus its efforts. A statutory fiduciary duty is not the most transparent, timely and cost-effective way to deal with the central regulatory problem the OSC faces, which is determining what behaviours registrants can and should undertake, and cannot and must not perform. Far from it. Litigation is costly, messy, slow and authorities rarely get the results they want. Quasi-criminal prosecutions from the OSC will provide far more of a deterrence effect than telling advisors that they must act in the best interests of their clients, since so many of them feel they are already doing just that. The evidence is simply not at hand to support such an expensive and drastic regulatory regime change.

Instead, Advocis would urge the OSC to reinvigorate its efforts at using the more-than-sufficient regulatory tools at hand for the OSC (and, indeed, other CSA members) to use. The issue should be to ensure regulators are properly using these tools prior to implementing any major changes. The common law in Ontario, as well as existing "Know Your Client" and suitability rules are adequate to the task at hand. That is, the issue is more one of enforcement using extant tools and resources.

In sum, a fiduciary duty already exists in Ontario at common law. Nor has Ontario, and the rest of Canada, had the problems that have led other jurisdictions to consider some form of fiduciary obligation. The result is that Ontario should be careful about changing a fiduciary regime that both currently – and historically – has functioned very well. Absent compelling evidence that the current common law fiduciary regime is not effective, and that the costs of replacing it with a statute-based fiduciary regime, won't do more harm than good, Advocis counsels against such a radical change. We look forward to working with the OSC in the consultations on this topic.

- **"The OSC will help investors get the necessary information to enable them to make better investment decisions by:**
  - **applying high standards of disclosure through robust prospectus and continuous disclosure reviews**
  - **developing alternative, tailored disclosure documents – such as: re-examining risk disclosure in the 'Fund Facts' as part of the Point of Sale initiative, and developing similar disclosure documents for other types of investment funds and scholarship plans."**

Advocis welcomes the OSC's intention to re-examine risk disclosure in the Fund Facts document and in disclosure documents generally. During the past year, Advocis met with the OSC to communicate our concerns regarding risk disclosure and the approach taken by self-regulatory organizations such as the Mutual Fund Dealers Association of

Canada (MFDA) to the assessment of investment risk in client portfolios. Advocis made a number of recommendations to the OSC for improvements relating to the assessment and disclosure of risk, including the following:

- that the OSC should work with SROs, dealers, advisors and others to improve KYC risk self-assessment and develop improved best practices and questionnaires;
- that the OSC should work with fund companies to improve their assessments of the risk of their investment offerings, and should require them to provide investors with follow-up reports on the accuracy of their assessments; and
- that the OSC should evaluate the MFDA's approach to assessing investment risk in client portfolios.

The Fund Facts initiative – based on a short, plain-language document that summarizes the key features of a mutual fund in an accessible format – will no doubt help some investors obtain the information they need to enable them to make better investment decisions. The initiative is also of great assistance to financial advisors who serve the much larger group of investors who lack the acumen and interest to make their mutual fund investment decisions on their own. Accordingly, Advocis agrees with the decision to continue the examination of risk disclosure in the Fund Facts in particular and in disclosure documentation more generally.

However, merely increasing the amount of information disclosed to a potential investor is no guarantee that the investor will become better informed. When it comes to mutual funds, studies continue to demonstrate the key role played by financial advisors. Indeed, "investors who purchase mutual funds through an advisor continue to rely on their advisor when making decisions about mutual funds."<sup>6</sup> Advocis believes this is because the majority of retail investors do not fully understand the fundamental objectives, risks, fees and costs entailed by their mutual fund investments. This is why millions of Canadians continue to seek professional financial advice which is delivered by a knowledgeable and trustworthy intermediary, such as an accredited financial advisor who adheres to a professional code of conduct, ongoing continuing education and practice standards, maintains membership in a recognized professional body, and carries adequate errors and omissions insurance to protect both the consumer and the financial advisor. Such advisors can help the average investor better understand some of the major areas in which the current Fund Facts format is inadequate, such as its vague low to high risk measure (which is a self-assessment by the fund sponsor).

Finally, it should also be noted that some mutual fund investors find even the simplified disclosure contained in Fund Facts to be somewhat complicated. Others simply lack the time or inclination to try to understand Fund Facts. For such investors, acquiring professional financial advice from an advisor remains their best way of investing in mutual funds in a way that meets their unique needs. While Advocis might endorse an effort to extend a simplified disclosure requirement beyond Funds Fact to other investment products sold to individual Ontarians, we would urge that the problems

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<sup>6</sup> Investment Funds Institute of Canada, "Canadian Investors' Perceptions of Mutual Funds and the Mutual Fund Industry 2010," p 19.

stakeholders have cited with Fund Facts – such as risk assessment and fee disclosure – be resolved before that happens.

- **publishing rules that ensure investors receive from their dealers/advisers reports on the ongoing costs and performance of their investments”**

Advocis believes that transparency is a key ingredient in any advisor client relationship. Further, Advocis believes that one of the most effective ways to educate and protect consumers is to ensure that they receive professional financial services advice. Given that investment products and strategies are evolving rapidly, and becoming increasingly complex to meet the needs of middle-class Ontarians, Advocis believes that the OSC should recognize that more and more consumers are turning to professionals for assistance when making financial decisions given the increased complexity of a more diverse marketplace. These Ontarians wish to rely on the advisor-client relationship, and not on the disclosure of information they may not understand and are disinclined to read.

We would welcome discussions with the OSC prior to the publication of any rules for comments to ensure that any proposed rules are necessary, and consistent with principles-based regulation. Moreover, the OSC should ensure that any new rules deemed to be necessary are drafted so that consumer choice and needs are respected and responded to. Given the impact that additional rules will have on compliance costs, it is critical that regulators properly consider all costs associated with proposed rules.

- **“The need to assist and protect investors is critical given the availability of complex products, greater reliance on the exempt market for distribution, and potential intermediary conflicts of interest in the distribution of products. The OSC will:**
  - **Examine the exempt market to obtain a better understanding of how and why individual investors participate not only in terms of direct investment in issuers, but also through structured investments sold through exempt market dealers.”**

As noted above, Advocis is concerned about individual investor protection with regard to certain exempt market products. This is, in part, why Advocis stresses the importance of professional advisors and their key role in providing advice to individual clients on suitable exempt market products.

Advocis welcomes changes to exempt market regulation which will place greater regulatory scrutiny on registered representatives who distribute products through the exempt market, especially on through retail channels. Both advisors and dealers involved in the sale of these products should be required to have demonstrated proficiency in exempt markets through having completed an approved exempt market course.

Advocis would urge the OSC be mindful of the need of new and small- to mid-sized companies to be able to access capital through the exempt market. It is estimated that \$83.9 billion was raised in the exempt market in 2010 alone. Advocis therefore believes that informed retail investors who deal with exempt market registrants and sign a risk acknowledgment form should still be able to invest in various exempt market products.

In recent years, certain dealers have failed to properly collect sufficient Know Your Client information in order to reasonably determine whether a client qualifies as an accredited investor. As noted under our comment on Goal 1, Advocis feels that eliminating or even significantly restricting the existing prospectus exemptions is a disproportionate regulatory response. Instead, Advocis believes that the OSC should work with SROs and membership associations to help ensure that advisors or dealers who distribute exempt market securities understand how they function. Such working knowledge is an essential prerequisite for an advisor or dealer to be able to determine if the product is suitable for the client. Advocis firmly believes that existing Know Your Client and suitability requirements provide adequate regulatory force to effectively deal with advisors and dealers who lack sufficient understanding of exempt market products.

New financial instruments and structured products have implications for retail investors. Complex new products make it all the more important for investors to have access to knowledgeable professional financial advisors. We believe capable professional advice is crucial to ensuring that investors understand the risks and suitability of such products and are able to make informed choices. Access to detailed disclosure about risks is not sufficient.

We accordingly submit that the OSC, in reviewing the investor protection implications of new retail investment products, should consider the very positive role that professional investment advisors can play in ensuring that investors are able to make sound decisions.

In terms of retail investor protection with regard to more complex financial products, such as CFDs, leveraged or inverse ETFs, and OTC derivatives, Advocis believes that advisors and dealers must ensure that both they and their clients understand the product being sold and its attendant risks and costs. Certain high risk complex financial products should not be sold to individual retail investors without the advisor or dealer exercising due diligence in terms of adequately establishing that their client has necessary and sufficient level of financial sophistication to understand the product. Advocis believes that advisors, dealers and manufacturers of these complicated products are well-positioned to help clients and investors determine if such products are appropriate for them.

#### **Goal #4 – Run a Modern, Accountable and Efficient Organization**

- **“The OSC continues to pursue its mandate and efforts to improve the efficiency and effectiveness of its operational and policy work. In its efforts to become a more performance-based and accountable organization, the OSC will...”**

Advocis is confident that all stakeholders support the OSC in this part of its mandate and suggests the OSC publish a prioritized list of targeted goals with accompanying metrics to help it achieve greater operational and policy efficiencies.

- **“Prioritize and coordinate policy development. A dedicated committee will be established for the control and prioritization of policy initiatives, to ensure they are aligned with the goals and objectives of the organization and that investors’ concerns and operational issues are considered early in the policy process.**

**Greater emphasis will be placed on assessing the implications of policies, testing implementation of regulations and on collaboration with other domestic and international regulators.”**

Advocis supports this decision by the OSC to employ more testing implementation of new rules, and looks forward to offering input and advice in this and other aspects of the policy development process. Given the size of its membership, Advocis feels that it can be a valuable resource in the process of providing insight on the unforeseen consequences of the current and proposed rules.

We believe the OSC would enhance its ability to prioritize and coordinate policy development, especially with regard to investor protection, by placing on such a committee representatives of everyday consumers, of financial advisors, and of associations like Advocis which advocate on their behalf. No single stakeholder group spends more time interacting with and educating retail investors than financial advisors. As the main point of actual contact and interaction between investment and mutual fund dealers and their clients, financial advisors are uniquely privileged to offer valuable insights to the OSC. Consultation, if it is to be meaningful, must begin early in the policy development process, and must be ongoing.

- **“Establish an Emerging Risk Committee that will develop a framework for the identification and analysis of risk.”**

Advocis supports compliance efforts focusing on new and high risk market participants. But enhancing compliance reviews of market participants to identify and prevent violations of Ontario securities laws should be done through a risk-based approach. As noted earlier, Advocis encourages the OSC to significantly enhance its risk-based approach to compliance oversight to ensure it is targeting riskier situations to be more effective and efficient with its resources.

Advocis believes that there is a high degree of utility to be found in placing on an Emerging Risk Committee a representative for financial advisors, in order to provide to the OSC the advisor's unique perspective. As noted above, no single stakeholder group spends more time interacting with and educating retail investors than financial advisors. The result is that advisors are sometimes “the first in the field” to identify potentially emergent risks – and to help elucidate for regulators their impact on individual retail investors, well before these risks become significant problems in the marketplace.

- **“Expand its research and data analysis capabilities to adopt a data-based approach to identifying issues, decision making and policy development. A dedicated group will be created to further enhance the research and analytical functions to bring about a more disciplined approach to policy development, a better understanding of investor behaviour and needs, and improved and timely identification of risks and issues in order to react faster.”**

Advocis welcomes any efforts to ensure that OSC policymaking is informed by sound empirical research and analysis. Significant advances in the disciplines of economics and psychology are yielding a much richer understanding of how and why investors make decisions, and Advocis believes such a focus on attaining a better grasp of investor behaviour when crafting policy is long overdue.

- **Goal #5 – Support and Promote Financial Stability**

**“The OSC aims to build the capabilities required to play a more active role in assessing risks to its own objectives and to financial stability arising from the interaction between securities and other financial services activities.”**

Advocis welcomes the decision by the OSC to add the issue of systemic risk to its list of goals. A new regulatory regime for the over-the-counter derivatives market – especially in light of G20 commitments to regulatory reform – will further enhance the level of investor protection in Ontario.

Advocis looks forward to the final Statement of Priorities, and to working with the OSC to assist it in achieving its objectives for the coming fiscal year.

We would be pleased to meet with you to further discuss our issues and concerns. Should you have any comments or questions you wish answered before any such meeting, please do not hesitate to contact the undersigned, or email Ed Skwarek at [eskwarek@advocis.ca](mailto:eskwarek@advocis.ca).

Sincerely,



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