



Canadian Foundation *for*  
Advancement *of* Investor Rights

September 30, 2015

M. Richard Boivin

Sous-ministre adjoint aux politiques relatives aux institutions financières et au droit corporatif  
Ministère des Finances

8, rue Cook, 4e étage Québec (Québec)

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Sent by email to: [consultation\\_ldpsf@finances.gouv.qc.ca](mailto:consultation_ldpsf@finances.gouv.qc.ca)

Dear Mr. Boivin:

**RE: Consultation on the Report on the Application of the Act respecting the distribution of financial products and services (the “Act”)**

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FAIR Canada is a national, charitable organization dedicated to putting investors first. As a voice of Canadian investors, FAIR Canada is committed to advocating for stronger investor protections in securities regulation. Visit [www.faircanada.ca](http://www.faircanada.ca) for more information.

FAIR Canada is pleased to provide comments to the Québec government on its consultation arising from the Report on the Application of the Act. FAIR Canada agrees it is important to ensure that oversight of stakeholders in the industry is adequate in order to maintain public trust in financial products and service offerings. FAIR Canada believes that robust consumer protection is essential for developing a fair and efficient financial services marketplace and building confidence in that marketplace.

FAIR Canada provides these comments to highlight policy reforms that will improve both consumer protection and the fairness and efficiency of the financial services marketplace. We hope the principles set out below will help guide the Ministry when assessing policy options as well as key reforms we see as essential for adequate consumer protection and consumer confidence. Finally we provide comments on the proposals set out in the consultation document in respect of changes to the Fonds d’indemnisation des services financiers (FISF).

FAIR Canada notes that the Québec financial services regime benefits from an integrated regulator who oversees the regulation of both the securities and insurance sectors. Reforms should capitalize on this regulatory design for the benefit of consumers and industry stakeholders.

## I. General Comments

Existing regulatory requirements and financial services industry practices in Canada (including those in Québec) do not provide adequate protection for financial consumers. FAIR Canada has sought policy reforms to bring about adequate protections and better financial outcomes for consumers, an increased level of professionalism in the financial services industry, and effective competition.

Regulators have made little progress to date on these objectives. There has been fierce opposition by many industry stakeholders who deny any problems exist, respond with stock arguments (such as “unintended consequences” and “choice for the consumer”), and try to delay initiatives for as long as possible. Real leadership is needed to ensure a healthy financial services marketplace for the public.

Those who lead must come to grips with certain critical and interconnected realities:

- The overwhelming majority of consumers have a low level of financial literacy and rely heavily on the advice of their financial service providers.
- A large degree of information asymmetry exists between consumers and their financial services providers.
- Consumers believe and expect that financial service providers are required to provide advice that is in their clients’ best interests.
- Financial service providers routinely portray themselves to the public as professionals who act in their clients’ best interests; however, this is often far from the truth. Consumers regularly receive advice that is not in their best interest, from what are actually salespeople whose interests are not aligned with those of their clients.
- Compensation arrangements, which often generate serious conflicts of interest, have a significant impact on the quality of advice consumers receive.

There is an overwhelming body of academic literature<sup>1</sup> and empirical evidence<sup>2</sup> demonstrating that consumers are poorly served in the current system and are suffering harm as a result.

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<sup>1</sup> Dr. Edwin Weinstein, PhD, The Brondesbury Group, “Mutual Fund Fee Research” (Spring 2015), online: [https://www.osc.gov.on.ca/documents/en/Securities-Category8/rp\\_20150611\\_81-407\\_mutual-fund-fee-research.pdf](https://www.osc.gov.on.ca/documents/en/Securities-Category8/rp_20150611_81-407_mutual-fund-fee-research.pdf), which did an extensive review of the academic literature. In particular, see Susan Christoffersen, Susan EK, Richard Evans, and David K. Musto, “What do consumers’ fund flows maximize? Evidence from their brokers’ incentives.” 1 J Fin 68 (2013), at p 201-235, online at: <http://www.afajof.org/details/journalArticle/4240211/What-DoConsumers-Fund-Flows-Maximize-Evidence-from-Their-BrokersIncentives.html>; and Foerster, Stephen, Juhani T. Linnainmaa, Brian T. Melzer, and Alessandro Previtero, “Retail Financial Advice: Does One Size Fit All?” National Bureau of Economic Research, No. w 20712 2014, online at: <http://dx.doi.org/10.2139/ssrn.2522934>.

<sup>2</sup> See empirical studies referenced in The Brondesbury Group’s Mutual Fund Fee Research literature review and the recent Mystery Shopping Report released by the Ontario Securities Commission, online at:

Many consumers receive poor quality advice that does not comply with existing rules. Consumers often aren't told how much investment products cost, nor are they informed about the risk-return relationship or how their advisor gets paid. Advisors use a bewildering array of unregulated and frequently misleading titles that falsely convey high levels of seniority, experience or executive authority and that don't reflect the standard of advice being provided. And consumers (often unknowingly) pay too high a cost – fees charged for mutual funds, the most common investment held by Canadians, are higher in Canada than anywhere else in the world.

As a result of the defects in the advice they receive, consumers take on more risk than they otherwise would be inclined to take, or than they need to take in light of the availability of alternate investment products, and consumers have experienced substandard performance in their investment portfolios.<sup>3</sup> Consumers are routinely subject to:

- (i) unsuitable recommendations regarding investments;
- (ii) recommendations that, whilst they may be suitable, are high cost;
- (iii) recommendations that may not be found to be unsuitable but may have been provided with only a cursory review of the individual's circumstances and financial goals and without having adequately considered such important issues as their capacity to suffer any financial losses, the trade-off between risk and return (both upside and downside presentation of risks) or what product fees or compensation charges will have to be incurred and therefore what the ultimate value (if any) will be for the consumer;
- (iv) inadequate financial plans that have unrealistic or negligent assumptions underlying the plan's conclusions; and
- (v) unsuitable recommendations to borrow to invest and other problems which arise, not from the financial plan itself, but as a result of conflicts of interest and misaligned incentives that currently exist.

All of this occurs in a context where consumers are unable to assess the quality of advice they're receiving and, as a result often believe the advice is good.<sup>4</sup> This is not surprising given

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<https://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf>.

<sup>3</sup> The Mystery Shopping Report concluded that, overall, 37 percent of investment advisors did not follow the process required of them and thereby failed to meet regulatory expectations.

<sup>4</sup> Janet McFarland, "Ontario financial advisers pass muster with undercover 'mystery shoppers'", *Globe and Mail*, (September 17, 2015), online at: <http://www.theglobeandmail.com/report-on-business/initial-client-meetings-need-more-consistency-investing-watchdogs/article26405859/>. The article quotes Leslie Byberg of the Ontario Securities Commission who stated: "...even though 88 per cent of clients were happy with the recommendations they received, regulators concluded one-third of the cases did not meet compliance expectations, including 29 per cent that did not comply with know-your-client or suitability requirements. She

the low level of general financial literacy, the complexity of today's investment products and capital markets, and consumer's expectations (reinforced by financial services providers' marketing) that their financial advisors are required to act, and are in fact acting, in their best interests. All of this adds to consumers' vulnerability.

The public rightly expects more than what it is getting and there is a pressing need for reforms. Better financial outcomes for consumers will be best achieved by making key changes to existing regulatory requirements in order to bring about a more efficient (i.e., competitive and healthy) financial services marketplace and, with it, more proficient and professional advice for financial consumers.

As the availability of employer-sponsored pension plans declines, more Canadians (including those in Québec) are required to become self-reliant when saving for retirement and are forced into the markets as a result. Due to the increasing number of individuals entering the market, the current regulatory regime has rightly become a serious concern for government policy-makers and society as a whole.

Foreseeable future economic and market trends also make it essential for governments to act now to improve our existing regulatory framework. Developed economies with aging populations continue to experience low economic growth and low interest rates, and we continue to see evidence that significant numbers of workers are forced into retirement earlier than planned through circumstances beyond their control. This makes it all the more imperative that individuals must have the ability to save. Government must reform the regulatory framework in order to improve the way that people in the province can save their money.<sup>5</sup>

## **II. Principles to Guide Reforms**

**FAIR Canada strongly believes there is an urgent requirement for a comprehensive and coordinated solution that keeps its focus squarely on consumers' needs and their capabilities.**

FAIR Canada believes that reforms must deliver these key outcomes:

- (i) Consumers must receive a similar level of protection in respect of their investments and in respect of the investment advice they receive regardless of which sector of the financial industry the product or sale originates from.
- (ii) Like investment products must be regulated in like manner.
- (iii) The regulation of the financial services firm (dealer, insurer, managing general agency) must not be separated from the regulation of its employees and agents

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said it demonstrates that clients cannot always tell if they have received good advice. "It's really quite stark that in 37% of the cases, the adviser didn't follow the process, but the client thought it was great," she said."

<sup>5</sup> Seres Lu, "Nearly half of Canadians forced to retire earlier than planned, polls showed", (July 1, 2015) online at: <http://www.theglobeandmail.com/globe-investor/personal-finance/retirement-rrsps/nearly-half-of-canadiansforced-to-retire-earlier-than-planned-poll-shows/article25219041/>.

(i.e., financial service providers). The AMF's jurisdiction must include authority to oversee not only the firms it regulates, but also the firms' employees and agents. Integration of the *Chambre de la sécurité financière* within the AMF should be examined as an option to address the concerns referred to in the consultation document regarding overlap, incoherence and confusion as to responsibilities of firms and individuals, as well the confusion as to responsibilities of oversight over the firms and their respective agents and/or employees. This should be done in a manner that augments rather than diminishes the level of professionalism of financial service providers.

- (iv) All financial service providers must be subject to an interprovincial licensing system and automatic reciprocal enforcement of disciplinary orders by all financial services regulators. Disciplinary action against an individual and/or a firm by any financial services regulator (in any province or territory) should automatically result in equivalent disciplinary action by all other financial services regulators against that individual and/or firm.
- (v) A comprehensive, user-friendly national database must be established to assist Canadian consumers in checking the registration and disciplinary history of any person or firm offering financial advice, whether that advice comes from someone in the insurance regulated sector, securities regulated sector or the banking sector.
- (vi) There must be an adequately funded and informed consumer voice installed as part of the policy-making process; and
- (vii) A statutory best interests standard must be applicable whenever financial advice is provided to consumers regardless of which sector of the financial industry the financial service provider operates in and what type of investment, if any, is recommended or sold to the consumer. The best interests standard needs to be implemented in a comprehensive manner so that all of the following are consistent: the legislatively required standard of care; the practices and policies that are implemented by firms and imposed on their agents and employees; Québec's civil code provisions<sup>6</sup>; and the codes of ethics that the financial services representatives are required to adhere to.

Further harmonization of the regulatory framework is needed so that regulatory requirements meet this standard regardless of which sector the advice or product comes from. The advice

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<sup>6</sup> Sections 1309, 2100 and 2138 of the Civil Code are discussed in the CSA's "Consultation Paper 33-403 the Standard of Conduct for Advisers, Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is Provided to Retail Clients", (October 25, 2012) 35 OSCB 9558, at p 7, online at: [https://www.osc.gov.on.ca/en/SecuritiesLaw\\_csa\\_20121025\\_33-403\\_fiduciary-duty.htm](https://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20121025_33-403_fiduciary-duty.htm); and examined by Raymonde Crete, Martin Cote and Cinthia Duclos in their "memoire prepare dans le cadre de la consultation 33-403", (March 18, 2013), online at: [http://www.lautorite.qc.ca/files/pdf/consultations/anterieures/valeurs-mobilieres/commentaires\\_33-403/Universite-Laval\\_33-403.pdf](http://www.lautorite.qc.ca/files/pdf/consultations/anterieures/valeurs-mobilieres/commentaires_33-403/Universite-Laval_33-403.pdf).

provided by life insurers, managing general agencies and life insurance agencies and their life insurance agents on the insurance side should be at the same standard as that required of dealers, advisers and their registered representatives on the securities side. Relationship disclosure requirements, cost and performance disclosure requirements for insurance products with an investment component, and point of sale requirements should all be similar. This is especially true since the access point for the sale of these products is often through the same person (where the individual is dually licensed), and can even involve investment in the same mutual fund (with a ‘wrap’ product). Consumers should know the costs associated with a segregated fund (including embedded commissions) just as well as with their securities investments, for example.

### III. Specific Policy Reforms – Reform Mutual Fund Fees and Institute a Statutory Best Interests Standard

Proposals to reform the oversight of dealers and their representatives should be assessed focusing on the needs and capabilities of the consumer. **In order for consumers to obtain sound, professional financial advice, a ban must be imposed on conflicted remuneration structures, including third party embedded commissions. Only then will financial service providers be able to provide advice in a manner that aligns the interests of the consumer with those of their advisor.**

Even in the absence of a statutory best interests standard (which FAIR Canada strongly recommends), the removal of these influential conflicts from the relationship between advisor and consumer must be achieved in order for consumers to be adequately protected. While this may force changes to some business models used in the financial services industry, FAIR Canada believes it is not the proper role of government or regulators to protect those business models, especially ones that do not serve consumers’ interests and lead to poor outcomes for them.

**FAIR Canada calls on the Québec government to institute a statutory best interests standard in legislation governing the provision of financial service and products so consumers in Québec can *rightly and safely* expect to receive high-caliber professional advice from their financial firms and the financial service providers.<sup>7</sup> We also call on the government to equip the regulatory system with all compliance and enforcement resources necessary to enforce that standard.**

#### **Tiered Approach to Best Interests:**

Should regulators be unwilling to impose a best interests standard on all business models as we recommend, an alternative would be to take a tiered approach so that those who elect not to adhere to a best interests standard would be permitted to provide only “restricted advice” along the lines of the model adopted in the U.K.

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<sup>7</sup> See FAIR Canada’s submission responding to the CSA’s request for comments as to the desirability and feasibility of implementing a statutory best interest standard, (February 22, 2013), online at: <http://faircanada.ca/wp-content/uploads/2011/01/FAIR-Canada-Submission-re-CP33-403-Statutory-Best-Interest-Duty.pdf>.

Under this model, advisors who provide “restricted advice” (such as those financial service providers who are only permitted to sell proprietary products of the insurer or financial firm) must use the title “salesperson”. They also are subject to suitability requirements, and are precluded from holding out that they offer independent advice, that they act in the best interests of the client, or that they are a professional (whether it be a professional financial planner, financial advisor or otherwise). They must disclose in writing and orally that they are providing restricted advice, and that the advice they give is not required to be in the best interest of the consumer.

To keep consumers from being misled, stringent requirements with respect to marketing and use of business titles and credentials would need to be imposed. As noted by the CSA, “...some advisers and dealers market their services on the explicit or implicit basis that the advice they are providing is in the client’s best interests.”<sup>8</sup> Such misleading advertising and marketing would no longer be permitted and would be strictly prohibited in respect of dealers and advisors who offer restricted advice.

While this model is not FAIR Canada’s preferred approach (particularly given the confusion observed in the U.S. where many consumers do not appear to be aware of the different obligations of registered investment advisors and broker-dealers), we believe that a tiered approach would at least offer consumers a means of differentiating between sales pitches and professional financial advice.

#### **IV. FAIR Canada’s Comments on Proposals to Reform FISF and Certain Compensation Coverage Gaps**

FAIR Canada commends the Québec government for establishing the Fonds d’indemnisation des services financiers (FISF) with the objective of maintaining the public’s trust in representatives and firms by compensating the victims of fraud, fraudulent practice and misappropriation of funds. As noted in FAIR Canada’s recent Fraud Report<sup>9</sup>, the primary objective of victims of investment fraud is, generally, to recover their losses; however, the rate of recovery of losses from investment fraud is low. Consumers’ avenues for redress are limited. Prevention is therefore essential to protecting consumers. When prevention fails and investors are harmed, the FISF provides an avenue for consumers in Québec to obtain compensation. The upward amount of coverage available is \$200,000 which appears to cover the vast majority of claims<sup>10</sup>. FAIR Canada believes that other provinces and territories should examine the FISF model and should consider adopting it.

At the same time, FAIR Canada is of the view that Québec consumers, like those in other

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<sup>8</sup> CSA Consultation Paper 33-403 the Standard of Conduct for Advisers, Dealers at p 9585.

<sup>9</sup> FAIR Canada’s report “A Canadian Strategy to Combat Investment Fraud”, (August 2014), at p 3, online at: <http://faircanada.ca/wp-content/uploads/2014/08/FINAL-A-Canadian-Strategy-to-Combat-Investment-Fraud-August-2014-0810.pdf>.

<sup>10</sup> AMF’s Fonds d’indemnisation des services financiers, Presentation of consultation findings and proposed orientations, (September 2013), at page 20, which shows that 95% of claims filed between October 1, 1999 and March 31, 2011 fell under the \$200,000 limit.

provinces, should benefit from the presence of an insolvency-based compensation fund to which claims can be submitted in the event that a registrant mutual fund dealer becomes insolvent. The absence of coverage by the MFDA Investment Protection Corporation (“IPC”) in Québec is a gap<sup>11</sup> that should be addressed by the provincial government – either by requiring that all mutual fund dealers in Québec become members of the MFDA (which, by extension, would extend IPC coverage to all customers of those mutual fund dealers) or by establishing a separate Québec compensation fund for the mutual fund industry to receive claims in the event of insolvency. Such a fund should be in addition to, rather than in place of, the FISF; and it would ease some of the burden on the FISF.<sup>12</sup>

FAIR Canada agrees with the Government’s proposal to “[M]ake provision for a consumer to be compensated when he is the victim of a fraud perpetrated by a certified representative even if the claim concerns the sale of products that the representative was not authorized to offer”. FAIR Canada believes consumers should not bear the onus of ensuring that the financial product they purchase falls within the parameters of the registrant’s authority in order for the consumer to be compensated by the FISF. Given the increasing complexity of financial products and the complexity of the financial services sector, this places a burden on consumers that they are incapable of bearing. Consumers should be covered where losses arise from fraud related to the purchase of a financial product so long as they purchased that product through a registrant.

FAIR Canada understands the concern that some consumers will mistakenly expect to be compensated, whether or not the person responsible for the harm is registered, simply because the FISF is managed by a public body. We agree it is essential to the fair operation of the FISF that public awareness about the significance of registration must be increased. A public education campaign is needed to emphasize the importance of dealing only with financial service providers who are registered and the importance of checking registration before investing. Correspondingly, a user-friendly, comprehensive system for checking registration must be made available to the public.

FAIR Canada also agrees that it makes sense to review the governance of FISF. When conducting such a review, the government should benchmark against international best practices for governance and ensure that any changes are in the public interest and, in

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<sup>11</sup> Coverage under the IPC is in the amount of up to \$1 million per customer account in respect of the loss of customer property held by a MFDA Member. As noted in FAIR Canada’s 2013 submission to the AMF, FAIR Canada supports the MFDA’s call for mandatory compensation fund participation (insolvency-related) for investment fund managers (to protect investors who hold their investment fund securities in client name at fund managers) and portfolio managers (to protect investors of portfolio managers).<sup>11</sup> Consumers exposed to similar risks should be entitled to similar protections. Some companies are both fund managers and MFDA members. Maintaining confidence in a system with arbitrary distinctions is challenging and therefore we recommend that compensation gaps be addressed.

<sup>12</sup> FAIR Canada’s submission to the AMF regarding the Notice and Request for Comment regarding compensation for consumers of financial products and services, (March 9, 2012), p 4, online at: <http://faircanada.ca/wp-content/uploads/2011/01/120309-FAIR-Canada-submission-re-AMF-compensation-consultation.pdf>.

particular, foster confidence in the system.

We hope that our comments are helpful when assessing policy-reform options and would be happy to answer any further questions that you may have. Please contact Neil Gross at 416-214-3408 ([neil.gross@faircanada.ca](mailto:neil.gross@faircanada.ca)) or Marian Passmore at 416-214-3441 ([marian.passmore@faircanada.ca](mailto:marian.passmore@faircanada.ca)).

Sincerely,

A handwritten signature in blue ink, appearing to read "Neil Gross". The signature is fluid and cursive, with the first name "Neil" and last name "Gross" clearly distinguishable.

Canadian Foundation for Advancement of Investor Rights