INVESTMENT FUNDS IN CANADA

AND

CONSUMER PROTECTION

STRATEGIES FOR THE MILLENNIUM

A Review by Glorianne Stromberg

Prepared for Office of Consumer Affairs, Industry Canada

October 1998

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EXECUTIVE SUMMARY

Why the Review Was Undertaken

This Review was undertaken at the request of Industry Canada's Office of Consumer Affairs. It was prompted by the realization that Canadian consumers are increasingly turning to investment funds as a source of their retirement income.

The investment fund industry has been good for Canada and for Canadians. The increased popularity of investment funds, combined with strong market performance, has fuelled the growth of the investment fund industry. Most of this growth has occurred within the last five years or so. There are many new players, many different types of investment funds, and many new investors in investment funds.

However, what was once a simple means of accessing professional investment advisory services by pooling money with other like-minded investors has become very complex. Three main factors contribute to this complexity. They are:

- the different distribution structures and the costs related thereto;
- the lack of a common regulatory regime and of common standards respecting money management; and
- the structuring of investment funds and their alternatives so as to:
  - (i) avoid the consequences of certain tax laws, securities and other laws, or
  - (ii) take advantage of them.

The Office of Consumer Affairs therefore decided that it was appropriate to consider whether there are reasonable measures in place to protect consumer/investors given the increased tendency by the industry and consumers alike to regard investment funds as "consumer goods."

What I Was Asked to Do

I was asked to:

- assess the consumer's position prior to the 1995 Report, the changes that have been made since then that benefited consumers and what remains to be done;
- identify impediments to changes that would benefit consumers;
- recommend what facilitating role governments could play to increase consumer sovereignty and control over their assets;

- identify mechanisms that would better enable consumers to identify their goals, how to achieve them and how to assess risk; and

- review consumer redress and compensation mechanisms with a view to identifying how consumers receive greater or less protection depending on where the purchase is made.

Structure of the Review

The Review is structured to deal with these subjects as follows:

Section 1	This Section sets out the terms of reference and describes the review process.
Section 2	This Section outlines the purpose of the 1995 Report, the areas of concern it identified, the key recommendations that were made and the perspectives underlying the recommendations.
Section 3	This Section refers to changes that have occurred since the 1995 Report that should benefit the consumer/investor.
Section 4	This Section outlines changes that have resulted from governmental policy initiatives.
Section 5	This Section outlines changes in the strategic environment, with particular emphasis on the retailization of the marketplace, industry consolidation, and the consequences of the blurring and fusion of product, function and advice.
Section 6	This Section outlines various perspectives on whether the changes described in Sections 3, 4 and 5 have benefited consumer/investors.
Section 7	This Section outlines various perspectives on the impediments to change.
Section 8	This Section discusses the validity of the perspective of viewing investment funds as consumer goods or services. It also discusses the goals and objectives of consumer/investors and their expectations.
Section 9	This Section identifies factors that will make a difference for consumer/investors. These include measures to reduce the knowledge gap and to create a regulatory and supervisory structure that recognizes that consumer/investors have integrated financial needs.
Section 10	This Section outlines the need for regulatory coordination to reflect the changing marketplace and to meet the needs of all participants in the marketplace. The Section includes proposals for simplifying, streamlining and coordinating processes and for making sure that they are complementary.
Section 11	This Section assesses the current level of knowledge and awareness of consumer/investors and the implications for the regulatory and supervisory framework.
Section 12	This Section recommends new approaches to regulatory and supervisory

	strategies to reflect: • the need to meet the integrated needs of the consumer/investor; • the expanded business activities and the diversified geographical operations of today's participants in the financial services sector; • the need to de-fragment the regulatory structure; • the need for a common regime for money management; • the need to re-evaluate the effectiveness of the self-regulatory component of the regulatory regime; and • the need for international regulatory cooperation. It recommends changes to the regulatory structure to implement these approaches, including the establishment, pursuant to intergovernmental agreement, of an integrated regulatory body (the "Regulator") to reflect the fusion of product, function and advice which has occurred since the deregulation of the financial services industry that began in 1987.
Section 13	This Section recommends systemic changes to securities legislation including: • replacing the "closed system" of securities regulation with a simple issuer-based, integrated disclosure model; and • leveling the playing field with respect to the dissemination of information.
Section 14	This Section outlines the need for increasing the knowledge and awareness of consumer/investors. It recommends ways to do this through youth and adult learning programs aimed at filling information gaps and at enabling people to use information to make effective decisions to meet their personal goals and objectives.
Section 15	This Section outlines the need for a new approach to education and proficiency requirements for participants in the financial services industry to reflect the industry shift to advice-giving (with transactions to implement the advice being secondary). It recommends: • a process for establishing a financial planning and investment advisory education and proficiency standard; and • creating an independent, Non-Partisan Standards Council to identify this education and proficiency standard and to monitor and maintain the same. These recommendations are complementary to those in Section 12 and reflect the fusion of product, function and advice.
Section 16	This Section recommends a simplified approach to registration and licensing requirements for participants in the financial services industry. It recommends

	replacing all registration and licensing requirements with: • a ***single*** requirement for registration with the Regulator (referred to in Sections 10 and 12); and • a ***single*** membership in the Single SRO. The Single SRO (which would operate on a national basis) is described in subsection 16.3. It would be the single self-regulatory organization that would be recognized by the Regulator for the purpose of the required membership in a self-regulatory organization. This is a companion recommendation to the recommendations in Section 12 for the establishment (pursuant to intergovernmental agreement) of an integrated regulatory body (the "Regulator") and to the recommendations in Section 15 for an integrated education and proficiency standard to reflect the fusion of product, function and advice.
Section 17	This Section discusses: • what is needed for an effective disclosure system that will meet the information needs of consumer/investors; • the need to look beyond the prospectus to meet such needs; and • the role of the know-your-client and suitability requirements, confirmation/point-of-sale statements, account statements and annual and interim reports in meeting these needs. It contains recommendations for enhancing the usefulness of these requirements and documents to meet the needs of consumer/investors.
Section 18	This Section makes specific recommendations for changes aimed at improving disclosure including recommendations related to: • the disclosure of fees and charges and their impact on total return over a period of years; • timely disclosure of portfolio holdings and of ownership and control positions; • timely disclosure of ownership and control positions in the securities of issuers whose securities are included in the investment portfolio of the managed account; • the exercise of voting rights attaching to securities of issuers whose securities are included in the investment portfolio of the managed account; • timely annual and interim reporting of information relating to the operations of an investment fund; • using the Internet to bring about effective disclosure; and • enhancing the usefulness of SEDAR (the CSA's System for Electronic

	Document Analysis Retrieval).
Section 19	This Section discusses: • the critical role that fund governance plays in consumer protection; • the need for a legislative structure in Canada for "business trusts" comparable to the constating legislative structure that exists for corporations; and • the need for prudential oversight mechanisms and for establishing prudent operating procedure standards. It confirms the recommendations made in the 1995 Report relating to these matters.
Section 20	This Section discusses investment fund alternatives. It discusses the substantive differences that give rise to substantive concerns that relate primarily to: • the suitability of the particular investment alternative to meet the specific needs of individual consumer/investors; and • the level of prudential and regulatory supervision and oversight over the structuring of these products and the offering of the same to consumer/investors; and • the inability of consumer/investors to appreciate the differences in suitability and in prudential and regulatory supervision and oversight. The Section notes that the substantive concerns would be substantially addressed by the implementation of the proposals made in Sections 10 - 18 for: • an integrated regulatory structure; • a common regime for money management; • increasing the knowledge and awareness levels of consumer/ investors and their advisers; • effective disclosure; and by the additional proposals outlined in this Section for: • prudential enhancements; and • the removal of certain restrictions and preferences that add costs, distort investment decisions and provide some sectors of the financial services industry with a competitive advantage over other sectors of the financial services industry.

Section 21	This Section discusses some of the areas relating to the advice-giving/distribution activities of financial service providers that cause particular problems for consumer/investors. It contains recommendations to address these problems.
Section 22	This Section discusses some tax aspects relating to investment funds that are not well understood by consumer/investors and includes recommendations relating to these matters.
Section 23	This Section discusses the need for coordinated, cooperative and concerted action by all levels of government to simplify, modernize and harmonize basic laws relating to the ownership of property so that people's basic property rights are not dependent on where they live in Canada. This action would greatly facilitate the ability of consumer/investors to meet their goals and objectives. The recommendations deal specifically with the laws relating to the eligibility of investment funds as investments for trustees, the designation of beneficiaries, probate requirements, creditor-proofing, powers of attorney, in-trust accounts, and standard execution requirements.
Section 24	This Section discusses consumer redress mechanisms and includes some recommendations relating to them, including the need for further work to be done in this area.
Section 25	This Section discusses various investment fund maters relating to the need for additional prudential oversight and operating standards and procedures.
Section 26	This Section contains concluding remarks.

Key Perspectives Underlying Review Recommendations

Integration, Simplification and Rationalization: There is a need to integrate, simplify, streamline and rationalize regulatory requirements to serve the needs of the marketplace and of consumer/investors better. This theme underlies all of the recommendations in the Review.

The continued maintenance of a segmented regulatory structure based either on:

(i) the fragmented "four pillar" structure of the financial services industry that existed prior to the 1987 deregulation, or

(ii) the fragmented "inter" or "intra" provincial (and national) boundaries;

is becoming increasingly unrealistic.

Retailization of the Marketplace: The convergence of strategic forces has resulted in:

(i) the consumer/investor (the "retail investor") assuming more market risk; and

(ii) providers of financial services (the "institutional investor") structuring their activities and products to reduce or eliminate their market risk

This in turn has led to:

(i) an increased blurring of the lines between the “retail investor” and the “institutional investor”; and

(ii) a corresponding erosion of the basis for distinguishing regulatory strategies on whether the investor is a “retail investor” or an “institutional investor”.

In this environment, the regulatory and supervisory structure should not favor the “institutional investor” over the “retail investor”. This is particularly so when the institutional investor may also be a purveyor of advice, services and products to the individual consumer/investor.

Fusion of Product, Function and Advice: The activities of industry participants have outpaced the regulatory structure.

The focus of all participants in the financial services industry is on asset gathering, asset allocation services and asset management. This has led to substantial changes in the distribution side of the financial services industry as it shifts from a transactions-based business to a fee-based, relationship-driven, financial services business. It has also led to substantial changes in the advisory side of the financial services industry as it shifts to gain access to distribution.

The need to gain market share and to protect income streams has resulted in the blurring (and in some instances the fusion) of product, function and advice. With this fusion has come a corresponding shift in emphasis from the success of the transaction to the success of the portfolio. The traditional product sales-oriented representative has evolved into, or is being replaced with, a relationship-oriented advisory-based manager whose role is focused on acting as a conduit for internal or external money managers.

Banks, insurance companies, trust companies, credit unions, independent mutual fund management organizations, independent mutual fund dealers and full service investment dealers now offer, directly and indirectly, a full range of investment advisory services and products. Many of them, through equity interests in other segments or sectors of the financial services industry or through strategic alliances, have multiple entries into both advisory and distribution channels.

The activities carried on, directly or indirectly, by the various sectors of the financial services industry are virtually indistinguishable to consumer/investors yet they are often regulated differently. Regulation (or the lack thereof) varies according to the type of investment product, the institution issuing the investment product and the intermediary involved. The ramifications of these differences are not readily apparent.

It is difficult for consumer/investors to identify:

(a) when they are being provided with independent advice; and

(b) when they are simply being sold a product which may be:

    (i) advice packaged as a product,

    (ii) a proprietary product, or

    (iii) a product in which the seller/adviser has a substantial financial interest.

Common Regime for Money Management: Consumer/investors are seldom able to appreciate the legal and regulatory differences that flow from the different types of investment participations or products. This highlights the need for there to be a uniform regime for all aspects of money management and to bring all aspects of money management for others under a common regulatory structure.

Integrated Needs of the Consumer/Investor: The needs of consumer/investors are integrated.

Consumer/investors have recognized the need to adopt sound personal financial management practices. A large number have recognized that because of their lack of personal financial expertise (or their lack of confidence in their expertise) they will need to turn to someone for advice. When they turn to an adviser for advice they expect (and should be entitled to expect) that:

(i) the advice they get will be based on a full client-needs assessment;

(ii) the person providing the advice and the related financial planning/investment advisory services will have the capability to make that assessment;

(iii) the person providing them with financial planning/investment advisory services will be able to (and will) provide them with advice that is in their best interests;

(iv) this advice (and the plan to implement such advice) will be based upon a full range of money management services and products being available to meet their goals and objectives; and

(v) the ability to carry out transactions to implement the plan and to provide ongoing monitoring and reporting services is and will be ancillary to the foregoing.

In order to meet these reasonable expectations, a fresh approach to regulatory structure, educational courses and proficiency requirements, and to registration requirements is required. The changes should be enabling (as opposed to maintaining or creating barriers) provided that minimum standards based on competence and safety are met.

In addition, systemic changes in the regulatory system and in basic laws relating to the ownership of property, securities laws, corporate laws, personal property security laws, bankruptcy and insolvency laws, and tax laws are also needed to make these laws work together as effectively as they should to promote economic well-being.

Reducing the Knowledge Gap: The single most important thing that could be done to benefit the consumer/investor would be to reduce the knowledge gap - i.e. the gap between those who know and those who do not. This knowledge gap, which economists refer to as “informational asymmetry”, usually operates to the disadvantage of the consumer/investor and results in consumer/investors receiving too little value at too high a cost. This is what happens when “sellers” know a lot more about the nature of the product and what the services are than the buyers generally do. This is what happens when the economic interests of the “sellers” and the “buyers” are not aligned. Alignment of economic interests and knowledge and awareness usually go hand-in-hand.

Measures to enhance the knowledge and awareness of consumer/investors should reduce the knowledge gap. Enhanced knowledge and awareness should equip consumer/investors with the basic life skills that they need for informed decision-making, including the ability to understand information that is communicated to them. It should empower consumer/investors to take charge of their own economic well-being.

Information is a critical tool and it is a major equalizing force. It is a valuable commodity. Access to it in an open and timely manner is a crucial ingredient to leveling the playing field. However, if consumer/investors do not have the fundamental ability to understand and make use of the information that is communicated to them, none of the other consumer protection remedies (particularly those based on disclosure) will work effectively.

Knowledge and awareness are the keys to economic well-being. According to the World Bank's 1998 *World Development Report*, knowledge has become so critical to economic and human development that countries that do not make it their top priority will find themselves "mired in poverty" in the next century. The World Bank notes that both developing and developed countries need to make the creation and flow of knowledge their primary concern.

The need to enhance knowledge and awareness and to build key competencies for consumer/investors, industry participants and regulators alike to enable them respectively to make use of the information that is communicated to them is a theme that underlies all of the recommendations in the Review.

Blueprint for Change

The proposals in this Review create a blueprint for change in the regulatory and supervisory structure to reflect the changes that have occurred in the marketplace, and to address the needs of all participants in the marketplace better, including those of consumer/investors. The proposals recommend new approaches to regulatory and supervisory structures and strategies. They propose systemic changes to securities legislation and they highlight the need for changes in basic laws relating to the ownership of property, securities laws, corporate laws, personal property security laws, bankruptcy and insolvency laws, and tax laws to make these laws work together as effectively as they should. The proposals focus on ways to build on existing regulatory structures and strategies and to simplify, streamline and coordinate processes to make them work more effectively together. The proposals envisage (and are dependent upon) the involvement, cooperation and agreement of all levels of government.

It is important to recognize that the proposals are conceptual in nature. Filling in the details will involve a coordinated, concerted effort on the part of governments, industry and consumer/investors. It must be a community effort fuelled by leadership, a common vision and unity of purpose. Collectively, we need to find a way to give meaning to the often overworked words of "coordination, cooperation and harmonization". No one sector or regulatory group or government acting alone has the ability or power to do this.

Although we need to act together, the reality is that nothing will happen unless it is made to happen by a leadership role being assumed by those at the highest levels of the federal and provincial governments and industry.

We need to remember that it is people who make things happen and that it is people who keep things from happening. There is a positive role for everyone to play. The well-being of Canadians depends upon it.

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GLOSSARY

The following terms used in this Review have the following meanings:

1995 Report refers to the Report prepared by Glorianne Stromberg for the Canadian Securities Administrators that was issued in January 1995 entitled *Regulatory Strategies for the Mid-'90s - Recommendations for Regulating Investment Funds in Canada.*

Canadian Securities Administrators or **CSA** refers collectively to the securities regulatory authority in each of the provinces or territories of Canada.

CDS refers to The Canadian Depository for Securities.

CDIC refers to the Canada Deposit Insurance Corporation.

CIPF refers to the Canadian Investor Protection Fund.

CICA refers to the Canadian Institute of Chartered Accountants.

FPSCC refers to the Financial Planners Standards Council of Canada.

IALS Report refers to the Canadian Report on the International Adult Literacy Survey entitled *Reading the Future: A Portrait of Literacy in Canada* which was released in September 1996. The IALS Report followed the December 1995 release by Statistics Canada and the Organization for Economic Cooperation and Development of the International Adult Literacy Survey entitled *Literacy, Economy and Society.*

IDA refers to the Investment Dealers Association of Canada.

IFIC refers to The Investment Funds Institute of Canada.

IOSCO refers to the International Organization of Securities Commissions.

MFDA refers to the Mutual Fund Dealers Association of Canada referred to in subsection 3.9 of this Review.

MRRS refers to the mutual reliance review system described in subsection 3.10 of this Review.

Non-Partisan Standards Council refers to the non-partisan standards council described in subsection 15.10 of this Review

OECD Paper refers to the Background Paper by Glorianne Stromberg entitled *Regulation and Supervision of Investment Funds in the New Financial Landscape - A Canadian Perspective* dated June 12, 1997, which was presented as part of the background material for the third session of the Expert Meeting on Institutional Investors organized by the OECD Committee on Financial Markets in July 1997. (1998 OECD Publications, *Institutional Investors In The New Financial Landscape*, page 449).

OSFI refers to the Office of the Superintendent of Financial Institutions.

OSC refers to the Ontario Securities Commission.

Regulator refers to the integrated regulator contemplated by the proposals contained in Sections 10 and 12 of this Review that would be created pursuant to intergovernmental agreement.

SEDAR refers to the CSA's System for Electronic Document Analysis Retrieval.

Single SRO refers to the single self-regulatory organization described in subsection 16.3 of this Review that would be recognized by the Regulator for the purpose of mandatory membership.

SRO refers to the strong, independent, effective self-regulatory organization described in Section 9.02 of the 1995 Report that would operate on a national basis in which membership would be mandatory for everyone (regardless of their status) who is selling securities, including investment fund securities, to the public.

TSE refers to The Toronto Stock Exchange.

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1. TERMS OF REFERENCE

1.1. The Task

In February of 1998, I was asked by Industry Canada's Office of Consumer Affairs to review the requirements for the reasonable protection of the retail consumer/investor who is increasingly turning to investment funds as a source of retirement income.

The review was prompted by the growing realization that investment funds have become "consumer goods" and that it was appropriate to consider whether there are reasonable protection measures in place to protect the consumer/investor.

I was asked to:

- assess where the retail consumer/investor was prior to the 1995 Report[1], the changes that were made after the 1995 Report that have benefited retail consumer/investors and what still needs to be done;

- identify impediments to changes that would benefit retail consumer/investors;

- recommend what facilitating role governments could play to bring about changes that would increase individual consumer/investor sovereignty and control over their assets, with specific recommendations for initiatives that could be undertaken by the Committee of Consumer-Related Measures and Standards[2];

- identify mechanisms that would enable retail consumer/investors to better identify their goals, the means of achieving them and to assess risk; and

- review consumer redress and compensation mechanisms with a view to identifying how the retail consumer/investor receives greater protection or less depending on where the purchase is made.

1.2. The Process

As I did when I prepared the 1995 Report, I turned to the investment fund industry for assistance. This assistance was unstintingly given and I am most grateful for it.

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[1] See *Regulatory Strategies for the Mid-'90s - Recommendations For Regulating Investment Funds in Canada* prepared by Glorianne Stromberg for the Canadian Securities Administrators, January 1995.

[2] The Committee of Consumer-Related Measures and Standards is composed of federal, provincial and territorial officials whose mandate is to monitor, implement and administer specific commitments made under Chapter Eight of the Agreement on Internal Trade by the federal, provincial and territorial governments relating to consumer-related measures and standards.

The process has involved extensive consultation with industry participants, their advisers, and industry organizations. I also sought input from industry regulators. The consultation process primarily involved personal interviews and meetings. This was supplemented by letters, telephone, fax and e-mail communications from people across the country expressing their views. Some industry organizations, in response to my invitation to do so, invited their members to contact me directly to express their views. This contact was extremely helpful.

The terms of reference did not contemplate that any independent economic analysis would be conducted or that any focus groups would be held or that any surveys or polls would be undertaken. Accordingly, I did not undertake any such work.

Industry participants did, however, make available the results of some of the empirical research that they had carried out on issues that are also relevant to this Review. To the extent that I refer to such research in this Review, I have identified the sources.

My comments are based on information that has been provided to me by knowledgeable industry participants and on my assessment of this information. There is a high level of consistency in the identification of the issues and in the identification of the solutions. As might be expected, people differed on the details and on the timing of initiatives to address the solutions.

It is a tribute to the industry that so many people with such competing interests in today's increasingly competitive marketplace made such a substantial commitment in time and resources to participate in the Review. I want to acknowledge publicly and to express my thanks for the unqualified help and support that was provided to me by so many during the course of the Review.

It is important to note that the comments, views and recommendations that I express in this Report are my own. They are not necessarily shared by the Ontario Securities Commission or by any of the other Canadian Securities Administrators or anyone involved with any of the Canadian Securities Administrators.

1.3. The Position of the Consumer/Investor Prior to 1995

To assist in understanding the position of the consumer/investor prior to the release of the 1995 Report, the Review begins with an outline of:

(i) what the purpose of the 1995 Report was;

(ii) what the areas of concern were;

(iii) what the key recommendations were; and

(iv) what the perspectives underlying the recommendations were.

This outline is contained in Section 2 of the Review.

2. THE 1995 REPORT

2.1. A Review of the Investment Fund Industry in Canada

In 1994 the Ontario Securities Commission commissioned a review of the investment fund industry in Canada for the benefit of all of the securities regulators in Canada. This Review was prompted by the rapid growth of the mutual fund industry[3] and the fact that it had been at least 25 years since the last major review of this industry had been undertaken.[4]

The main reason for the 1994 review was to be sure that regulation was keeping pace with changes in the marketplace, to identify any changes that were needed to align industry interests with those of investors, and to respond to industry vulnerabilities. In particular, recommendations were requested on the role of self-regulatory organizations and on how the systems and procedures of the Canadian Securities Administrators[5] ("CSA") could be structured for more effective and efficient regulation of investment funds.

To this end, the 1994 review included:

(i) an identification of the significant trends in the industry and their impact on regulation;

(ii) an assessment, from a regulatory point of view, of the problems affecting the investment fund industry and investors and how they might be remedied; and

(iii) an identification of the emerging issues in the investment fund field that should be addressed by the CSA and their impact on the resources that are required by the CSA.

In view of the importance of the investment fund industry to Canada and the investing public, industry leaders, as well as regulators, recognized that it was an appropriate time to review practices and refocus on objectives. Early in the process, the industry recognized that the results of the review would be largely dependent upon the quality of the industry's input into it. As a result, people made a real commitment to participate in the review. The review served as a catalyst for industry participants to focus on what was happening in the industry, what the concerns were and how they could be meaningfully addressed.

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[3] In 1993 assets invested in mutual funds grew from C$67.3 billion to C$114.6 billion. The extraordinary growth has continued. According to statistics issued by IFIC, at August 31, 1998, total assets under management by IFIC Members were about C$286.2 billion (July 31, 1998 - C$320.1 billion). These assets are held in approximately 39.1 million unitholder accounts maintained by IFIC Members. Appendix A sets out statistical information issued by IFIC for the ten year period ended August 31, 1998.

According to information provided by Investor Economics Inc., investment funds' penetration of the Household Balance Sheet (Canada) at the end of 1997 is approximately 20.2% (1996 - 15.7%).

Information provided by CIBC Wood Gundy Inc. indicates that at the end of 1997 the approximate amount per household that Canadian households have invested in mutual funds is C$24,452 (1996 - C$18,557). 37.4% of United States households owned mutual funds at the end of 1997 (1996 - 37.2%) with the amount of money per household being US$44,915 (1996 - US$35,777). CIBC Wood Gundy Inc. advises that accurate figures relating to the number of households in Canada that own mutual funds are not available. Anecdotally the estimated number ranges from 35% to 40%.

Ernst & Young's analysis from its 1998 report on *The Canadian Investment Funds Market* indicates that in May 1998 household penetration for Canada was 38% (United States - 37.5%) and that the average Mutual Fund Assets per Fund-owning household is C$73,300 (United States - C$156,000; US$104,600).

[4] See the Report of the Canadian Committee on Mutual Funds and Investment Contracts - A Provincial and Federal Study published in 1969 by the Queen's Printer for Canada.

[5] In Canada, jurisdiction over securities matters is exercised by its ten Provinces and two Territories. The term "Canadian Securities Administrators" or "CSA" refers collectively to the securities regulatory authority in each of the Provinces and Territories of Canada.

Industry participants were, and continue to be, proud of the fact that the industry has grown to the size it has without there being any major problems. They recognized, and continue to recognize, the importance of ensuring that the public's expectations are met. Industry participants stressed, and continue to stress, the importance of there being the right regulatory environment designed to support the integrity and trust upon which the industry is founded but freed of impediments such as interprovincial or national barriers that make it difficult and costly for the industry to develop and function on a national basis or globally.

Industry participants were, and continue to be, mindful of the potential benefits that could flow to Canada by encouraging the development of a Canadian-based investment fund service industry that has access to and is supported by the technological infrastructure necessary to provide services not only to Canadian-based operations but also to global ones. To encourage and sustain this development in Canada, they advised, and continue to advise, that there is a need for Canada to provide highly-trained people and a competitive tax and regulatory environment.

The 1994 review culminated in a report (the "1995 Report") issued January 31, 1995 entitled *Regulatory Strategies for the Mid-90s - Recommendations for Regulating Investment Funds in Canada*.[6] The 1995 Report discusses:

(i) the major strategic forces affecting the investment funds industry in Canada;

(ii) what is happening in the industry as a result of pressures brought to bear on investment fund managers, changing consumer attitudes, and the competition for consumer savings;

(iii) the major factors contributing to the widely-held view that changes in the securities regulatory system are needed to serve the needs of the marketplace better;

(iv) the major areas that present regulatory challenges; and

(v) the proposals that were made for a new regulatory framework.

2.2. Post 1995 Report Activity

The 1995 Report generated a lot of discussion and a lot of activity. Virtually every firm and organization involved in the financial services industry formed its own committees and/or participated in industry committees to consider the recommendations.

Investment Funds Steering Group

A key group was the Investment Funds Steering Group, a joint industry-regulatory group appointed under the auspices of the CSA, that in turn established several working committees to consider the recommendations. In November, 1996, the Investment Funds Steering Group issued its report[7] which in effect validated the findings contained in the 1995 Report, endorsed the core strategic recommendations that were made for dealing with the identified challenges and made

[6] A copy of the 1995 Report and of the Briefing Notes that were issued in connection with the 1995 Report may be obtained from the Ontario Securities Commission, 8th Floor, P. O. Box 55, 20 Queen Street West, Toronto ON M5H 3S8 - Telephone: 416-593-8117; Fax: 416-593-8122. The Report and Briefing Notes are also available on the Ontario Securities Commission's website at <http://www.osc.gov.on.ca>.

[7] A copy of the Investment Funds Steering Group Report, *The Stromberg Report: An Industry Perspective*, may be obtained from the OSC as noted in Footnote 6.

recommendations for actions to implement the strategic recommendations. In many cases the recommendations coincided with those contained in the 1995 Report; in other cases they did not.

CSA Implementation Committee

Following the release of the Investment Funds Steering Group Report, the CSA established a CSA Implementation Committee to consider the 1995 Report and the Investment Funds Steering Group's comments thereon and to recommend a course of action for the CSA. The CSA Implementation Committee's proposals for action were approved by the CSA in April of 1997.[8]

Discussion and Debate

The Investment Funds Steering Group's review was only part of the process for digesting the 1995 Report and its implications. The 1995 Report stimulated intense public discussion and debate both before and after its release. It caused many organizations to look inward to their own processes and to make some fundamental changes. It sparked renewed effort on the part of IFIC to contribute to the regulatory and self-regulatory policy process. It brought together people who were not accustomed to talking with each other and provided them with a forum for discussion that contributed to improved knowledge and understanding of each other's needs and expectations. In doing so it served as a means for identifying areas where common goals were shared.

Quebec Consultative Committee

The 1995 Report also prompted the Quebec Securities Commission to establish its own Consultative Committee. The Report of the Quebec Consultative Committee was issued at the end of January 1997. One of the members of this Committee was also a member of the Investment Funds Steering Group. The responses in the Quebec Consultative Committee Report and in the Investment Fund Steering Group Report are substantially the same.

CICA Study Group

In addition, The Canadian Institute of Chartered Accountants ("CICA") established a Study Group as part of its continuing research program to review the current practices of Canadian investment funds with a view to providing guidance to the industry and users on accounting and financial reporting matters. The CICA Research Report was issued in May of 1997.[9] It is anticipated that as a minimum the CICA Research Report will be used by all types of investment funds as supplementary guidance to the recommendations in the CICA Handbook as to what constitutes "generally accepted accounting principles". The CICA Research Report is supportive of the recommendations made in the 1995 Report about accounting and financial reporting matters.

International Attention

The 1995 Report has been broadly distributed throughout the world and is receiving considerable attention in various countries where comparable regulatory challenges exist.

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[8] See *Report of The CSA Investment Fund Implementation Group Endorsed by the Canadian Securities Administrators* dated May 15, 1997 published in the OSC Bulletin at (1997) 20 OSCB 2512.

[9] *Financial Reporting by Investment Funds*, CICA Research Report, May 1997 published by the CICA.

Consumer/Investor Attention

Most importantly, the 1995 Report has caught the attention of individual Canadians and has made them aware of issues that impact their well-being and what they should expect from the investment fund industry and its regulators. The impact of this increasing knowledge and awareness of individual consumer/investors is being felt by fund managers and by fund distributors alike and should ultimately have an impact on how the industry is regulated.

2.3. Areas of Concern Identified in the 1995 Report

The major areas of concern identified in the 1995 Report relate to:

(i) how investment funds are structured;

(ii) how they are sold;

(iii) the inherent conflicts of interest with respect to both the structuring of investment funds and the distribution of their securities that can result in the interests of the consumer/investor not being placed first;

(iv) the adequacy of the proficiency and training of some of the people who sell investment funds and of some of the people who manage funds;

(v) the adequacy of the resources (human, technical and financial) of some industry participants to carry on the activities that they carry on;

(vi) conflicts of interest with respect to the management of the investment portfolio;

(vii) the fact that many investors seem to have an imperfect understanding of investment issues;

(viii) the fact that the disclosure system in place in Canada is ineffective in actually informing investors of material information they need in order to make a reasoned investment decision and is perceived by many in the industry (as well as by investors) as being irrelevant to them;

(ix) the fact that there is a lack of comparability of performance information about investment funds both within the same product category and with their functional equivalents;[10] and

(x) the fact that the securities regulatory regime in Canada is cumbersome and costly to comply with and lacks the resources to monitor compliance with its requirements or to respond in a timely manner to the changing marketplace.

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[10] Examples of investment funds that are the functional equivalent of mutual funds but which are not subject to comparable regulation even though they are made available to the retail investor include certain pension and other retirement plans, variable investment contracts and annuities offered by insurance companies, and certain types of pooled funds and wrap accounts offered by various dealers in securities, investment advisers and financial institutions. These investment fund “look-alikes” present a problem both from the perspective of the investor and from the perspective of the mutual fund manager. The problem for the investor lies in the lack of prospectus-level disclosure about the investment fund, the lack of comparability of performance and other information about the investment fund and the lack of required adherence by these investment fund “look-alikes” to merit regulation standards. The problem from the perspective of the mutual fund manager lies in the lack of a level playing field while competing for the same business. Further problems relate to the differences in proficiency and education and other licensing standards for the intermediaries through whom these products are made available.

2.4. The Perspective Underlying the 1995 Report Recommendations

The recommendations made in the 1995 Report reflect the following perspectives:

- what is good for the investor is good for the industry and will foster efficient and effective capital markets;
- the industry includes all aspects of money management;
- the foundations of the industry are integrity and trust;
- because there is frequently a lack of knowledge and a lack of bargaining power on the part of many investors, the concept of "buyer beware" cannot by itself be permitted to govern the activities that result in individuals investing their money in investment funds; there is a need, in this situation, to have regard for the interests of investors by ensuring that the system operates fairly and openly;
- there is a need to increase the knowledge and awareness of investors and to ensure that investors have timely, meaningful and relevant information to assist them in making their investment decisions and in monitoring the same;
- the line between selling and advising has substantially disappeared and there is a need to increase the proficiency and training of the persons dealing with the public to enable them better to serve the needs of investors;
- there is a need for **better** regulation rather than for **more** regulation; and
- within this environment, the regulatory strategy should be to allow competitive forces to operate with minimal intervention.

It is this perspective that has generated the attention of investors in Canada and has struck responsive chords globally.

2.5. Strategic Recommendations Made in the 1995 Report

Given the nature of the concerns identified in the 1995 Report in connection with the Canadian investment fund industry, it is not surprising that the recommendations made in the 1995 Report to address the problems center around two core concepts - **"fairness and integrity"** and **"information and knowledge"**. The recommendations contemplate a strong self-regulatory role for the industry that is supported by a strong regulatory structure that is founded on these core concepts. The recommendations are aimed at encouraging and assisting the industry and its regulators in addressing the areas of concern proactively and, in doing so, to continue to meet the public's expectations and to merit the public's confidence.

The framework for the recommendations is based upon proposals for:

1. Centralized, coordinated, streamlined, functional regulation; this would include provisions for:

    (1) simplifying the regulatory structure by combining provincial resources to create a single centralized unit to regulate investment funds;

(2) establishing a Joint Regulatory Coordination Group consisting of representatives of the Canadian banking, trust, loan, insurance, pension and securities regulators (including the self-regulatory organizations and the customer protection organizations) to provide a coordinating mechanism among the member regulators to ensure that there are no regulatory gaps arising from: (i) deregulation of the financial services industry, (ii) the entry of new industry participants into the marketplace, and (iii) the multiplicity of regulators having jurisdiction over various aspects of the business of the various participants in the industry; another function of the Joint Regulatory Coordination Group would be to provide a similar coordinating mechanism with their international counterparts;

(3) treating all types of arrangements whereby money is managed on a collective basis, directly or indirectly, for individuals as "investment funds" and bringing all such arrangements under a common regulatory structure; what is contemplated by this recommendation is a regime that would build specific requirements for specific types of investment funds on a uniform base of core principles (e.g. good faith requirements) that would be applicable to all investment funds regardless of what kind they were or who was offering or sponsoring them;[11]

2. strong, effective self-regulation by the industry in respect of the management and distribution of investment funds based on: (i) high ethical standards, (ii) fair practice and business conduct rules, (iii) effective and efficient internal and external systems, controls and procedures, and (iv) pro-active and timely monitoring; in this respect:

(1) the framework contemplates that a single, strong, effective self-regulatory organization would be established that would operate on a national basis and in which membership would be mandatory for everyone who sells securities (including mutual fund securities);[12]

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[11] The perspective underlying this recommendation is that regulatory requirements in respect of investment funds should apply equally to all industry participants and investors should be assured of certain common standards regardless of whether they are dealing with an independent investment fund organization, a bank, a trust company, a life insurance company or other financial institution, an investment counsel or an investment dealer, a mutual fund dealer or some other category of dealer or a financial planner.

[12]This self-regulatory organization ("SRO") would be required to adopt rules of fair practice and business conduct that would, among other things, address industry sales practices. It would also set standards for education, proficiency and training, advertising of performance and other investment information, capital requirements, internal systems, controls and procedures for SRO members, insurance and bonding requirements and contingency fund participation. In addition, the SRO would be responsible for monitoring compliance with its rules and for conducting supervisory audits.

The importance of this recommendation cannot be underestimated. Securities regulation in Canada is founded on the principles of: (i) disclosure of information, and (ii) the registration of persons who deal with the public or provide investment advice. The problem with the current regime on the registration side relates to the fact that not all persons who sell investment fund securities to the public are required to be a member of a recognized self-regulatory organization and to adhere to the higher standards of the self-regulatory organization with respect to rules of fair practice and business conduct, education and training, capital, bonding and insurance requirements and contingency fund participation. Most importantly, those persons who are not members of a recognized self-regulatory organization are not subject to the compliance monitoring procedures of the self-regulatory organization. Investors are often not aware of the different standards or of the impact that the differences in these standards can have. These differences result in potential problems for investors. These differences also present an economic problem for dealers who are members of a self-regulatory organization who are concerned about the lack of a level playing field when they are required to adhere to higher standards than their non-member counterparts while competing with them for the same business.

(2) the framework also contemplates that managers of investment funds would continue to be regulated by the Securities Regulator directly through registration with the securities regulator, with conditions of registration being attached designed to provide for the abovementioned high ethical standards, rules, systems, controls and procedures and for monitoring compliance therewith through a system of self-assessment review procedures comparable to those presently required of financial institutions in respect of deposits covered by deposit insurance;[13]

3. improved corporate governance provisions in respect of investment funds including:

(1) the enactment of an investment funds statute to provide a common statutory framework for the constitution and governance of investment funds, the need for which under Canadian law is discussed in Section 18 of the 1995 Report;

(2) provision for independent boards at the management level and at the fund level;

(3) improved oversight provisions through enhancing human, technical and financial resources to ensure the adequacy thereof for the functions carried out;

(4) codes of ethics and business conduct;

(5) proposals for dealing with conflicts of interest including those arising from the desire to:

(a) engage in principal trading with a related party;

(b) deal in securities of or guaranteed by a related party including securitizations and mortgages sourced by a related party;

(c) participate in related party underwritings;

(d) execute portfolio transactions through an affiliate of the investment fund manager or portfolio adviser;

(e) execute portfolio transactions through persons (or their related parties) who distribute securities of the investment fund (i.e. reciprocal trading);

(f) engage in inter-fund trading;

(g) create certain fund-of-fund structures; and

(h) engage in certain soft dollar transactions;[14]

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[13]The 1995 Report recommends that the Securities Regulator retain direct responsibility for the registration of investment fund managers by reason of the fact that the functions of a manager of an investment fund are so closely linked with the functions of its sponsored investment funds. As a result, it would be very difficult and inefficient to attempt to separate the regulation of the two. It was therefore recommended that the establishment of investment funds and the disclosure documents relating thereto should remain the direct responsibility of the Securities Regulator and should not be delegated to a self-regulatory organization and that the registration function with respect to managers of investment funds should also remain the direct responsibility of the Securities Regulator. See Section 14 of the 1995 Report for recommendations as to the standards required to be met in order to act as an investment fund manager.

[14] See Sections 19, 20, 21 and 22 of the 1995 Report.

4. increased emphasis on educational and proficiency requirements for industry participants aimed at providing industry participants with:

   (1) better training and proficiency skills;

   (2) better awareness of ethical standards, fair practice and business conduct rules; and

   (3) better ability to meet client needs and expectations;

5. increased emphasis on the importance of investor education aimed at improving the ability of investors to:

   (1) identify, request, review and understand the information needed to assess investment recommendations made to them;

   (2) apply the information to their own situation in making investment decisions; and

   (3) identify, request and review in a meaningful manner the information needed to monitor their investments on a continuing basis and assess whether adjustments are needed;

6. realignment of the elements of the disclosure system aimed at:

   (1) integrating primary and secondary disclosure requirements;

   (2) improving disclosure requirements to ensure that the information is timely, meaningful and relevant; and

   (3) ensuring that disclosure is integrated and continuing;

7. establishment of a basis for achieving comparability of performance information about different investment fund products and between investment fund products of the same type; this proposal contemplates:

   (1) the development of uniform rules respecting the calculation and use of performance information that would be required to be universally used by all industry participants with respect to performance information that such industry participants may choose to give to, or in respect of, all types of managed accounts; and

   (2) that it would be desirable (and probably essential) that international standards be developed in this respect;[15]

   this need for comparability is an important component of the disclosure proposals contained in the 1995 Report.

2.6. Relationship of the Strategic Recommendations to Each Other

The last four recommendations are integral to each other and to the efficacy of the continued reliance by governments and regulators on the adequacy of disclosure as an appropriate strategy on which to base the future well-being of consumer/investors. To continue to rely on the strategy of disclosure

[15] See Section 24 of the 1995 Report.

necessitates finding a better way to make sure that information that is timely, meaningful, and relevant to consumer/investors is communicated in plain language to them in a way that a reasonable person acting reasonably should be able to understand. It is submitted that information that has neither been communicated to, nor understood by, the consumer/investor cannot be considered to have been disclosed to the consumer/investor.

This strategy of disclosure is based upon the assumption that the consumer/investor has the knowledge and awareness to understand the significance of the information provided (or not provided) to the consumer/investor and to apply it to the consumer/investor's own circumstances. It also presupposes that industry participants and regulators have a comparable level of knowledge and awareness to understand the significance of the information that is provided (or not provided) in order for them respectively to carry out their responsibilities to consumer/investors adequately. Accordingly, increasing the knowledge and awareness on the part of industry participants, consumer/investors and regulators alike is an integral part of the process of achieving effective disclosure.

The need to increase knowledge and awareness goes beyond the fact of asymmetrical information flows in the marketplace. It goes to the fundamental ability of the consumer/investor to assume responsibility for his or her own well-being, whether acting directly or through an intermediary. Effective access to information and the ability to use it levels the playing field and enables the adoption of a regulatory and supervisory structure that allows competitive market forces to operate with minimal intervention.

The balance of the recommended strategies are structural in nature and/or go to the fundamental integrity of the investment fund product. All of the strategies are based on investing in solutions rather than paying for problems. They are based on "getting it right" in the first place. This is a well-recognized and well-proven strategy for enhancing one's competitive position in the marketplace.

3. CHANGES SINCE THE 1995 REPORT THAT SHOULD BENEFIT THE CONSUMER/INVESTOR

3.1. Post 1995 Report Changes in the Investment Fund Industry

There have been significant changes in all aspects of life during the last four years. One of the areas where the impact of these changes is most apparent is in the investment fund industry. The changes, for discussion purposes, are divided into three main categories

The first category relates to changes that have been made since the 1995 Report that should benefit the consumer/investor. These changes are discussed in this Section 3.

The second category relates to federal and provincial governmental policy initiatives that have been undertaken since the 1995 Report that will affect the consumer/investor. These changes are discussed in Section 4 of this Review.

The third category relates to changes in the strategic environment that have an effect on the investment funds industry. These changes are discussed in Section 5 of this Review.

3.2. Heightened Awareness of Issues

Probably the most important result of the discussion and activity generated by the 1995 Report has been people's heightened awareness of issues. This has happened at all levels regardless of whether one is a regulator, an investor, an industry participant or a combination of the three.

A major contributing force to this heightened awareness of issues is the interest that the media has taken in investment fund issues. The media has played an important role both in identifying and keeping these issues in the public light and in helping people to understand their significance.

Another factor is the increase in the number of books, newsletters, websites and other publications that deal with mutual funds and other investment products and with financial and retirement planning and investing generally. This ready availability of information has been a major contributing force to people's knowledge and awareness.

3.3. Industry-Generated Initiatives

The 1995 Report prompted a lot of organizations to implement initiatives without waiting for industry or regulatory endorsement. Industry participants tell me that changes have been made in the way business is done and that a lot of organizations are using the recommendations in the 1995 Report as benchmarks or standards against which to measure the changes.

In the case of fund managers that are public companies, industry participants have noted that their boards of directors have taken a heightened interest in their managed funds and that the audit committees of the fund managers increasingly are reviewing the financial statements of the managed funds, including the expense allocations between the managers and their respective managed funds. I also am told that more attention is being paid to the adequacy of controls and to code of conduct issues.

Another area where change is occurring is seen in the fact that more fund management groups have established, or are in the process of establishing, independent fund advisory boards.

3.4. Sales Practices Rule

On May 1, 1998, the CSA's National Sales Code Rule No. 81-105 together with the related Companion Policy No. 81-105 CP became effective.[16] This Rule is the result of three years of industry and regulatory efforts to establish rules of fair practice and business conduct relating to the distribution of securities of a mutual fund. The Rule and Companion Policy reflect the industry and regulatory responses to the concerns about sales practices and business conduct raised in the 1995 Report.

3.5. Mutual Fund Prospectus Disclosure

The CSA's proposals for mutual fund prospectus disclosure are contained in the proposed National Instrument 81-101, Forms 81-101FI and 81-101F2 and Companion Policy 81-101CP. These proposals have been published for comment in the OSC's Bulletin dated July 31, 1998. The proposals are posted on the OSC's website[17] and on IFIC's website.[18] The proposals are discussed in Section 17 of this Review.

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[16] National Instrument 81-105 and Companion Policy 81-105CP together with the related Notice of Rule and Policy were published in the OSC Bulletin in February of 1998 at (1998) 21 OSCB 747. Earlier versions were published for comment in the OSC Bulletin in August of 1996 at (1996) OSCB 4727 and in July of 1997 at (1997) 20 OSCB 3879.

[17] See Footnote 6.

[18] See Footnote 19.

3.6. Code of Ethics on Personal Investing

In May of 1998, IFIC released the Final Report of its Code of Ethics Committee on Personal Investing.[19] This Report is IFIC's response to the concerns about personal trading raised in the 1995 Report and to the increased public attention that is being focused on personal investing by portfolio managers and other persons having access to a mutual fund's trading practices.

Each Manager member of IFIC is required to adopt, and to confirm that it has adopted, a personal investing code of ethics containing the basic principles that IFIC has determined that all Manager members of IFIC must include in their personal trading codes. This must be done by December 31, 1998. IFIC has published a Model Code that incorporates its required basic principles in order to provide guidance to its Manager members who wish to write their own codes.

3.7. Personal Rate of Return Calculation Standard

Another initiative that will be helpful to consumer/investors in monitoring the performance of their investments is the adoption by IFIC of a standard formula for calculating personal rates of return.

In a press release issued June 4, 1998, IFIC announced that its Members who choose to provide personal rates of return as a value added service have agreed to use the methodology and to adhere to standards of presentation determined by IFIC and outlined in IFIC Bulletin (number twenty-one). The methodology that is required to be used is the Modified Dietz Method with monthly linking. IFIC's announcement states that this methodology will provide investors with a percentage return figure indicating how their investments have performed rather than simply how the fund performed.

IFIC Members have the option of deciding: (i) whether to prepare rates of return for investors, and (ii) which clients, if any, will receive the information. The industry standard (Modified Dietz Method with monthly linking) is required to be identified as such when providing investors with personal rates of return. Members may, in addition, provide rates of return using another formula but all relevant differences from the IFIC standard must be identified in the documents in which the personal rate of return appears at the first time of presentation.

In announcing the adoption of its standard, IFIC stated that to the best of its knowledge, the Canadian mutual fund industry is the only mutual fund industry group in the world to tackle the issue of personal rates of return and to come up with a consensus.[20]

3.8. Standard for Categorizing Mutual Funds

Over the past several months, suppliers of fund data have produced what they describe as a set of rigorous criteria to determine how to categorize mutual funds.[21] Their proposals have been developed by a committee composed of representatives from Portfolio Analytics Limited, BellCharts, The Financial Post, Southam News, FundData, The Fund Library, The Globe and Mail and Fund Masters. IFIC has participated as an observer. The committee has agreed to:

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[19] *Final Report of the Code of Ethics Committee on Personal Investing*, May 1998 published by IFIC. A copy of the Report is posted on IFIC's website at <http://www.ific.ca/regulation>.

[20] See IFIC's News Release dated June 4, 1998 - *Mutual Fund Industry Standardizes Personal Rates of Return*.

[21] See Rudy Luukko, Fund Watch, February 1998 - *The Drive for Clearer Fund Categories. Also see* Jean Murphy, Investment Executive, July 1998 - *New mutual fund categories in use later this year* and September 1998 - *Categories, criteria to be released this month.*

- establish clear criteria and apply the criteria using known holdings data as well as investment objectives established by the fund companies;

- publish all ranking and "quartile" information based on these fund categories so that each provider of mutual fund information is consistent in terms of ranking individual funds with others;

- make public, via the Internet and other means, the final document that details the criteria, philosophy and membership of each fund in each category so that ***the process is completely transparent to the investing public****;* and

- review the category membership of each fund annually, while maintaining a monthly watch on new funds with the result being possible reclassification.

In September 1998, the committee plans to distribute its proposed criteria and new fund categories to industry participants (including fund companies and analysts) and the relevant media for a three week review and comment period. The committee plans to release the final criteria with the resulting fund categorization in October 1998.

There is a special significance to the agreement that has been reached on common categorization standards. The significance of this agreement is that mutual funds will always be found in the same category regardless of which newspaper, newsletter, software program or other medium is providing the information. This has been an area of great discrepancy because prior to the categorization agreement, the different suppliers of data used different sets of criteria to categorize funds. This discrepancy has enabled fund companies to cherry-pick its rankings and to advertise the supplier's ranking that was most favorable to it.

The categorization of investment funds is very important for consumers and financial advisers. Shortcomings in fund categorization criteria and the resulting rankings have been a concern for some time. The need to develop standards in this area was discussed in the 1995 Report.[22] The end result of the new categorization criteria will be a new tool for consumers and financial advisers.

3.9. Mutual Fund Dealers Association of Canada

In 1997, IFIC and the IDA were asked by the OSC to come forward with proposals for a self-regulatory organization for mutual fund dealers. This request was endorsed by the CSA. The proposals have resulted in the recent incorporation of the MFDA. It is intended that the MFDA will ultimately be recognized throughout Canada as a self-regulatory organization and that it will be mandatory for each mutual fund dealer that is not a member of the IDA or of a stock exchange that is a self-regulatory organization, to join the MFDA.[23]

Both IFIC and the IDA will play a key role in the MFDA. The objective is to take advantage of IFIC's knowledge and experience in the mutual fund industry and of the IDA's experience and credibility as a self-regulatory organization to build a new self-regulatory organization from the ground up in a short time frame.

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[22] See the 1995 Report - *Categorization of Investment Funds* at page 209 and at page 221.

[23] The Request for Comments on Proposed Rule 31-506 - SRO Membership - Mutual Fund Dealers was published in the OSC Bulletin of June 19, 1998 at (1998) 21 OSCB 3875.

To this end, governance of the new self-regulatory organization will be shared by IFIC and the IDA. The Chair of the MFDA will be the IFIC Chairman. The President and Chief Executive Officer of the MFDA will be the IDA President and Chief Executive Officer. IDA supervisory staff will provide management, direction and administrative support for the MFDA. The chief operating officer of the MFDA will be appointed by the board of directors of the MFDA. The MFDA board of directors will consist of 21 individuals with equal representation from fund distributors, the IDA and the public. It has been agreed that an independent mutual fund dealer, who is not a member of IFIC or of the IDA, will be a member of the board of directors and that the IDA bank-related board nominees will be limited to three.

Five committees have been established to address key issues integral to the development of the MFDA's self-regulatory by-laws and regulations. These committees will provide distributors with the opportunity to shape and inform policy and make recommendations to the board. The committees include IDA members and CSA observers and, in most cases, one of the public directors. Fund managers will be invited to provide their perspective. The five committees will deal with (i) capital requirements and an investor protection fund, (ii) proficiency and continuing education, (iii) sales practices, reporting and advertising, (iv) administration, and (v) franchising.

3.10. Mutual Reliance Proposals

While the goal of creating a single securities regulatory body in Canada remains elusive, there is a spirit of renewed cooperation among the ten provincial and two territorial commissions. The end result of this initiative, if successful, will be to create a "virtual" single securities regulatory body for people to deal with. At the heart of this cooperative effort are proposals for mutual reliance by the respective CSA members on work that will be substantially performed only by the "designated jurisdiction" for the issuer or registrant. The mutual reliance program is proposed to extend to the filing of prospectuses, applications for exemptive relief and the registration of dealers and advisers. The program is premised on reaching agreement on: (i) common standards for selective review criteria, (ii) a common approach to how matters are reviewed, and (iii) uniform or harmonized regulatory requirements. Each jurisdiction will retain the ability to opt out.

The CSA have published for comment the memorandum of understanding that sets out the working arrangement among the CSA.[24] The Mutual Reliance Review System ("MRRS") is expected to be effective in early 1999. The MRRS will apply initially to the (i) filing of prospectuses (including mutual fund prospectuses) and initial annual information forms, (ii) registration applications for advisers and dealers who are members of a self-regulatory organization, and (iii) applications for discretionary relief. It is anticipated that the MRRS may be extended to other categories of filings such as continuous disclosure documents and rights offering circulars and related documents.

The CSA in its Request for Comments[25] state that they agree that in addition to simplifying and facilitating the use of the regulatory system for filers, an objective of the MRRS is also to effect a unified approach to the many aspects of securities regulation in Canada. The CSA state that in order to achieve this objective, the Memorandum of Understanding provides for:

1. Participation in staff development and training programs organized by CSA committees to standardize the review processes and to develop common approaches to issues.

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[24] The Request for Comments on the Mutual Reliance Review System Memorandum of Understanding is published in the OSC Bulletin of June 19, 1998 at (1998) 21 OSCB 3882.

[25] See Footnote 24.

2. Consultation to promote consistency and communication in the review of material filed pursuant to the MRRS and to coordinate changes to the MRRS.

3. The provision of adequate funding by the participating CSA to support the training and consultation components of the MRRS.

4. The possible coordination of the utilization of personnel among themselves under which the staff of one securities regulatory authority may be utilized by another in fulfilling its obligations as principal regulator.

3.11. Cooperation between Insurance and Securities Regulators

In June of 1998, provincial insurance regulators and securities regulators agreed to work together in determining how segregated funds should be regulated. The federal Office of the Superintendent of Financial Institutions ("OSFI") is also participating in this initiative. It is expected that the working group will present its recommendations in the fall of 1998.

3.12. Coordinating Mechanism for Regulation

On June 22, 1998, the Ontario Insurance Commission issued a discussion paper on the regulation of insurance distribution and the coordination of financial services regulation in Ontario.[26] The discussion paper proposes that a body to be known as the Ontario Council of Financial Regulators ("Council") would be established. The Council would be composed of the Chief Executive Officers of the Financial Services Commission of Ontario, the OSC and the proposed Insurance Distribution Regulatory Board. The discussion paper notes that:

> "The Council would have a mandate to enhance the quality and efficiency of the regulation of financial services in Ontario by:
>
> - identifying ways to coordinate activities, reduce duplication and avoid unintended gaps or conflicts in the regulatory net,
> - making recommendations to their constituent bodies on effecting complementary regulatory initiatives,
> - coordinating activities with their counterpart financial services regulators in other jurisdictions within and outside Canada.

The proposals in the discussion paper are the first public indication that the recommendations made in the 1995 Report for a cross-sector, coordinating mechanism for regulation[27] is receiving some attention in Canada. The proposals also draw on the recommendations relating to regulatory structure made in the OECD Paper.

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[26] *Discussion paper on Regulation of Insurance Distribution and Coordination of Financial Services Regulation in Ontario*, dated June 1998 and issued by the Ontario Insurance Commission (Financial Services Commission of Ontario). A copy is posted on its website at <http://www.ontarioinsurance.com>. Paper copies in English can be obtained by calling 1-800-263-7965. Copies in French can be obtained by calling 1-800-668-5821.

[27] See Sections 5, 7 and 8 of the 1995 Report.

3.13. CICA Audit of Investment Funds Research Project

In the Spring of 1998 the CICA initiated a research project to identify and address audit issues that relate to the recommendations and conclusions set out in the CICA Research Report *Financial Reporting by Investment Funds.*[28] It is anticipated that this project will:

(i) express the Study Group's views on what action should be taken by the CICA's Auditing Standards Board with respect to the audit of investment funds;

(ii) provide guidance to auditors and other interested parties on various issues that pertain to investment funds; and

(iii) offer suggestions to regulatory authorities on what changes should be made to existing requirements.

4. CHANGES RESULTING FROM GOVERNMENTAL POLICY INITIATIVES

4.1. Federal Government Policy Initiatives

In response to the current economic and social environment and the impact of this environment on the marketplace several initiatives are underway. These include proposals for social program and pension reform, a review of the foreign property tax rules for pension and other retirement plans, the establishment of a task force on financial institution reform and an examination of the role of the institutional investor by the Standing Senate Committee on Banking, Trade & Commerce.

4.2. Provincial Government Policy Initiatives

In Ontario, pension, trust and insurance regulation have been brought under the umbrella of the Financial Services Commission of Ontario.

In Quebec, new initiatives are underway aimed at regulating the distribution of financial products and services by creating a single financial services bureau to be known as the *Bureau des services financiers*. The Bureau's mission will be to protect the public. It is proposed that the powers to regulate representatives will be shared between the Bureau and the Quebec Securities Commission based on whether the representatives pursue activities in the insurance or financial planning sectors or the securities sector.

4.3. Self-Funding

The chronic under-funding problems of the various CSA - or of at least the four largest jurisdictions - have been addressed. Self-funding is now in place for the securities regulatory authorities in the Provinces of Alberta, British Columbia, Ontario and Quebec and provision has been made to enable them to operate in an autonomous, but nevertheless accountable, manner.

[28] See Section 2.2 of this Review under the sub-heading, *CICA Study Group.*

5. CHANGES IN THE STRATEGIC ENVIRONMENT

5.1. Strategic Forces

In 1994, the key strategic forces driving the growth of the investment fund industry centered around:

(i) the economic and demographic factors relating to an aging population;

(ii) there being fewer people supporting such population;

(iii) the lack of the likelihood of lifetime employment;

(iv) the likelihood of substantial underemployment; and

(v) the recognition of the inadequacy of public and private pension plans to provide for retirement needs.[29]

These strategic forces still continue to affect the investment fund industry. However, in 1998, these forces are subsumed to even broader strategic forces that have emerged. The predominant strategic forces in 1998 include:

(i) the impact of globalization;

(ii) the reality of financial services deregulation;

(iii) the impact of information technology;

(iv) the impact of advanced communications facilities; and

(v) the strengthening of the free market economic system.

These are all enabling forces and they have converged to empower individuals as well as institutions. This convergence has in itself resulted in the emergence of the consumer/investor (a term whose bottom-line meaning ultimately describes us all) as a strategic force in his or her own right.

The impact of the emergence of the consumer/investor as a strategic force in the investment fund industry is placing demands and expectations not only on the marketplace but also on the regulatory and supervisory framework. Our current regulatory and supervisory framework is simply not structured to meet these demands and expectations.

5.2. The Changing Face of the Investor in the New Financial Landscape

One of the major changes that has occurred is in respect of the marketplace itself and in the “face” of the institutional investor. The financial marketplace has traditionally been viewed as being composed of “institutional” investors and “retail” investors. Traditionally, the institutional investor has been exempt from the application, and the benefit, of various provisions of securities legislation on the theory that the institutional investor is able to look out for its own interests.

[29] These forces are discussed in Sections 2 and 3 of the 1995 Report.

This approach was reflective of an era when the institutional investor generally was a financial institution (such as a bank, trust company, loan company, insurance company) or a defined benefit pension fund or endowment fund investing money for its own account. Regulation and supervision of such institutional investors was primarily focused on solvency issues and prudential regulation aimed at ensuring that such institutions would be able to meet their respective obligations to depositors, policyholders, plan participants and beneficiaries as the case may be. Investor protection was not part of the regulatory or supervisory focus for such institutions.

In the current Canadian financial landscape, the face of the institutional investor has changed. This is partly a result of the deregulation of the financial services industry that began in Canada in 1987 when restrictions on the nature of the activities in which regulated financial institutions could engage were substantially eliminated. This enabled such financial institutions to expand their money management and other business activities substantially.

While institutional investors still manage money for their own account, an increasing amount of the money that is managed by institutional investors is being managed in a representational capacity rather than for the institutional investors' own accounts. The fact that institutional investors in managing money in a representational capacity have discretionary authority (whether limited or unlimited) does not change the fact that these institutional investors are managing ***other people's money*** and that their authorization to continue to manage such money may be terminated on relatively short notice or, in some cases, no notice.

The increasing representational role of the institutional investor is seen not only in the case of the traditional "financial institutions" but also in the case of pension and retirement plans, which are increasingly being structured as defined contribution plans (instead of defined benefit plans) or as registered retirement savings plans. In the case of pension plans, one of the implications that flows from the shift from the use of defined benefit plans to the use of defined contribution plans to provide retirement benefits is that the money held in defined contribution plans or registered retirement savings plans is being managed in a representational capacity for the direct benefit of the plan participants whose rights to the accumulated assets held for their respective accounts are fully vested in them.

This is in contrast with the ownership interest that the plan sponsor of a defined benefit plan has in the assets held in the defined benefit plan where the investment performance of such assets directly impacts on the plan sponsor's funding obligations and its liability for any benefits' shortfall.

Although mutual funds (which are separate legal entities formed at the instance of a mutual fund management organization as a vehicle to enable individual investors to pool their money for investment purposes) are regarded as institutional investors and are sometimes described as being "financial institutions", it should be kept in mind that:

(i) in Canada there is no constating statutory basis for their constitution and governance as a "financial institution"; and

(ii) the assets of a mutual fund are invested in a representational capacity for investors who are entitled, usually on a daily basis, to demand repayment of their interest in the mutual fund at the net asset value thereof.

Retailization of the Marketplace

The purpose of focusing on the distinction between the management of money by an institutional investor for its own account and the management of other people's money is to highlight the increasing "retailization" of the institutional investor and the resulting "retailization" of the marketplace when considering what regulatory and supervisory policies are appropriate for a marketplace that is increasingly made up of "*instividual*" investors.[30]

This "retailization" is occurring not just as a result of the expanded powers of financial institutions but also as a result of the convergence of several factors including:

(i) the increased awareness of individual investors of the need to move beyond deposit-type savings and life insurance to provide for their well-being,

(ii) the ease with which individual investors are able to invest not only in Canada but throughout the world as a result of new and improved technology and communication facilities, and

(iii) the increasingly global and free market perspectives underlying governmental policies.

The characterization of the marketplace as a "retailized" or "instividual" marketplace contrasts with what is perhaps the more common characterization of today's marketplace as one that is "increasingly institutionalized".

I do not think that the mindset reflected in this latter characterization is supported in today's reality. What is becoming evident is that the lines between the "retail investor" and the "institutional investor" are increasingly blurring and the basis for distinguishing regulatory strategies on whether the investor is a "retail investor" or is an "institutional investor" is eroding.

From the regulatory and supervisory perspective, the fact of whether an individual holds his, her or its investment interest in underlying securities directly or through some sort of collective investment vehicle should make little difference. This is particularly important when viewed in conjunction with the secular shift of household assets from deposit-type savings and life insurance products to investments (with investment funds being the investment vehicle of choice) that has occurred and is continuing.

The individual consumer/investor now has a direct ownership interest in his or her investments that fluctuates according to the market value thereof as opposed to simply having a contractual right to receive an agreed-upon payment or payments at a stipulated time or times.

The individual consumer/investor who holds his or her investments either directly or through some sort of collective investment vehicle is in direct competition with the institutional investor that invests for its own account. In this environment, the need for equality of regulatory treatment takes on a greater dimension. It is important that the regulatory and supervisory structure not favor the institutional investor over the individual consumer/investor, who traditionally is referred to as the "retail investor". This is particularly so when the institutional investor may also be a purveyor of advice, services and products to the individual consumer/investor.

5.3. Industry Consolidation

The period since 1994 has been marked by a lot of consolidation in the financial services industry. This consolidation is taking place in every aspect of the industry and is a major factor that is shaping the development of the investment fund industry in Canada.

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[30] One of the fundamental questions that needs to be asked in the light of this change in the marketplace is whether the so-called institutional investor should continue to be exempt from the application, and from the benefit, of various provisions of securities legislation on the theory that the institutional investor is able to look out for its own interests.

I simply mention industry consolidation as a strategic force[31] without going into detail. The implications of the industry consolidation that is taking place could well be the subject of a separate review.

However, the implications of industry consolidation will have an important bearing on the development of regulatory and supervisory policy which will need to be adapted to the reality of the industry structure that is resulting from the industry consolidation that is occurring.

The recommendations that I make in this Review regarding regulatory and supervisory structure are focused on addressing the reality of the emerging industry structure. The blurring of product and function that is discussed in the next two subsections is both (i) an example of the changes in industry structure that will require a change in the regulatory and supervisory approach, and (ii) a force in its own right.

5.4. The Blurring of Product and Function and its Consequences

Since 1994 another key factor that is having a significant impact on the marketplace is the increased blurring of product and function. This has occurred as the different segments of the marketplace continue to compete for the hearts and minds of the consumer/investor.[32] The increased blurring of product and function results from the need to gain market share and to protect income streams.

For example, the need to gain market share and to protect income streams has led to:

(i) life insurance companies increasing their focus on investment products such as segregated investment funds, universal life policies that are indexed to the performance of a pool of investment securities, and guaranteed investment funds;

(ii) banks focusing on how they can combine guaranteed deposit obligations with a market-linked return; the result has been to create guaranteed investment certificates where the return is indexed to the performance of a market-linked index and to create debt obligations that are linked to the performance of designated mutual funds or other identifiable pools of assets or commodities;

(iii) mutual fund management organizations exploring ways to offer mutual funds with a guaranteed return; some mutual fund organizations have chosen to enter into arrangements with an insurance company to offer their mutual funds with an insurance wrapper thereby converting the offering of their mutual funds into a segregated fund that is not subject to regulation under securities legislation; at least one mutual fund organization is offering its mutual funds with a guarantee that is issued by an insurance company;

(iv) independent mutual fund distributors establishing their own proprietary investment funds which are sold to their clients; by doing so, these distributors not only receive the distribution fees but they also receive the investment advisory and business management fees that their clients pay for the privilege of investing in their sponsored funds;[33]

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[31] One could well debate whether the consolidation that is taking place in the financial services industry is a strategic force in its own right or is simply the result of other strategic forces that are at work.

[32] See Section 3 of the 1995 Report.

[33] This capturing of the management fee revenue stream is seen as the distributors' response to the growing recognition that distribution fees will come under pressure from an increasingly knowledgeable consumer/investor. The creation of proprietary funds by the independent mutual fund distributors is referred to in the industry as "backward integration".

(v) mutual fund management companies increasingly focusing on sales and marketing activities as opposed to money management activities; and

(vi) banks, insurance companies, trust companies, credit unions, independent mutual fund management organizations, independent mutual fund dealers and full service investment dealers offering, directly and indirectly, a full range of investment advisory services and products.

It should be noted that many of the entities referred to in clause (vi) above, through equity interests in other segments of the industry or through strategic alliances, have multiple entries into the manufacturing and distribution channels. The packaging of these services and products is virtually indistinguishable to the consumer/investor. Unfortunately, it is all too common that the consumer/investor does not know what he or she has invested in. All too often the consumer/investor does not know whether it is a mutual fund, a segregated fund, an equity-linked GIC, a wrap account or whatever and is unable to describe the nature of the underlying investments.

Sales-Focused Fund Management

One of the fundamental challenges that the investment fund industry faces today is how to ensure that the exigencies of marketing pressures do not prevail over the fiduciary obligations of the investment advisory activities.

The increased focus by mutual fund management companies on sales and marketing activities as opposed to money management activities reflects the pressure that results from the mutual fund management companies having competing securityholders' interests[34] that make it necessary for the mutual fund management companies to focus on increasing their sales in order to increase assets under administration to generate the revenues needed to service the various interests. This pressure to manage for sales has become such a predominant force in the investment advisory industry that the line between managing money and simply selling product is no longer clear.

Whole departments have been established to deal with marketing strategies, to provide marketing support to distributors, and to service elaborate dealer compensation payment structures relating to the payment of trailing commissions and to keeping track of deferred sales commission obligations. Where once portfolio management skills were the most sought after skills for mutual fund management companies, marketing skills are now perceived as an even more essential asset.[35] As one fund manager expressed it to me, the fund management industry is becoming a home for marketing personnel who have left the consumer products industry.

[34] An increasing number of mutual fund management companies have issued shares to the public. There are potential conflicts between the interests of the shareholders of the mutual fund management companies and the securityholders of the sponsored investment funds. Many mutual fund management companies have also financed the payment of sales commissions in respect of mutual fund securities that are sold on a deferred sales commission basis by raising money from the public in a variety of ways including limited partnership offerings, income trust offerings, securitized offerings and debt offerings. The interests of the various securityholders of these offerings may in some instances conflict with the interests of the securityholders of the sponsored investment funds. See Section 3.01 of the 1995 Report for a discussion of the various pressures on investment fund managers.

[35] The ever-increasing costs of distribution that are borne by the fund management companies are reflected in the comments made by a senior officer of a mutual fund organization at its 1998 annual meeting. He explained the substantial increase in the company's cash position as being due to "soft" sales in its funds because the company did not have to pay out as much in up-front commissions to brokers and financial planners in respect of back-end load sales made by such brokers and financial planners. (See Shirley Won, The Globe and Mail, June 25, 1998 - *Trimark unveils segregated funds*.)

Skilled as these marketing personnel may be in the marketing of consumer products, it will be important for fund management organizations to ensure that this expertise is sufficiently combined with a deep-rooted understanding of the fundamental fiduciary obligations that an entity that manages other people's money is bound by.

In other words, it will be important to the consumer/investor that fund management organizations ensure that their marketing personnel understand the inherent essence and obligations of the money management service/product. This need also applies to the proprietary funds that have been and are being created by mutual fund distributors.

Consequences of the Blurring of Product and Function

There are several consequences that result from the blurring of function and product. These include:

(i) the difficulty of delineating when and in what circumstances a service becomes a product and vice versa; and

(ii) the difficulty of identifying the differences among products that are offered as equivalents, with or without added features.

It is difficult for consumer/investors to identify when they are being provided with independent advice and when they are simply being sold a product[36] which may be a proprietary product or a product in which the seller/adviser has a substantial financial interest.

It is difficult for consumer/investors to identify the risks that are present in these products, particularly when the products are marketed as being "guaranteed" or as "protected". It is difficult to identify just what is in fact guaranteed.

It is virtually impossible for consumer/investors to identify the cost of:

(i) the advice;

(ii) the service;

(iii) the product; and

(iv) the guarantee.

There is no transparency. Without the ability to identify these differences and to understand their associated costs, it is an impossible task for consumer/investors to identify whether their financial planning objectives are being met or to understand the level of risk that they have undertaken.

In this environment, it is no wonder that the consumer/investor is so often left in a state of dependency that is not adequately addressed either by the financial services industry or by today's fragmented regulatory and supervisory structure.

It is particularly unfortunate that this state of affairs is occurring at a time when most people have realized that they have to do something more - both individually and collectively - to assure their future well-being. The reality is that most people are poorly equipped to do so.

[36] It should be noted that "products" may include advice packaged as a product.

Lured by the double digit returns offered by mutual funds and stock market indices, people have turned away from deposit instruments to mutual funds and, we are told, have become “investors” rather than “savers”.[37] However, many people have done so without comprehending the difference between being an “investor” and being a “creditor” of a regulated financial institution that is backed by governmental safety nets. Many people do not have any comprehension of risk and do not have any idea of how to manage risk. Many people do not appreciate that there is risk inherent in being too conservative in managing their affairs.

Something needs to be done about this. The efforts that are made to remedy this situation need to be supported by the education system, by employment and labor laws, by tax laws, by pension laws, by securities laws and by the basic laws relating to property rights. This support needs to be coordinated and to be complementary across the legal and regulatory system. The recommendations contained in this Review are designed to provide a blueprint for building the underlying framework

People’s rights and opportunities should not be permitted to depend on which province or territory that they live in. Their rights and opportunities should not be permitted to be lost in regulatory gaps or to be tied up with needless and costly bureaucracies or institutional power struggles for the right to provide for their needs.

6. POST 1995 REPORT EFFECT OF CHANGES ON CONSUMER/INVESTORS

6.1. Industry Perspectives on Whether Consumer/Investors Are Better Off Today

This Section of the Review discusses the question of whether the changes that have occurred since the 1995 Report have resulted in consumer/investors being better off today. I asked this question of virtually everyone with whom I spoke during the course of this Review. The answers varied.

On the positive side, a number of industry participants said that:

- the industry has gone a long way in trying to adapt to the recommendations in the 1995 Report and is better than it was in 1994;
- there is no evidence of there being really big problems in the industry;
- there has been lots of growth and new entrants as well as some failures but no one has yet lost any money; however, lots of fine-tuning is needed;
- more attention is being paid to compliance;
- the initiatives aimed at bringing all mutual fund dealers under the umbrella of a self-regulatory organization, the implementation of the sales code and business practices rule, the issuance of guidelines on personal trading by portfolio managers and other access persons, and the enhanced oversight by audit committees and independent boards are all indicators of very positive improvements for the industry and for consumer/investors.

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[37] Given the increased popularity of “guaranteed” products such as segregated funds, variable market-linked universal life policies and index-linked GICs, there is reason to question whether Canadians have really become “investors” rather than “savers”.

On a less positive note, a number of industry participants said that there is not a whole lot of difference observing that:

- "shills" are still very much in evidence;

- trips are coming back;

- inappropriate product sales are still being made;

- there are some fundamental structural problems with the investment fund industry that center on the fact that consumer/investors think they are dealing with an independent professional investment adviser when in fact they often are simply dealing with a salesperson;

- the foregoing situation is aggravated by the fact that there is insufficient control over the use of descriptive terms such as "financial planner", "financial adviser", "financial consultant", "investment adviser", and other terms which do not clearly differentiate between the qualifications of the intermediary as a professional investment adviser able to exercise discretionary authority and the qualifications of a sales representative who is not permitted to exercise such discretion;

- there is still poor disclosure of what the consumer/investor is paying for and what service this includes.

Other industry participants expressed their responses to the question by commenting that the consumer/investor is not worse off and is probably better off. They observed that:

- the market has provided "fabulous returns" and people have enjoyed good returns on their investments;

- the profile of the investment fund industry is higher than it was in 1994 with the result being that more information is readily available;

- the availability of information has increased people's knowledge and awareness of issues affecting their investments; it has heightened their awareness that they have more to learn; and it has made it relatively easy for people who want to learn, to do so;

- there has been a voluntary increase in initiatives to make fund prospectuses more readable, user-friendly and meaningful;

- interim reports are more informative and readable;

- individual rates of return are being provided to consumer/investors along with comparisons to benchmarks.

However, they noted that the improvements in the quality and relevancy of the information are not standard across the board. They also observed that a lot of the information continues to be aimed at the investment adviser rather than at the client who is the consumer/investor.

Some industry participants complained that there is too much reporting and that the reporting is not timely. They complained about the amount of "paper" that is involved. They observed that the popularity of mutual funds has resulted in an explosion in the number of new mutual funds that have been created with the number that are now offered to the public being almost double the number that were offered four years ago. This development (according to them) has not benefited the consumer/investor.

They expressed concern about the popularity of mutual funds having resulted in the proliferation of products that bear a close resemblance to publicly offered mutual funds but have substantial differences that are not readily apparent to the consumer/investor, including the fact that the products are not regulated.

They observed that one reason why these differences are often masked to the consumer/investor is that the increased visibility and popularity of mutual funds has created a false sense of confidence of "knowing all that there is to know about mutual funds". However, consumer/investors often fail to realize that there are substantial differences between mutual funds and the products that they are being advised to buy and that these differences substantially change the nature of their investment and/or the relationship.

6.2. My Evaluation

I believe that all of the observations referred to in subsection 6.1 are accurate. Accordingly, how one evaluates these observations in relation to the question of whether the changes that have occurred since the 1995 Report have resulted in consumer/investors being better off than they were in 1994 depends on whether one sees the universe in terms of the glass being half-full or the glass being half-empty. I prefer the former view.

Having said this, I do not think that there is any room for complacency. Although a lot has been done, a lot more remains to be done.

7. IMPEDIMENTS TO CHANGE

7.1. Industry Perspectives on Impediments to Change

The second question I asked the people with whom I spoke was what did they regard as being impediments to change. Again, people's responses differed.

Many industry participants said that the biggest impediment to change was the continuation of the bull market. They said that the strength of the market returns that were being enjoyed by consumer/investors masked fundamental structural and operational weaknesses in the industry.

One senior executive of a fund management organization answered the question by saying, "big players; big money - why would anyone change what's successful?"

Another senior executive referred to the high management expense ratios as being a major impediment to change, observing that "it's a pretty profitable world today for the producer and the distributor. They don't want to cut their cloth". Similar views were expressed by other industry players.

Other responses by industry participants to the question included:

- the observation that the industry is made up of different groups with different interests;

- the underlying "politics" of the shifting balance of power among industry participants;[38]

- the regulators; in this respect concern was expressed about:

  (i) the adequacy of regulatory staffing both in terms of expertise and in terms of the sufficiency of resources directed to investment fund matters;

  (ii) the length of time it takes for regulatory initiatives to be undertaken and implemented;

  (iii) the multiplicity of regulators and the lack of awareness and understanding on the part of some regulators;

  these factors are seen as serious impediments to change and as contributing to the complexity of actually bringing about change;

- the high cost of communicating fundamental changes to investors because of the high cost of the regulatory fees that must be paid in conjunction with filing amendments to prospectuses;

- the cost of "compliance" - i.e. the cost of putting in place, maintaining or enhancing the adequacy of, good internal, controls, systems and procedures - is seen as an impediment to change;[39]

- the lack of understanding by consumer/investors of:

(i) the fee structure;

  (ii) the impact of the fee structure on their total return;

  (iii) fundamental concepts such as the time value of money and the effect of compounding;

  (iv) performance numbers in general;

  (v) the differences between mutual funds, segregated funds (including the different types thereof), pooled funds, wrap accounts, equity-linked GICs, investment contracts, income interests in trusts, and other similar products;

  (vi) the fact that despite the appearance of being provided with independent advice tailored to their specific needs, consumer/investors are often only being sold products;

- the difficulty consumer/investors have in assessing the significance of the information with which they are provided and in knowing how they should use it to determine what they should or should not do.

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[38] In this respect, the June 1998 withdrawal by Dynamic Mutual Funds from IFIC is viewed by some industry participants as an impediment to change and not in the best interests of the industry and investors because it fragments both the industry and the industry association in the eyes of investors and regulators.

[39] The observation was made that industry producers and distributors would prefer to spend their money on marketing and sales rather than on the enhancement of internal controls, systems and procedures.

7.2. Anomalies Driving the Investment Fund Industry

Again, I think there is validity in the observations referred to in subsection 7.1 of this Review. The observations highlight the fact that there are a lot of anomalies that are driving the investment fund industry. The key ones are:

- professionalism vs. marketing (i.e. the provision of professional investment advisory services vs. the sale of product);

- advocating reliance on the principles of integrity and trust while operating on the basis of the principles of opportunism and buyer beware;

- the analysis/paralysis syndrome;

- recognition of the need to change combined with a reluctance to be the first to change because of concerns about the loss of competitive advantage;

- a regulatory system that despite its purpose to protect investors and to foster efficient and fair capital markets:

  (i) gives rise to opportunities to move between the gaps;

  (ii) relies on self-regulation but falls short on adequate oversight;

  (iii) has, in seeking to be responsive to the needs of the marketplace, become too reliant on ensuring that there is unanimous consent to the regulatory provisions and thereby falls short of addressing the needs and expectations of the marketplace; and

  (iv) has become very technical and legalistic, the result of which has been the emergence of technical schemes that steer their way between the regulations, thereby achieving technical compliance but falling short on substantive compliance.

8. INVESTMENT FUNDS AS CONSUMER GOODS OR SERVICES

8.1. Viewing Investment Funds as Consumer Goods or Services

This Section of the Review discusses the soundness of the assumption that investment funds are consumer goods or products. The discussion focuses on this from the perspective of:

(i) whether investment funds are consumer goods or services;

(ii) whether it makes a difference, from the perspective of the type of problems that consumer/investors who own investment funds encounter, if investment funds are considered to be consumer goods or services; and

(iii) whether it makes a difference, from the perspective of the remedies that are available to address these problems, if investment funds are considered to be consumer goods or services

While I have always viewed investment funds from the perspective of the fairness to the consumer/investors who invest in them, I have not, in thinking about investment funds, categorized them as being “consumer goods or services”.

The traditional thinking about investment funds is that they are a simple means:

(i) to pool your money with other like-minded investors;

(ii) to have your money professionally managed by independent investment advisers at a reasonable cost;

(iii) to diversify your investments;

(iv) to have the administrative work in connection with owning investments performed in a cost-effective manner by persons who are trained to provide such services; and

(v) to have your investments held in safekeeping by a professional custodian at a lower cost than you could arrange on an individual basis.

To the extent that investment funds are regulated, they are regulated under applicable securities legislation.

This traditional investment fund perspective places the emphasis on investing, with the benefit of independent professional advice, rather than on just purchasing a product (or more accurately, being sold a product).

I have continued to look at investment funds from this traditional perspective despite the increasing tendency on the part of both fund management organizations and distribution organizations over the past several years to view and position investment funds simply as another commodity that is sold.

However, I found when talking with industry participants about whether investment funds were consumer goods or services, a ready acceptance of the perspective that investment funds are "consumer goods or services". This is the reality in which industry participants work and therefore explicit recognition of this reality is welcome.

Several industry participants made comments to the effect that the "securities model" is no longer working and that we need to think in terms of building a "consumer model". They observed that people who are buying investment funds (and in particular mutual funds) have the mindset of a consumer and not the mindset of an investor. As consumers, they are not "investing". They are simply buying a recognized brand name. The particular fund does not matter. What matters is that what they are buying is a recognized brand.

While I have concerns about simply viewing investment funds as products or services that are sold like laundry soap, blue jeans or sports shoes, the reality is that this is how they are being positioned in the public eye and how they are being viewed by many of the key participants in the investment fund industry. Given this reality, it is useful to step back from the specifics of the investment fund industry and to look at investment funds as if they are just a type of consumer product or service. My starting point was to look at the main areas that traditionally have posed problems for consumers.

Traditional Problem Areas for Consumers

The traditional problems encountered by consumers with respect to consumer goods or services can be divided into six main areas:

- ***Problems Related to Price*** Is the price reasonable? Uncertainty over whether a price is reasonable increases with the complexity of the product or service and with the infrequency of the purchase of the product or service.

- ***Problems Related to Quality or Suitability*** Does the product or service meet the requirements for which it is purchased?

- ***Problems Related to Availability*** How much choice is there in the marketplace? Is the product or service universally available or are there certain people (e.g. people with low incomes or in regional markets) who have their choices restricted? Are similar products or services being promoted as being different? Are different products or services being promoted as being the same or as equivalent?

- ***Problems Related to Safety*** Is the product or service as secure as it is professed to be? Is it fit for the purpose that it is professed to be?

- ***Problems Related to Information*** Is sufficient information about the product or service available? Problems arise when the available data about the product or service is insufficient, inaccurate or untimely.

- ***Problems Related to Redress*** When a product or service is found to be defective or deficient or unfit for the purpose, is access to redress available on a timely basis and at a reasonable cost?

Traditional Consumer Protection Measures Used to Address Problems

I then reviewed the traditional consumer protection measures that are used to address the traditional problems encountered by consumers with respect to consumer goods or services. These measures fall into seven main categories.

- Disclosure of the material facts relating to the product or service.

- Registration or licensing of the intermediary and/or of the product or service, with proficiency requirements, capital requirements and insurance and bonding requirements that vary according to the nature of the product or service.

- Prohibition of transactions where there are conflicts of interest.

- Prohibition of unfair trade or business practices.

- Prohibition of misleading advertising.

- Fitness for purpose or product suitability requirements, contractual formalities and withdrawal rights.

- Redress mechanisms if problems occur as a result of the consumer acquiring an unsuitable or defective product or service including compensation funds.

Overlaying all of these measures are efforts to improve the knowledge and awareness of consumers.

Comparisons

I then compared the areas where problems commonly occur in relation to investment funds with the areas where problems commonly occur with products and services that are more generally thought of as “consumer goods and services”. I also compared the remedies used to deal with the respective problem areas.

It is interesting that in both comparisons, there is a perfect correlation**. What this shows is that it does not matter whether you characterize investment funds as consumer goods or services. The types of problems that consumer/investors have and the types of remedies for their problems are the same**.

If one looks at the securities legislation of the respective Canadian jurisdictions from this perspective, one recognizes in this legislation the use of the same traditional consumer protection measures that are used in respect of other consumer products and services.

It is just that in the effort to deal with the complexity of the current securities legislation and the minutiae of the detail necessary to achieve “certainty,” the tendency during the last three or so decades has been not to think about securities legislation in basic consumer protection terms.

If one looks at the 1995 Report, one recognizes that the 1995 Report reflects an approach to investment funds and to the investment fund industry that:

(i) centers on the traditional areas that have caused problems for consumers; and

(ii) reflects in its recommendations the application of traditional consumer protection remedies, adapted to reflect the nature of the products and services provided by the investment fund industry.

In other words, we do have a “consumer model” of regulation in place. The challenge is to make sure that this model continues to protect consumer/investors.

It should be helpful to industry participants (and to regulators) to keep this “consumer-model” perspective in mind as they deal with their clients - the public - rather than to think of the provisions of securities legislation as being unique to the financial services industry and as perhaps being unwarranted interference with the way they do business.

It is important to remember that the provisions in securities legislation (and the recommendations that have been made to enhance them) are basic consumer protection measures applied to specific types of consumer goods and services. **The refocusing by industry participants and their regulators on the primacy of the consumer protection purpose of securities legislation should be of benefit the public, the consumer/investor**.

8.2. Consumer/Investor Goals and Objectives

When one views investment funds as consumer goods or services, it is important to focus on some key questions. These include:

(i) Why does the consumer/investor want to acquire the goods or services?

(ii) What does the consumer/investor expect to achieve as a result of the acquisition?

An Investors Group/Gallup Canada Survey conducted in May of 1998 indicates that most Canadians who save and invest do so because they want to be financially independent when they retire.[40] The

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[40] 9th Annual Investors Group/Gallup Canada Survey, 1998 Feature Report.

survey indicates that the desire for financial self-sufficiency is what is driving most people to invest. Fear of not having enough money in their old age and of not wanting to be a burden on their family are other motivating factors.

When one focuses on the meaning of "financial self-sufficiency" and on the action verb, "to invest", it is a challenge to reconcile how these concepts can be fulfilled if the consumer/investor is simply ***being sold*** products. "Financial self-sufficiency" and "investing" are reflective of long-term planning objectives. Buying - or more accurately, being sold - products is more reflective of acquiring something with a view to satisfying an immediate or short-term need that will be consumed within the immediate or short-term time frame.

The resulting mismatch (or potential for mismatch) raises the issue of the suitability of the products for their intended purpose of achieving long-term financial self-sufficiency or, in "consumer terms", it raises the question of the fitness of the product for its purpose and the corresponding issue of product warranty obligations that flow from this.

The issue of suitability of the products or goods for their intended purpose is magnified by the fact that the intermediaries all offer assurances of their integrity and of the products they offer together with assurances that the consumer/investor is justified in placing reliance and trust in both the intermediaries and their products.

When one thinks about the need to adapt the regulatory regime and the way the industry operates, it is important to keep this consumer perspective in mind.

Apart from the need to provide an investment and regulatory climate that is aligned with the needs of consumer/investors to achieve their goals of financial self-sufficiency, there is also a fundamental economic need for the industry to protect itself from liability for claims based on wrongful advice and from product liability claims. One could well envision a scenario where shortfalls in retirement obligations could become the obligation of an industry that may not have the requisite resources to cover the obligations.

There is also the need from the perspective of governmental social and retirement planning policy to ensure the investment and regulatory climate fosters the ability of consumer/investors to meet their goals.

Taking the abovementioned needs into account and having regard to the blurring of functions and to the anomalies driving the investment fund industry[41] - and indeed the investment industry generally - it would benefit us all if some fundamental thinking were to be done about the regulatory regime and how it needs to be adapted to an environment, that although it purports to be an advisory one built on relationships, in reality is still one that is transaction or product-driven and focused on "sales".

We would be well-served if some fundamental thinking were to be done about aligning the compensation system to remove inherent conflicts of interest between the intermediaries (including the

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Also, the 1997 Annual SIA Investor Survey: *Investors' Attitudes Towards the Securities Industry* which was prepared for the Securities Industry Association by Yankelovich Partners Inc. in November 1997 indicates that planning for retirement continues to be the most important goal for US investors with 49% of investors saying retirement is their most important goal (down from 55% in 1996) and one-fifth of investors (21%) saying that being prepared for the future is their most important goal (up from 16% in 1996).

[41] See subsections 5.4 and 7.2 of this Review.

investment funds) and those who are availing themselves of the intermediaries' services whether as investors, clients or plan participants.

Inherent in this review is the need to examine the appropriateness from the perspective of the consumer/investor of the continuance of the commission-based compensation structure. Complementary to this review is the need to ensure that the professional advisory component of the investment fund industry is not compromised by sales product biases.

I make this recommendation fully recognizing that once something becomes an industry practice, it is unlikely that there will be much enthusiasm for re-examining the practice or for changing it. This reality simply presents an additional challenge for those who think that fairness, effective decision-making, and efficiency makes changes in industry practices necessary.

Alan Greenspan, the Chairman of the United States Federal Reserve Board, expressed this thought recently by saying that change often comes slowly and is viewed as threatening by many. He went on to say:

> "… it is frequently difficult to reform the rules of the game, as it were, because change requires easing rules and opening options for some while increasing competition for others, redrawing lines that create new limits, and applying some pre-existing regulatory structures to new institutions. However, … our financial system has clearly reached the stage where pressures from the market will force dramatic changes regardless of existing statutory and regulatory limits. The ability of financial managers to innovate and find loopholes seems endless. Recognizing this reality, the congressional landscape appears to have made the decision to attempt to fashion a new set of rules that are both comprehensive and perceived as equitable to all participants."[42]

Mr. Greenspan's observations about effecting change in the American financial system are equally applicable to describing the challenges faced in Canada in effecting change in the structure, regulation and supervision of the Canadian financial services industry.

9. MAKING A DIFFERENCE FOR CONSUMER/INVESTORS

9.1. Recognition of Fundamental Needs

There are innumerable things that would make a difference to consumer/investors. However, before addressing what would make a difference to consumer/investors, there are some fundamental needs that must first be recognized in order to make a difference to consumer/investors. These fundamental needs are discussed in this Section 9.

9.2. Reducing the Knowledge Gap

The single most important thing that could be done to benefit the consumer/investor would be to reduce the knowledge gap - i. e. the gap between those who know and those who do not. This knowledge gap, which economists refer to as "informational asymmetry", usually operates to the disadvantage of the consumer/investor. The need for reducing the knowledge gap was highlighted in the observations of

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[42] Remarks of Alan Greenspan, Chairman of the United States Federal Reserve Board, at the Charlotte Chamber of Commerce, Charlotte, North Carolina, July 10, 1998.

Keith P. Ambachtsheer[43] during his testimony on November 18, 1997 at the hearings to examine the state of the financial system in Canada (Institutional Investors) held by the Standing Senate Committee on Banking, Trade and Commerce. Mr. Ambachtsheer said:

> ***"The key thing I would look for in hiring a third party outside investment counsellor would be the alignment of economic interests***. … Once you go to a third party, whether it is investment counselling or most of the mutual funds, there is an interesting dichotomy of economic interest in the sense that these businesses are owned by other people who are trying to maximize their own bottom lines. They are in the business of running that business, and they are looking at revenues, less costs, equaling their profits. ***There is a question as to whether there is a clarity of economic interest between serving the customers well and how they enhance their own bottom lines.***
>
> ***In theory, the market should work these things out, but unfortunately, this is an area of great informational asymmetry where the sellers know a lot more about the nature of the product and what the services are than the buyers generally. Economics tell us that when you have informational asymmetry, generally the outcome is low quality products at too high a price. That is one of the challenges - namely, how do you deal with great informational asymmetry typically between the buyers of investment management services and the sellers of investment?*** I do not have an obvious answer to that other than raising the general level of clarity about what the product is producing and a level of understanding of capital market efficiency."[44] (Emphasis added)

Until we address this knowledge gap, the consumer/investor will remain seriously disadvantaged in being able to participate in the marketplace as a fully-informed person able to assess on a continuing basis his or her needs and the best means of meeting them.

Until the knowledge gap is closed other regulatory strategies aimed at consumer protection will not be fully effective. This has serious implications for governmental social, economic and retirement policies. It has serious implications for the efficacy (from both a national and global perspective) of the operation of the desired free market economic system and for the desire to provide the least restrictive regulatory alternative necessary for investor protection.

9.3. Recognition of the Consumer/Investor's Integrated Needs

The four-pillar structure of the financial services industry that existed before the deregulation of the industry that began in 1987 fragmented client finances among the four categories of players (namely, banks, trust companies, insurance companies and brokerages) with there being a separate regulatory structure for each category of player and with each category of player vying for a larger portion of the consumer/investor's business.

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[43] Keith P. Ambachtsheer is an economist and President of KPA Advisory Services Inc., a pension fund advisory firm in Toronto, Canada.

[44] See page 23 of the transcript of the evidence for November 18, 1997 presented to the Standing Senate Committee on Banking, Trade and Commerce during its Hearings to Examine the State of the Financial System in Canada (Institutional Investors).

This fragmented structure resulted in both a *product-category bias*[45] and a *firm-product bias*[46] in favor of the firm and created the product-driven business model that continues to this day notwithstanding the 1987 deregulation of the provision of financial services. Apart from any other inadequacy of a product-driven business model, what such a model ignores is the reality that consumer/investors have integrated financial needs.

When one focuses on the integrated financial needs of the consumer/investor, including the need for the consumer/investor to become less reliant on governmental social, economic and retirement plans and the corresponding need to take on the risk (and the opportunity) of participating in corporate and private retirement plans, it becomes clear that a governmental, business or regulatory model that is not driven by the integrated financial needs of the consumer/investor will fall short of both public and private expectations and needs.

When one focuses on the integrated financial needs of the consumer/investor, one recognizes that there is an added challenge and complexity to meeting these needs. This challenge and complexity is created both by the division of powers under the Canadian constitution and by the structural division of the way the powers within each of the respective federal, provincial and territorial jurisdictions are exercised.

One cannot readily change the reality of the constitutional and intra-governmental structures but one can strive to make the structures work better to serve the needs of the Canadian consumer/investor regardless of where he or she lives in Canada. Making the structures work better is the place where the work needs to start. Section 10 proposes a framework for doing this.

10. REGULATORY FRAMEWORK

10.1. Regulatory Coordination

One of the most important things that could be done to benefit the consumer/investor would be to review our financial services regulatory regime. We need to look for ways to simplify, streamline and coordinate our processes and to make sure that they are complementary.

In the course of this review, we need to examine the roles of the various regulatory authorities having jurisdiction over investment, insurance, pension and retirement matters including tax, pension, securities, insurance, employment and labor matters.

We need to update, clarify, align and harmonize the applicable laws.

We need to eliminate laws that are no longer necessary or serving the purpose for which they were intended. This needs to happen not only on a cross-regulatory basis within each Canadian jurisdiction

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[45] A financial adviser representing a specific type of product/service and behaving rationally can be expected to offer that product/service to the client over another thereby introducing a "product-category bias" in relationship with the client (e.g. investment funds).

A financial adviser representing a single product and behaving rationally can be expected to sell that product/service to the client thereby introducing a "product bias" in the relationship with the client (e.g. Brand X investment funds). The single product bias may also be brought about by the fee, commission and other reward structures offered by the suppliers.

[46] A financial adviser representing a firm and behaving rationally can be expected to represent the firm's products and services to the client thereby introducing a "firm-product bias" in the relationship with the client (e.g. ABC Bank's products).

but also on a cross-regulatory basis among the thirteen (and soon to be fourteen) governments that are involved.[47]

Ideally, this review would result in some sort of centralized, coordinated, streamlined and functional regulation or at least in a mutual recognition system that truly is non-duplicative. This could be achieved pursuant to intergovernmental agreements.

The cost of continued, multi-jurisdictional, multi-layered, fragmented regulation is too great a burden on Canadians and is not meeting the integrated financial planning and investment advisory needs of the consumer/investor.

Fortunately, there are indications that these needs are being recognized and that work is under way. Subsections 3.10, 3.11 and 3.12 of this Review deal with important initiatives that are being proposed.[48] It is important that these initiatives be encouraged, harmonized and proceeded with on a timely basis. We will all be disadvantaged if the status quo is permitted to continue.

It is encouraging that one of the areas that was looked at during the hearings of the Standing Senate Committee on Banking, Trade and Commerce[49] was the merit of an integrated regulatory and supervisory system.[50] Other countries including the United Kingdom, New Zealand and Australia are in various stages of moving towards an integrated regulatory and supervisory structure.

Proceeding with the development of an integrated regulatory and supervisory system for Canada would be one of the most important things that could be done to benefit consumer/investors. It is beyond the scope of this Review to try to work out the details of such a system. However, what I have in mind is an integrated regulatory and supervisory system that would focus on:

(i) prudential and solvency concerns that relate to various activities (such as, for example, banking, insurance and liability trading) of the respective institutions, and

(ii) the advice-giving/distribution activities of the intermediaries with specific product knowledge being subsumed under the framework of the advice-giving/distribution activities.[51]

Another example of the recognition of the need to streamline and coordinate our processes and to make sure that they are complementary is seen in the submission[52] of Senator Pitfield on the proposals in Bill C-2 with respect to revisions to the Canada Pension Plan and the establishment of the Canada

[47] One diversified financial services company advises that it has at least 85 regulatory authorities in Canada to which it reports. Much of the information that is required is duplicative in nature. Filing fees and other costs associated with dealing with the various regulatory authorities are very high.

[48] Subsection 3.10 deals with the MRRS proposed by the CSA. Subsection 3.11 deals with the agreement between securities and insurance regulators to cooperate. Subsection 3.12 deals with the proposal made by the Ontario Insurance Commission to establish a Council of Financial Regulators.

[49] These hearings were held in November 1997 and in May and June 1998 to examine the state of the financial system in Canada (Institutional Investors).

[50] One of the recommendations made in the OECD Paper and in subsection 12.2 of this Review is for an integrated regulatory and supervisory system.

[51] Also see Sections 15 and 16 of this Review.

[52] Senate Debates, December 16, 1997, at pages 817 - 819.

Pension Plan Investment Board. In his remarks, Senator Pitfield emphasizes the necessity of streamlining and coordinating social and retirement planning with tax and investment initiatives and appropriate accountability mechanisms.

The Agreement on Internal Trade is yet another important example of the recognition by governments of the need to review “measures”. The Agreement on Internal Trade was entered into by the federal and the provincial and territorial governments of Canada. It bears the formal execution date of July 18, 1994 and became effective on July 1, 1995.

While the Agreement on Internal Trade, with certain exceptions, does not for the most part extend to “measures” that are related to “financial services” or “financial institutions”[53], it does provide a structure for a broad review if the respective governments should wish to use it to extend the initiatives referred to in subsections 3.10. 3.11 and 3.12.

10.2. Additional Initiatives

Hopefully, we will see more initiatives that will reflect a fundamental rationalization of how powers are exercised with a corresponding reduction in the burden of regulation and heightened value for consumer/investors.

10.3. Leadership and Vision

The single most important thing that is needed at the moment is the leadership and vision to address the identified problems as a whole. At present, there is no single, easily identifiable and accountable body that has the mandate to do this. Accordingly, problems are dealt with on a piecemeal basis and the results are perceived as being less than satisfactory.

Perhaps if we created the regulatory structure (as suggested in subsection 12.2 of this Review), the leadership and vision that is necessary to fulfill its mandate would emerge. The starting point is clarity of vision followed by achieving unity of purpose and gaining the momentum to implement this vision.

Unless we know what we want to do, there is no way that we will ever be able to do anything other than to react to yesterday’s problems in an effort not to lose further ground. We therefore need to work together in a coordinated and cooperative way to find a means for allowing competing interests to thrive under the umbrella of some basic common structures.

10.4. Provision of Sufficient Resources

There is also the need to dedicate the necessary human, capital and technical resources to implement the regulatory changes that are needed and to address the concerns about the securities regulatory system that are outlined in the 1995 Report and in this Review.

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[53] See Article 1806 of the Agreement on Internal Trade. The terms “financial service” and “financial institution” are defined at some length in Article 200 of the Agreement on Internal Trade. The term “measure” is defined as including any legislation, regulation, directive, requirement, guideline, program, policy, administrative practice or other procedure. The term “harmonization” is defined as meaning “making identical or minimizing the differences between standards or related measures of similar scope”. The term “mutual recognition” is defined as meaning “the acceptance by a Party of a person, good, service or investment that conforms with an equivalent standard or standards-related measure of another Party without modification, testing, certification, re-naming or undergoing any other duplicative conformity assessment procedure”. These definitions are contained in Article 200 of the Agreement on Internal Trade.

There is a need to apply some project planning skills to the implementation process. The specific recommendations should not be looked at as “stand-alone” items to be prioritized or cherry-picked as to what will be done or not done. Instead, there is a need to stand back and recognize how the recommendations fit together as part of an integrated whole and how they are implementing of each other. There is a need to prepare a project plan for an “integrated whole” with critical paths identified as to what needs to be done in what sequence and what can be done on parallel tracks. Someone needs to be put in charge and to be made responsible for making things happen.

I have identified these needs before[54] and I identify them again. Acting effectively on this identification would go a long way to making a big difference for consumer/investors.

11. IMPLICATIONS OF THE CURRENT LEVEL OF KNOWLEDGE AND AWARENESS

11.1. Consumer/Investors Current State of Knowledge and Awareness

This Section of the Review discusses the current level of knowledge and awareness of consumer/investors and what the implications of this are for the regulatory and supervisory framework.

Many people today are inadequately equipped with basic life skills that enable them to identify their needs, to identify the means to achieve them and to evaluate whether the choices they have made are meeting their needs. Many people are unable to read beyond an elementary level and their numerical skills lag their literacy skills.[55] People are vulnerable to being sold a “get rich quick” scheme without truly understanding what they have bought, its suitability for their needs, or the “fine print” that negatively impacts on them. People tend to ignore what they do not understand - particularly if it is intangible. People often spend more time comparison shopping for a television set or planning their vacations than they do planning and managing their affairs to meet their current and future financial needs or choosing a consultant to help them do so.

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[54] For example, see *Remarks of Glorianne Stromberg Respecting the Response to Stromberg and to the Steering Group Report* at the 1997 Annual Mutual Funds Symposium of The Canadian Institute, Toronto, Ontario - April 14, 1997.

[55] “Literacy” according to the definition used by ABC Canada, a Canadian literacy organization, means the information processing skills necessary to use the printed material commonly encountered at work, at home, and in the community. Literacy is the ability to read, write, calculate, speak, and understand as well as sign (for the Deaf) and communicate in other forms of language, according to need. It is a continuum of these skills necessary for everyday life in the home, at work, in education and in the community.

According to information posted by ABC Canada on its website, <http://www.abc-cananda.org> the reading skills of 16% of Canadian adults are too limited to deal with the majority of the written material they encounter in everyday life. Reading and numeracy skills are closely related. 62% of Canadians have numeracy skills sufficient to handle the numerical tasks normally encountered in everyday life. 24% of Canadians do not possess the necessary skills to meet most everyday numeracy requirements but can deal with familiar documents that require simple math skills such as addition and subtraction. The remaining 14% of Canadians cannot perform numerical operations consistently but can recognize numbers in isolation or in a short text. ABC Canada states that these statistics are based on a 1990 survey, *Adult Literacy In Canada: Results of a National Survey,* Ottawa: Statistics Canada, 1990.

In September 1996, the Government of Canada issued a report entitled, *Reading the Future: A Portrait of Literacy in Canada*, which is the Canadian Report on the International Adult Literacy Survey (IALS) that was conducted by Statistics Canada and the Organization for Economic Cooperation and Development entitled, *Literacy, Economy and Society*. At the broadest level, the IALS findings are consistent with those that resulted from the survey on which the ABC Canada statistics are based. However, the IALS approached literacy from a different perspective defining it as “the ability to understand and employ printed information in daily activities at home, at work and in the community, to achieve one’s goals and to develop one’s knowledge and potential”.

The need to do something about this rather bleak situation is beginning to be recognized by people in their individual capacities as consumer/investors as well as by others who are responsible for the strategic development of business plans, governmental policy and educational and training programs.

The identification of the need of the consumer/investor to adopt sound personal financial management practices and the recognition that most consumer/investors because of their lack of personal financial expertise will need to turn to someone for advice, has created vast business opportunities for those in the financial services sector to convert personal financial management know-how into an economic good that adds value to the customer and for which there is a market.

This conversion of personal financial management know-how into a marketable commodity has highlighted the importance of the need for increasing the knowledge and awareness of industry participants who seek to provide this know-how. In fact, the survival of these industry participants as intermediaries is directly dependent on their ability to do so. I say this because if industry participants fail to use every opportunity to increase their knowledge and awareness and to add value to the services that they provide to their clients they risk losing their clients to their competitors.

Here, the competition is not just from other intermediaries. The competition is also coming from the incredibly powerful tools that technology and communications facilities have made readily available to the consumer/investor at nominal cost. Today, many people in their home environment have access to better state-of-the-art services than sometimes are available in their workplace. Recent Statistics Canada studies indicate that one in three households in Canada now use computers for communication purposes or for surfing the Internet and that 60 per cent of the households that have computers use them at least seven times a week.[56]

The impact of technology on personal financial planning cannot be overestimated. For the first time in the history of the investment funds industry, the consumer/investor has access to information and knowledge that was once the preserve of only the most expert investment professionals. These tools and facilities empower the consumer/investor not only to identify his or her own needs but to compare alternatives and, in the case of investments, to customize his or her own portfolio, to monitor its performance, and to bring it into line when necessary. The usefulness and versatility of, and the access to, these tools increases almost daily.

As Alan Greenspan, the Chairman of the United States Federal Reserve Board, noted in his recent remarks,[57] the rapid growth of computer and telecommunications technology has lowered the cost and broadened the scope of financial services. These developments have made it increasingly possible for the consumer/investor to transact business directly without the need for an intermediary and for a wide variety of financial products to be tailored for very specific purposes. As a result, competitive pressures in the financial services industry are greater than ever before. Technological innovation has accelerated financial globalization and the combination of technological innovation and financial globalization has resulted in expanded cross-border asset holdings, trading and credit flows, with many organizations having increased their cross-border operations. Mr. Greenspan observes that deregulation has been as much a reaction to technological change and globalization as an independent factor. I agree. I also think he is right when he observes that:

> "the sharply enhanced market signals emanating from the vast set of technology-driven new products have undermined much regulation which rested on the ability to maintain

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[56] Wallace Immen, The Globe and Mail, June 18, 1998, *Families with young at home with computers.*

[57] See Footnote 42.

market segregation … the continuing evolution of markets suggest that it will be increasingly difficult to support some of the remaining rules and regulations established for a different economic environment."

11.2. Implications for the Regulatory and Supervisory Framework

As noted in subsection 5.1, globalization, deregulation, information technology, communications facilities, and the strengthening of the free market economic system - all of which are enabling forces - have converged to empower not only institutions but also individuals. This has significant implications for the regulatory and supervisory framework not the least of which is how to provide for investor protection and market integrity in a marketplace that for all practical purposes has become global.

Investors are becoming increasingly intolerant of what they perceive to be regulatory barriers, maintenance of monopolies, unequal treatment and regulatory inefficiency. At the same time, investors want a regulatory structure that assures fairness, equality of opportunity, integrity of the people and firms who are registered to provide advice and investment services to others, integrity of the product and service provided, effective oversight and monitoring of activities, and speedy action to deal with problems and to keep them from re-occurring.

Two factors that present major challenges to the structure of the marketplace and to the regulatory response thereto relate to conflicts of interest and to what is described as "market fragmentation".[58] These factors converge into the fundamental issue of whether an intermediary can be on both the buy side and the sell side of the same matter. An example where this occurs is the situation where an institution underwrites, either directly or through affiliates, the issue of securities and then exercises discretionary authority to place such securities in its managed accounts.[59] Another example where this question occurs relates to situations where an institution, either directly or through affiliates, engages in principal trading with its managed accounts either directly or through the order flow. The resolution of these issues will have more fundamental implications for consumer/investors and for the functioning and fairness of the marketplace than debating the number of branches of financial institutions that are needed in a community.

Another challenge to the structure of the marketplace and to the regulatory response thereto relates to the need to decipher when the voice of the institutional investor is the voice of hundreds and thousands of individual investors calling for needed market and regulatory reform and when it is the voice of institutional self-interest that is not aligned with the interests of individual consumer/investors, some of whom may be their clients.

11.3. Adequacy of the Current Regulatory and Supervisory Framework

When one considers the foregoing in conjunction with the strategic forces outlined in Section 5 of this Review and the consumer/investor goals and objectives outlined in subsection 8.2 of this Review, it

[58] The term "market fragmentation" is used to describe order routing from the floor of a recognized stock exchange such as The Toronto Stock Exchange or the New York Stock Exchange to a private upstairs trading system (often referred to as a "PUP") operated by a dealer or to a proprietary (private) electronic trading system (often referred to as a "PET") such as Instinet. Another draw of orders from the floor of a recognized stock exchange comes from the "pay-for-order" firms such as Bernard L. Madoff Investment Services.

[59] Some financial institutions argue that because the power conferred on them under the legislation deregulating the financial services industry to participate in both the business of underwriting and in the business of providing investment management and advisory services to others allows them to do this, the normal fiduciary obligations (some of which are currently expressed as statutory prohibitions on certain conduct) should not apply.

becomes clear that the current regulatory and supervisory framework may not be serving the consumer/investor as effectively as it should be for two reasons:

(a) the continued differentiation between retail investors and institutional investors sometimes operates at cross-purposes given the increased retailization of the institutional investor; and

(b) the fact that notwithstanding the deregulation of the financial services industry that began in 1987, the current regulatory framework has continued to segment the financial services sector along the product lines that were conventionally provided by each of the so-called “four pillars”, with there being a separate regulatory structure for each pillar regardless of the fact that each pillar is now able to deal, directly or indirectly, in all products and provide all services.[60] [61]

12. SUGGESTED APPROACHES TO REGULATORY AND SUPERVISORY STRATEGIES

12.1. Suggested Approaches

The passage of time has confirmed the appropriateness of the directional strategies identified in the 1995 Report to address the issues we are faced with today. These directional strategies are outlined in subsection 2.5 of this Review.

The needs of consumer/investors, and indeed of all market participants, would be effectively met on both a national and on an international basis, by the implementation of these directional strategies. Included in these strategies and the recommendations for their implementation is the need to harmonize national and international regulation and supervision.

There are, however, some additional observations and suggestions[62] that I would make to take into account the clearer trends that have emerged in the intervening four years by reason of the increased global focus of the marketplace, the improvements that have been made in communications facilities, the informational and other technological advances that have been made, and the increasing knowledge and awareness of participants in the marketplace. I also pose some questions with a view to stimulating consideration of alternative structures and strategies.

12.2. Regulatory Structure

Integrated Regulatory Structure

Given the expanded business activities and the diversified geographical operations of today’s participants in the financial services sector, there seems to be an even greater need to find a way to bring about centralized, coordinated, cooperative, streamlined and functional regulation.

The continued maintenance of a segmented regulatory structure based either on:

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[60] See subsection 5.4 - The Blurring of Product and Function and its Consequences.

[61] In the context of the integration of financial services provided by institutions, it is interesting to note that mutual fund organizations, (which are sometimes referred to as the “fifth pillar”), through their acquisition of trust companies, have expanded the products and services that they are able to provide and have directly accessed the ability to participate in the Canadian Payments System.

[62] These observations and suggestions are outlined in Section 12 and subsequent Sections of this Review.

(i) the fragmented “four pillar” structure of the financial services industry that existed prior to the 1987 deregulation, or

(ii) the fragmented “inter” or “intra” provincial (and national) boundaries;

is becoming increasingly unrealistic.

Section 10 of this Review outlines a suggested regulatory framework that could be brought about by agreement among all levels of government.

Detailed regulation needs to give way to systemic changes that can and will operate on a universal basis in each jurisdiction.

In identifying these systemic changes, there are some threshold questions that need to be addressed such as the following:

1. How can regulation be made relevant to today’s marketplace?

2. Have the factors of globalization, technology and instantaneous communication on a worldwide basis resulted in regulators becoming largely irrelevant to the process?

3. Is the process really controlled by the financial institutions and other large transnational corporations who have the ability to operate directly or indirectly and through the flow of capital across borders?

4. Is the process really controlled by the software companies and the providers of the communications facilities that make the instantaneous flow of information and capital possible?

5. Will the role of regulators be focused increasingly on ensuring that reciprocal enforcement actions are speedily taken in their respective jurisdictions for “fraud on the market” type activities when harmonized standards have not been met so that there is “no place to hide”?

Common Regime for Money Management

Consistent with the need to de-fragment the regulatory structure, is the need to give high priority to bringing all aspects of money management for others under a common regulatory structure. This arguably goes beyond the recommendation in the 1995 Report which only referred to arrangements whereby money is managed on a collective basis, directly or indirectly, for individuals. However, technological advances have now made it economically feasible to permit customized investment portfolios to be maintained on an individual basis for relatively small amounts that until a short time ago would not have been economically feasible to manage except in some sort of collective investment vehicle. There is a growing recognition that mass marketing can now be reduced to a mass audience of one. These factors make it desirable that there be a uniform regime for all aspects of money management as the consumer/investor is seldom able to appreciate the legal and regulatory differences that flow from the different types of investment participation.

Effectiveness of the Self-Regulatory System

It is time to take a fresh look at the effectiveness of the self-regulatory component of the securities regulatory regime. Questions that should be asked in the context of this review include:

1. Is there too much “self” in “self-regulation”?

2. Would the regulatory system work more effectively if the focus were to change from "self-regulation" to "self-management" of regulatory requirements?

3. Have regulators abdicated too many of their functions to self-regulatory organizations?

4. How effective is regulatory oversight of the activities of self-regulatory organizations?

5. What is the purpose of self-regulatory organizations?

    (i) Is their purpose to protect the public?

    (ii) Are they structured appropriately to do so?

    (iii) Are their functions focused on protecting the public?

    (iv) How effectively is the public interest addressed and protected?

6. How effective is the governance structure of self-regulatory organizations?

7. How pro-active are self-regulatory organizations in making timely changes that would benefit the marketplace?

8. Do competitive interests interfere with or delay the rule-making process of the self-regulatory organizations?

9. Would we be better off to privatize, through outsourcing or otherwise, the performance of certain regulatory activities?

10. Does the self-funding status of securities regulators remove or reduce the necessity for regulation being delegated to self-regulatory organizations?

11. With governmental securities regulation now being vested in free-standing, self-funded agencies, would it be possible (assuming appropriate restructuring of ***what*** work is done and the ***way*** it is done) to eliminate the intervening layer of regulation that the self-regulatory organizations represent?

12. Are consumer/investors well-served by the continuation of this two-tier structure of securities regulation?

13. How adequately, timely and effectively are the complaints, problems and concerns of consumer/investors dealt with in this two-tier structure?

14. With respect to career advancement, how dependent are staff of the self-regulatory organizations on the goodwill of the members?

15. Are we continuing to design our processes and procedures as if the significant changes resulting from the advances in technology and communications facilities and self-funding have not taken place?

16. If we are, how is this serving the needs of consumer/investors?

17. Are some self-regulatory organizations such as stock exchanges with their electronic trading systems or their proposals for such systems now in direct competition with the market participants that they regulate?

18. Should there be a separation of member regulation activities, market regulation activities and industry trade association or advocacy activities?

19. Is the public interest served by having a multitude of self-regulatory organizations for each "pillar" of the industry and/or for each product sold by members of that pillar?

These are all questions that affect consumer/investors regardless of whether they invest directly or through some sort of collective investment vehicle. There no doubt are more questions. We need to address the questions. We need to address the underlying issues.

12.3. International Regulatory Cooperation

Today's technology has effectively eliminated time and distance to create a borderless world in terms of virtual reality. This has made it even more important to coordinate the cross-border regulatory activities in what people still think of being the "real world". Common, practical regulatory approaches to the use of facilities such as the Internet need to be developed. These approaches need to reflect the reality of the marketplace.

Efforts to improve and simplify international regulatory cooperation need to be encouraged at every level. The work of the International Organization of Securities Commissions ("IOSCO") has been an important catalyst in this respect.[63]

IOSCO's work in the investment fund area which resulted in the adoption of principles of regulation for collective investment vehicles as a preliminary step to creating an "IOSCO passport" is of particular interest in the present context. Perhaps it is time to renew the efforts to create an effective IOSCO passport and to define the parameters of its use. For instance, should nationals of one country be able to invest in investment funds domiciled in another country if the investment fund meets the IOSCO criteria? Free trade agreements, tax treaties, on-line interactive communications facilities and other kinds of technology make ideas such as these more feasible to pursue.

If this type of international investment were to be permitted, it would be necessary to consider what changes (in addition to changes in securities laws) would be necessary in other applicable laws to provide adequate remedies in the event of the need to pursue such remedies.

While the idea of a supra-national securities regulatory regime has appeal, it is probably premature to concentrate resources on trying to establish such a regulator. Instead, it might be more productive and effective to concentrate efforts on extending international regulatory cooperative efforts beyond compliance and enforcement activities to include developing protocols for mutual reliance by regulators in one country on work done by regulators in another country.

[63] An important step forward was taken by IOSCO at its 23rd Annual Conference held September 12 - 18, 1998. At this Conference, IOSCO adopted its "Objectives and Principles of Securities Regulation", Disclosure Standards to Facilitate Cross-Border Offerings and Listings of Multinational Issuers, and authorized the publication of a report on securities activities on the Internet. The IOSCO Press Communiqué about these "milestones" is posted on the IOSCO website at <http://www.iosco.org>.

The development of international mutual reliance, compliance and enforcement protocols, combined with establishing joint regulatory coordination groups as advocated by the Tri-Partite Group of securities, banking and insurance regulators (of which IOSCO is a member), and supporting the work of IOSCO should go a long way to creating international standards and to meeting the needs of the marketplace.

Complementary activities would include entering into reciprocity agreements to take regulatory action or enforce judgments in the "home office" jurisdiction for breaches of applicable laws in other jurisdictions. This is an extremely complex area that various IOSCO Working Groups have been working on for some time.

It is often easier to agree on the adoption of uniform standards than it is to agree on ceding jurisdiction. Therefore, common standards of universal application should go a long way towards facilitating cross-border activities and minimizing the need for regulatory constraints. The importance of creating international standards cannot be overestimated.[64]

13. SYSTEMIC CHANGES IN THE REGULATORY SYSTEM

13.1. Systemic Changes

This Section discusses the need for systemic changes in the securities regulatory system. Two fundamental changes are discussed. These changes are aimed at putting all investors on an equal footing and improving the quality and timeliness of the information that is in the marketplace.

13.2. Consideration of an Issuer-Based Integrated Disclosure Model

The most fundamental issue that needs to be addressed as a result of the changes that have occurred in the financial services industry is the need to consider whether there is a more effective system for securities regulation than the current "closed system" that is in place in various countries including Canada and the United States.[65]

When one considers the strategic forces discussed in Section 5 in combination with the increasing knowledge and awareness of individuals and the resulting trend towards disintermediation, the time seems to have arrived to consider replacing the "closed system" of securities regulation[66] with an issuer-based disclosure model. This model would focus on ensuring that at the time of entry into the marketplace, full, true and plain disclosure of the material facts respecting an issuer and its securities is made and that this information is kept current through continuous disclosure requirements designed for this purpose. This model would result in an integrated disclosure system, the feasibility of which has now been made possible by the technology and communications facilities that exist today.

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[64] See Footnote 63.

[65] The closed system focuses on the primary issue of specifically identified securities and it distinguishes its requirements on the basis of who the purchaser of the securities is and, in some cases, who the issuer is by creating classes of exempt purchasers and of exempt securities. It is a very legalistic, technical structure that is fraught with compliance pitfalls and does not sufficiently recognize the fact that securities of the same class or series of a class are fungible and that most trading activity takes place in the secondary market.

[66] Securities regulation is based on two fundamental requirements. These are: (i) requirements to disclose information about the securities and the issuers thereof, and (ii) requirements that the persons who deal in securities or offer advice about securities be registered.

It is important to note that the emphasis in this proposal is on disclosure about the "issuer" rather than on disclosure about the issuance of specific securities. The information about the issuance of specific securities by the issuer would be included as part of the timely disclosure information in the marketplace about the issuer.

For example, new issues would simply be preceded by a timely disclosure notice with an appropriate delay period to allow dissemination of the information into the marketplace and an opportunity for securities regulators to require further disclosure (or whatever) if there is concern that the integrated disclosure forming the information record of the issuer is deficient.[67]

This shift in emphasis should simplify the ability to raise capital at a reasonable cost while enhancing investor protection. In the case of investment funds, where basic information about the nature and structure of the investment funds changes infrequently, it should eliminate the need to file a prospectus each year once the initial base disclosure document has been filed. This would represent an enormous cost saving for consumer/investors.[68] Section 18 of this Review includes complementary suggestions for enhancing disclosure about investment funds for the benefit of consumer/investors.

The shift in emphasis contemplated by the proposal for an issuer-based integrated disclosure system parallels the shift in the nature of the relationship between intermediaries[69] and their clients. This relationship is now focused on advice-giving (with the transactions to implement the advice being incidental) as opposed to being transaction-based (with the advice-giving being incidental to the transaction). Section 16 of this Review (which deals with registration matters) discusses some of the aspects of this shift in the nature of the relationship between intermediaries and their clients and includes some specific recommendations that should be of benefit to consumer/investors.

The shift to an issuer-based integrated disclosure system should allow securities regulators to devote more attention to the ***quality*** of the information that is in the marketplace on an ongoing basis. This is consistent with the selective review procedures of the CSA which are premised on less time being spent on reviewing primary distribution issues and more time being spent on the review of continuous disclosure documentation. The shift should also free up the substantial time and resources of securities regulators that are devoted to dealing with applications for exemptive relief from the prospectus and registration requirements of applicable securities legislation as there should be less need for such exemptions resulting from a less technical system of securities regulation.

The shift should also enable securities regulators to focus more attention on registration-related issues such as the suitability for registration and for continued registration of those who are authorized to deal with the public. Section 16 of this Review (which deals with registration matters) includes suggestions for initiatives that should be of benefit to consumer/investors.

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[67] The delay period that is contemplated in this example would not be longer than the current delay period in, for example, the prompt offering system.

[68] Changes in operations and activities would continue to be reported in the periodic reports. Material change reports would continue to be required to be filed or delivered to investors and regulators. The maintenance of the current prospectus disclosure system for mutual funds (including the proposals of the CSA referred to in subsection 3.5 to revise the disclosure system) is increasingly difficult to justify because of: (i) its costs, (ii) the fact that under the selective review procedures implemented by securities regulators the prospectus may not even be reviewed by the securities regulators with which it is filed, and (iii) the fact that (according to industry participants) the prospectus is not read by investors and often may not even be given to them.

[69] I include the investment fund itself in the meaning of the word "intermediary".

A key component to moving towards an issuer-based integrated disclosure model is to ensure that there are appropriate statutory civil remedies for misrepresentations.[70] A companion requirement is to provide for international reciprocity in respect of the enforcement of judgments.

13.3. Timely Disclosure - Level Playing Field

The suggestions for an issuer-based integrated disclosure model are based on the belief that information is a major equalizing force. Access to it in an open and timely manner is a crucial ingredient to leveling the playing field. Information is a valuable commodity. Systems that are designed or are permitted to operate in a way that withhold the timely dissemination of material information result in fundamental unfairness to the marketplace as a whole.

With today's technology and communications systems that provide ready access to all, there is no reason why individual investors should be put at an informational disadvantage to institutional investors in terms of access to the information. There is no longer any need to rely on intermediaries such as investment dealers and advisers to disseminate material information to the marketplace or to structure the regulatory system so that they have first access to it. This information can and should be directly and publicly available:

(i) through the Internet (or another universally accessible communications facility);

(ii) from issuers and regulators at no cost; and

(iii) obtainable through intermediaries.

Interesting developments in the marketplace are occurring that make it practical for the first time in history for the regulatory system to provide for equality of access to information and there is increasing pressure from vocal individual investors to be allowed such access.

Examples of what is happening in this area include the opening of "analyst calls" to individual investors who are able to listen in on issuers' calls with research analysts and key institutional investors on both a real-time and a deferred-time basis.

Another example is the ability to attend shareholder meetings via Internet access on both a real-time and deferred time basis. An example of this is the Annual Shareholders Meeting of BCE Inc. where for the last two years shareholders who were unable to be physically present at the meeting were able to "be present" through the use of Internet facilities that enabled them both to hear and see what was transpiring at the annual meeting as it occurred. Shareholders who were not able to "attend" in real time were able to access the proceedings on a deferred-time basis. It is not unreasonable to expect that one day facilities of this nature will be extended to allow "distant" shareholders to ask questions at the meeting in the same manner as those who are physically present at the meeting are able to.

The extension of this type of facility to enable consumer/investors to "attend" informational and other types of meetings in respect of the various types of investments fund participations that they own would be a significant initiative to provide consumer/investors with the tools they need to make decisions that will help them achieve their objectives.

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[70] Proposals for a Statutory Civil Remedy for Investors in the Secondary Market were published for comment in the OSC Bulletin dated May 29, 1998 at (1998) 21 OSCB 3335. The text of the proposed legislation appears in the OSC Bulletin at (1998) 21 OSCB 3367.

Yet another example is the growing practice of issuers to give advance notice of when earnings or other announcements are to be made and to provide telephone or Internet access to information facilities or services that enable the public to hear, first-hand and on a real-time basis, the information that is being released.

The application of improvements in technology and communications facilities brings an entirely different dimension to the ability to make timely, meaningful and relevant disclosure to investors of the material facts (and of the changes in the material facts) that they need in order to make reasoned investment decisions both initially and on a continuing basis.

Despite this all of our regulatory efforts at reform in this area are still focused on the "paper world" with arguments over whether one should have to use "plain language" and what information should be permitted to be kept hidden in regulatory or issuer files rather than provided to investors.

It is submitted that we need to use the tools that are now readily available to bring about, or at least to increase the likelihood of bringing about, effective disclosure. I use the term "effective disclosure" as describing timely, meaningful and relevant information that has been communicated to investors and is understood by them, or at least is capable of being understood by investors who are reasonable persons acting reasonably. Section 17 of this Review includes some specific suggestions designed to achieve effective disclosure.

It is acknowledged that there will always be situations of unequal knowledge and of informational asymmetry but at least the facts would be available for all to have access to equally.

Whether people choose to use the information and what their individual capabilities are to evaluate the information they have will depend on the respective abilities of the individuals involved. The important thing is that the choice of whether to use the information or to get help from an intermediary if help is needed to understand it, is theirs to make. Section 14 of this Review includes suggestions for enhancing the knowledge and awareness of consumer/investors with a view to reducing the knowledge gap between those who are aware and those who are not. Section 15 of this Review includes suggestions for enhancing the knowledge, awareness and proficiency of the financial intermediaries who deal with the public which should benefit the consumers/investors to whom they provide investment advisory and financial planning services.

14. KNOWLEDGE AND AWARENESS OF CONSUMER/INVESTORS

14.1. What is Needed to Make a Difference

Two areas that I was asked to address in this Review relate to:

1. What facilitating role governments could play to bring about changes that would increase individual consumer/investor sovereignty and control over their assets?

2. What would enable consumer/investors to better identify their goals, the means of achieving them and to assess risk?

The simple answer to both questions is "education".

While I have some hesitation in focusing on "education" as a solution to the above questions because of the tendency to look to education as the universal remedy for all sorts of problems, the reality is that education is often the most effective solution. ***This is so because education reduces the knowledge gap and it empowers people to take charge of their own well-being.***

It is particularly significant that consumer/investors have themselves identified education as a means to enhance their abilities to plan and manage their financial resources and to improve their personal economic circumstances. This illustrates a receptivity to the solution that should make its implementation particularly effective.

Examples of this receptivity are found in research conducted in January, 1996 for the Canadian Securities Institute regarding investor attitudes to learning. This research indicates that 63% of Canadians *strongly* agree (and 27% somewhat agree) that they need to become better at investing if they are to have enough money to retire comfortably. 54% of Canadians *strongly* agree (and 34% somewhat agree) that learning about investing should be their top priority.[71]

The November 1997 Yankelovich Survey[72] also found that investors feel there is a lot they have to learn about making good investment decisions. Investors want to learn more about investing and they feel that the securities industry should do more to educate investors. According to the Yankelovich Survey, only 4% of investors think they know “everything they need to” in order to make good investment decisions while 59% feel they know “just some” or “very few of the things necessary” to make good decisions. 81% of investors believe the securities industry should be doing more to educate the public about good investing.

According to the Survey of Canadians’ Economic and Financial Understanding prepared in December 1997 by Gregg, Kelly, Sullivan & Woolstencroft: The Strategic Counsel Inc. for the Canadian Bankers Association and the Canadian Foundation for Economic Education,[73] Canadians recognize the importance of an understanding of the economy and the relationship of such an understanding to their financial prospects and personal economic circumstances. More than two-thirds of the population believe that a better understanding of the economy and how it functions would enhance their abilities to plan and manage their financial resources and improve their personal economic circumstances. However, the authors of the Study conclude that Canadians exhibit little depth of understanding about the economy, economic indicators and their influence on their personal financial and economic circumstances. They report that fewer than one-in-five Canadians can be categorized as having “some” knowledge about the economy, with more than eight-in-ten emerging as having “only some” or “extremely limited” knowledge. Their conclusion is that Canadians need more information and that the self-described levels of understanding and confidence overstate actual understanding and confidence.

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[71] The Canadian Securities Institute is the educational arm of the IDA. The attitudes reflected in this research study are said to be held by a broad cross-section of people - from those under 30 years of age through 60 plus, from people whose households make less than $30,000 to those who make more than $100,000, from those who have less than high school education to those who are university graduates. This research study is based on an Angus Reid Group’s Omnibus Survey that was conducted in January 1996 by telephone among a representative cross-section of 1,500 Canadian adults. The results are considered reliable +/- 2.5 percentage points 19 times out of 20. The Canadian Securities Institute used the information derived from this Research Study in making its decision to launch the Investor Learning Centre in February 1996.

[72] See Footnote 40.

[73] This survey of 1,500 Canadians was conducted on a nation-wide, proportionate basis between November 3 and November 10, 1997 among adult Canadians, 18 years of age and older. The margin of error for a sample of this size is +/- 2.6 percentage points, nineteen times out of twenty. In response to the needs identified in this survey, the Canadian Bankers Association in April 1998 launched its program called “Building a Better Understanding”, the purpose of which is to provide useful financial information that is relevant and meaningful to the lives of Canadians. Ten (out of a planned series of 14) easy-to-read reference booklets are available in French and English on its website at <http://www.cba.ca> or by calling 1-800-263-0231. These booklets are also available in alternative formats (Braille, Large Print, Compact Disc and Audio Tape). The Canadian Bankers Association advises that over 80,000 booklets have been ordered since the Building a Better Understanding Program was launched. Their website has received over one million hits and their call center has handled over 22,000 calls.

The information-needs index derived from the abovementioned Study reveals that not only are confidence levels related to a range of financial activities somewhat low (with only up to four-in-ten Canadians describing themselves as very confident about their competence and abilities in managing a range of financial activities), but informational needs are high in virtually all areas of financial management among ***both*** those who describe themselves as "at least somewhat confident" and those who report "a lack of confidence". The conclusions of the Study also state that:

> "[e]fforts aimed at building a better understanding of both "big picture" economic indicators and their influence on understanding both the economy and personal financial management combined with a direction to sources of information that will enhance confidence in personal financial management will be extremely useful to Canadians. ***The data … all points to a clear need within the population for more information that will improve Canadians' knowledge and provide a clearer context for personal decision-making***." (Emphasis added)

Another study conducted for the Canadian Securities Institute in November of 1997 confirms that investors want to understand the implications of national and international events for the stock market. This finding corresponds with the findings in the abovementioned Survey that was conducted for the Canadian Bankers Association and the Canadian Foundation for Economic Education.

It would therefore appear from the foregoing that one does not have to overcome the hurdle of persuading people that what they need is education. One simply has to find an effective and efficient way to provide the appropriate education.

14.2. Filling the Information Gap - Youth

As noted in Section 11, many people are inadequately equipped with the basic life skills they need to function in the world in which they find themselves. There is no need for this situation to continue. There is evidence (as noted in subsection 14.1) that people do not want this situation to continue. There is a need to put in place measures to ensure that current and future generations are equipped with the basic life skills to function in today's world.[74] This is an area where coordinated government action could marshal the forces necessary to bring about the needed changes.

The goal of our education system needs to be to create a lifelong learning process that will be a tool that people can continuously use to build on their knowledge and their ability to apply it to make decisions where they feel competent and confident.

The success of this learning initiative is dependent upon the following:

- parents clearly seeing the value and the need for addressing the skills needed for economic life in our school system;

- ministries and departments of education recognizing and assigning the priority that this area of education deserves;

- teachers recognizing the value and contribution that this area of instruction can bring to the lives and futures of their students; and

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[74] See the observations made by Gary Rabbior, the President of the Canadian Foundation for Economic Education, regarding this matter. His observations are set out in Appendix B to this Review.

- effective leadership and coordination to chart the course for a better future.

Educators have a crucial role to play in this learning initiative. They bear the first line of responsibility for ensuring that educational programs (starting in kindergarten) equip individuals with the basic life skills they need for informed decision-making that will enable them to determine their own economic well-being ***including the ability to understand information that is communicated to them. Without this fundamental ability to understand information that is communicated to them, none of the other consumer protection remedies (particularly those that are based on disclosure) will work effectively.***

Identification of Needed Competencies

I believe that the starting point is to identify the skills or, in other words, the competencies that people need in the knowledge-based world in which we live. Competency is a term that is used to refer to the skills that are required to put knowledge to work to achieve a result. Competency is the catalyst that is needed to make effective use of information.

I believe that we need to bring together a group of key people (including people from the education field, from business and industry, from government and from the Canadian public) to identify the key competencies that are needed and the indicators that will measure them. Once this is done, it should be a relatively simple task to design, or to modify and/or supplement existing, education programs to ensure that the people who emerge from our schools do so with the necessary set of life skills that equip them for decision-making in the world in which they live.

Raising Literacy and Numeracy Skills

One of the first areas that will need to be addressed is the issue of raising literacy and numeracy skills. Without remedial work in this area it will be difficult for both youth and adults alike to learn and to function effectively.

Appendix B sets out some of the significant conclusions from the IALS Report regarding the linkage between lifelong learning skills, economic success and the ability to capitalize on and adjust to structural change.

Empowering Teachers

A teacher's confidence and knowledge in a subject area is one of the biggest factors that affects whether something will be taught and how well it will be taught.

The matter of preparing teachers to help prepare students for economic life is one that needs to be addressed right at the beginning of the learning initiative. I am advised that there is currently no program in Canada that prepare teachers in this respect.

Teaching Methodology

A related area is that of the teaching methodology that is used. I believe that there is a need to shift the focus from teaching to learning. ***There is a need to concentrate on helping people to develop lifelong learning skills by helping them learn how to learn.*** These are the skills that are needed in the workplace today and it is what our children will need when they enter it.[75]. To do this, there is a need

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[75] See Appendix B - IALS Report.

to shift the focus from what is described as “didactic information dissemination” to “discovery learning”. Discovery learning is a term that is used to describe the ability to apply principles to problem-solving.[76]

Provision of Resources

We need to concentrate on obtaining the necessary resources to support curriculum opportunities and teacher capability. This is discussed in Appendix B to this Review.

Curriculum Design

Curriculum design is crucial to the success of any initiative aimed at better equipping people to deal with the requirements of today’s workplace and the related decision-making that is required to function in today’s world. Appendix B to this Review includes some suggestions that were made by, and resulted from discussions with, industry participants with expertise in curriculum design. The key principles underlying these suggestions are:

- the need to integrate outcomes related to economic life and understanding into other courses of study;[77]

- the need to make reliable, knowledgeable, non-partisan support and assistance available to provincial government departments and ministries;

- the need for curriculum, starting at an early age, to provide sequential development opportunities over the years of schooling so that concepts and fundamentals that are introduced in the early grades can be expanded, applied and integrated into a broader range of courses and incorporated into day-to-day life activities and decisions;

- the need to support teachers by providing, as part of their basic or continuing teacher training programs, development and training in economic fundamentals so that they feel confident with the curriculum proposals in this area.

The importance of the linkage between the opportunity for instruction (curriculum design), the ability to provide instruction (training and resources) and the learning outcomes cannot be overemphasized.

14.3. Filling the Information Gap - Adults

Identification of Needs

As noted in subsections 14.1 and 14.2, consumer/investors have themselves identified the problems they have and what they need to fix it. They have recognized that their needs are integrated and that their lack of awareness and their lack of ability (or the lack of confidence in their ability) to make the basic economic decisions of life that they are called upon to make on a daily basis are serious impediments to their achievement of their objectives of lifetime financial self-sufficiency for themselves and their family. Many people want to do something about this. This is an evolving process and not everyone is at the same stage in the process.

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[76] This teaching methodology is often not encountered until graduate school and sometimes not even then.

[77] Mathematics and numeracy skills are an example. Addition, subtraction, multiplication, division, fractions, percentages, formulas, relationships, probabilities and so on are all integral parts of the world of money and finance and personal financial planning.

Seeking Help - Advisers

In the first stage (once they decide that they need to do something) people usually turn to an adviser. They often just want "someone to tell them what to do" thereby either abdicating or at least sharing the responsibility for the choices that are made and for whether these choices reflect their goals.

Sometimes they have not even identified their goals or prioritized them. Sometimes people take a perverse sense of pride in removing themselves from the decision-making, saying things like "I don't read prospectuses - that's someone else's job - I rely on them - I can't even balance my cheque book." It is often not long before these people become anxious about whether they have done the right thing particularly if they see a higher rate of return posted somewhere. They bounce from product to product and sometimes from adviser to adviser, usually at a substantial financial cost to them.

Seeking Help - Seminars

Sometimes people attend an investment or retirement planning seminar thinking that they are going to learn what they need to know to make informed decisions. They do not recognize that many of these seminars are just opportunities for selling products or for making contacts to sell products, either directly or via follow-up contacts. Sometimes they think that because the seminar is held in a school or workplace there is reason to believe that the seminar carries with it an endorsement of the merits of the seminar and that there is no product-category bias, product-bias or firm-category bias. Sometimes they are persuaded by the speakers at these seminars that they need to follow very aggressive investment strategies that expose them to risks that they often do not understand and that put their life savings (including their homes) in jeopardy.

This situation is very unsatisfactory. It is unsatisfactory for the consumer/investors who find themselves in it. It is unsatisfactory for most of the advisers who are trying to deal responsibly with those who consult them. I believe that from both perspectives the solution will be found through education.

Seeking Help - Enhancing Knowledge and Awareness

Fortunately this is an area where industry participants, regulators and consumer/investors respectively see a need for investor education. Indeed, investor education - i. e. increasing people's knowledge and awareness - is one of the core recommendations of the 1995 Report and of this Review.

However, before a lot more money is spent on investor education, I think we need to stand back and focus on what we mean by this term. Is "investor education" only an euphemism for selling more product in the guise of advice, the cost of which is added to the product? I do not think so. Is "investor education" only about providing consumer/investors with information about firms, products and services? I do not think so.

The experience of the last four years has broadened the focus of what is needed in the area of investor education. This is seen in the survey results that are referred to in subsection 14.1. The results show that people have recognized that they need more than just "investor education" or "information". ***They show that people have recognized that they do not really know what to do with the information that is conveyed to them and that they have an insufficient understanding about the implications of much of the information that is provided to them. Most of them feel overwhelmed with the information that is given to them or do not understand how to use it or its relevance to them or to what they are doing***. Investor education must therefore address these needs.

Challenges Faced - Taking Charge

Most people recognize that they have to be more proactive in managing their affairs but they feel ill-prepared to do so whether directly or through an intermediary adviser. They do not know how (or lack confidence in their ability) to go about systematically setting their objectives and implementing a plan to achieve their objectives. They do not understand (or lack confidence in their ability to understand) the relationship of return to risk.[78] They do not know how (or lack confidence in their ability) to monitor their performance effectively against their objectives. They do not know how (or lack confidence in their ability) to adjust their activities effectively to meet their objectives better. Sometimes this is due to a lack of specific knowledge. Sometimes it is due to a lack of understanding of how to apply the knowledge that they have to solving their real-life problems and to testing the effectiveness of their solutions.

Challenges Faced - Changing Workplace

Most people also know that their workplace is changing. They are faced with the need to learn new skills in order to remain employed. Often they find it difficult to adapt to the changing workplace culture which expects people to be part of a "learning organization" and to engage in lifelong learning. They have not had to learn anything since they left school. Helping people learn how to learn is a key factor in sustaining employment and productivity. Substantial resources are invested in training and education programs in order to ensure an ever-growing set of competencies and skills for employees. Coincidentally, one of the areas that is receiving increased attention in the workplace is the need for employee education in financial planning matters as new compensation and benefit plans are introduced that shift the benefits, as well as the risks, to employees.

Providing Supplementary Learning Opportunities

There is a convergence of all of these disparate factors - indeed, they are different sides of the same coin - that points to the need to provide Canadians with supplementary learning opportunities that are structured to enable Canadians, competently and with confidence, to make the basic economic life skill decisions that they are called upon to make in their daily life. Decisions about investing are only one aspect of these economic life skill decisions.

The simplest way to provide Canadians with supplementary learning opportunities would be to extend the process outlined in subsection 14.2 in relation to the youth learning programs to the people who no longer "go to school". Most adults need, or could benefit from, the same type of learning program that is recommended in subsection 14.2 for their children. These basic life skills programs would show people how to be lifelong learners, a characteristic that is increasingly essential in the knowledge-based world in which we live and work.[79] It would enable people to learn what they need to know and how to apply it to achieve their very fundamental and practical objectives of financial self-sufficiency.

There is a natural synergy that flows from the suggestion to extend the process outlined in subsection 14.2 beyond the primary and secondary grade schools. For example:

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[78] There is little point in providing people with a graph or a chart if they do not know how to read it or if they do not know the difference between a linear or arithmetic chart and a logarithmic or percentage chart and how a linear chart can be misleading by creating a false visual impression of the information it purports to show. There is little benefit in providing people with benchmarks if they do not know what a benchmark is or if they do not understand its relevance to their own decision-making.

[79] See Appendix B to this Review - The Role of Literacy in Economic Life.

1. The curriculum for the adult learning program would basically be the same as for the youth learning program although the time that it would take to move through the adult learning program would be substantially shortened and would be adapted to the appropriate levels of existing knowledge for the adults taking the courses.[80]

2. The training programs that are developed for teachers of the youth learning program could be used to train additional people who could conduct the adult learning programs whether in the schools, in the workplace or in other locations.

3. The existing infrastructure of the schools could be used thereby enabling the delivery of the program in every community across the country.

4. The existing infrastructure of the workplace could be used to offer the adult learning program.

5. The existing investor learning center facilities could be used to offer the adult learning programs.

6. Distance learning techniques which use videos, video conferencing, telephone conferencing, CD-ROMS, computer programs, audio tapes and other means of delivery could be used to make the adult learning programs available to those who prefer self-directed learning either alone or as supplementary to attendance in person.[81]

7. National television and radio and national or local newspapers and magazines could be used to offer adult learning programs to those who prefer to learn in their own homes or to supplement adult learning programs offered in schools or elsewhere.[82]

8. The quality of the adult learning program could be maintained.

9. People attending the adult learning programs would have confidence in the independence of the information and the problem-solving techniques. In other words, concerns about product-category bias, product bias and firm-product bias could be eliminated.

10. A body made up of the key people referred to in subsection 15.8 could be constituted. This non-partisan body of key people (including people from the education field, from business and industry, from government and the regulatory world and from the Canadian public) would:

    (i) periodically review the curriculum for the adult and youth learning programs to ensure its continued relevancy and suitability;

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[80] An example of what I have in mind is language training programs. There are different programs for people who are "beginners" and for those who have varying degrees of familiarity with the language.

[81] These techniques also lend themselves to adaptation for use in conjunction with the youth learning program. An interesting extension of distance learning programs is seen in a recent announcement by Tutornet.com (<http://www.tutuornet.com>) of the start of a service using accredited teachers to provide assistance to students. This service offers scheduled live tutoring help in mathematics and science for a monthly subscription fee of US$59 for unlimited access. Scheduled tutorials are held both in the afternoon and the evening. The curricula are derived from the Fairfax County, Va. School System Programs.

[82] This coverage can also be adapted to target different segments of the audience including youth. It can also be used effectively to heighten people's awareness of the need to learn how to learn and of the ease of doing so. A model that I have in mind is the "Participation" advertising program which identifies very serious health problems that virtually everyone has or will have but offers simple, low or no-cost solutions like walking.

(ii) offer recommendations respecting the curriculum;

(iii) review specific programs for suitability; and

(iv) set standards to which anyone presenting an adult or youth learning program would be required to adhere.

The suitability review referred to in items 10 (i) and (iii) above would include a review of the conformance to these standards.[83] The suggestion in item 10 (iv) above should add greatly to the credibility of the programs offered and should help to overcome the distrust that many consumer/investors have of industry-organized programs and should also help them to overcome their reluctance to attend industry-organized programs.

The body referred to in item 10 could also serve as (or oversee the operations of) a "better business bureau" that could be consulted by consumer/investors who have had a negative experience with an adult learning program or who want to check on the accreditation of the program, including the accreditation of the person(s) presenting or teaching the program.

Additional benefits flow from the foregoing. These include the following:

1. Financial advisers would benefit from a better informed client. One of the outcomes of both the youth and adult learning programs would undoubtedly be the recognition of the need to start planning and investing at a very early stage and how to select and work with a financial adviser. This recognition would likely increase the client base of financial advisers.

2. The need for enhanced "employee education" in the workplace about the choices employees are faced with in connection with compensation and retirement benefit plans could be substantially met or supplemented by the adult learning programs. The adult learning programs should enable people to make better decisions in these areas.

3. Increased productivity of workers should result from people having learned how to learn and how to build on their learning and knowledge base and to apply it to a broad cross-section of matters both to solve problems and to innovate.

4. Canadians should be better placed to compete in the rapidly changing, knowledge-based global environment that exists today.

5. As consumer/investors, the ability to look after themselves and to use the information that is provided to them to make investment and other decisions should be greatly enhanced.

6. These outcomes should enable governmental and regulatory resources to be refocused into other areas. For example, a more knowledgeable and aware consumer/investor base should facilitate the implementation of a broader range of governmental initiatives in the area of pension and other retirement benefit programs including the increased privatization thereof.

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[83] The suggestions in item 10 would help address the concerns that exist about investment seminars that were discussed in the 1995 Report and that were a major contributing factor to the substantial losses that investors incurred in various matters that have been the subject of hearings before the OSC. The two most recent egregious proceedings relate to the activities of Bruce Warrington (reported at (1997) 20 OSCB 1454) and Dino DeLellis (reported at (1998) 3 OSCB 305). Also see the decision of Cavarzan, J. in the action brought in the Ontario Court of Justice (General Division) by Druiven et al against Bruce Warrington, Associated Financial Planners Limited and Moneysem Financial Consultants Inc. [1998] O.J. No. 647 (Gen. Div.) (QL).

Even if the youth learning program were not to be extended to an adult learning program, adults would benefit from the youth learning program in that parents who help their children to learn are likely to learn themselves as a result of working with problem-solving, application-related learning techniques. However, parents would learn more effectively if there were some supplemental training to help them do so. Also, as parents with school-aged children are not the only segment of the adult population who are lacking in basic life skills, there is a need to extend the learning opportunity beyond this group.

Fundamental Tool

This type of learning opportunity is the most fundamental tool to make available to consumer/investors. With this tool consumer/investors will be able to understand and to apply information to enable them to make decisions competently and with confidence.

What better objective could there be?

14.4. Elements of a Successful Adult Learning Program

Teaching Methodology

A lot has been written about adult learning programs. The best/preferred practices in youth learning methodology and the best/preferred practices in adult learning methodology seem to be fusing. This perhaps is due to the shift in emphasis from "didactic information dissemination" to "discovery learning" i.e. the ability to apply principles to problem-solving.[84]

One of the key differences between adult learning programs and youth learning programs is that often adult learners are more focused and motivated having seen the relevance and the benefits of knowledge and information. This challenges the program to be relevant and effective since adults usually will not suffer in silence. Adults are very critical or complimentary of programs based upon the utility of the program to their needs.

Factors to be Considered in Adult Learning Program Design

During the course of talking with industry participants and educators about investor education programs for adults several observations were made that are relevant to the design of these programs. These observations are also relevant to the design of learning programs for financial advisers and planners. Most importantly they are relevant to the disclosure documents that are provided to investors and to registration requirements.[85] The observations are summarized in Appendix B to this Review.

14.5. Specific Learning Tools for Consumer/Investors

During the course of talking with industry participants and educators about investor education programs several suggestions were made about specific tools and initiatives that could help consumer/investors achieve their objectives. These suggestions are summarized in Appendix B to this Review.

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[84] It may also be due to the fact that for this generation, both adults and youth have received a similar style of education which differs from the style that prevailed for the Depression/World War II parents and their baby-boom children.

[85] The disclosure documents include the prospectus, annual and interim reports, confirmations and account statements. The registration requirements relate to know-your-client/suitability requirements, education and proficiency requirements, confirmations and account statements.

14.6. Consumer/Investor Education Strategy

The recommendations for consumer/investor education include both short-term and long-term strategies. The proposals in subsection 14.2 relating to youth learning programs are examples of a long-term strategy. The proposals in subsection 14.3 relating to adult learning programs are a blend of both short-term and long-term strategies. What is important to recognize is that:

- the process is a continuing one of lifelong learning;
- this concept of continuous learning needs to underlie all learning programs; and
- great care needs to be taken to ensure that the person who is learning has a positive learning experience.

Industry participants and educators suggested some principles to ensure the success of any consumer/investor education strategy. These are summarized in Appendix B to this Review.

15. FINANCIAL PLANNING AND ADVICE

15.1. Education and Proficiency Standards for Industry Participants

Section 14 of this Review discusses the need for enhanced education measures for consumer/investors and suggests initiatives in this respect. Section 15 of this Review deals with the corresponding need for enhanced education and proficiency standards for industry participants and suggests initiatives in this respect. These initiatives center around the creation of a Non-Partisan Standards Council which is more particularly described in subsection 15.10 of this Review. This Non-Partisan Standards Council would form a core component of the self-regulatory structure proposed in Section 16 but would not itself be a self-regulatory organization.

One of the most essential components of consumer protection relates to the adequacy of the education and training that the intermediaries who deal with the consumer/investor must have. It is of the utmost importance to the consumer/investor that the matter of identifying the requirements for this education and training be proceeded with without delay. These requirements need to be based on what the intermediary is ***actually*** doing. In order to identify what the education and training requirements should be, it is necessary to start by first identifying what the intermediaries are actually doing, and then to identify the competencies and skills that they need to do this.

15.2. Beyond Product Sales

In order to make this identification, it is important to recognize the substantial changes that have occurred in the distribution side of the financial services industry.[86] The focus of all participants in the financial services industry is firmly on asset gathering, asset allocation services and asset management. The strategic shift from a transactions-based business to a fee-based, relationship-driven, financial services business by virtually all participants in the financial services industry is well underway.

The trends that were outlined in Section 2.02 of the 1995 Report have come about. The asset management services offered by the various categories of dealers compete directly with the

[86] See Section 5 of this Review.

comparable services offered by the independent mutual fund organizations, financial institutions and investment counsel firms. The “wrap account”[87] has become the dealers’ entry mode into the world of portfolio management. The result has enabled the dealers to capture all, or an increasing portion, of the income stream that flows from portfolio management. For the most part this has been done without the dealers having to give up any part of the income stream that they obtain from their distribution services.[88]

Function, product and advice have blurred and fused. With this fusion has come a corresponding shift in emphasis from the success of the transaction to the success of the portfolio. This has resulted in the need for the traditional trading-oriented sales representative to evolve into, or to be replaced with, a relationship-oriented manager whose role is focused on acting as a conduit for internal or external money managers.

A major factor that has brought about these changes is the changing needs of the consumer/investor.[89] Consumer/investors have recognized the need to adopt sound personal financial management practices. A large number of consumer/investors have recognized that because of their lack of personal financial expertise (or because of their lack of confidence in their expertise), they will need to turn to someone for advice.

This has created vast business opportunities for those in the financial services sector to convert personal financial management know-how into an economic good that adds value to the customer and for which there is a market. This conversion has heightened the need for increasing the knowledge and awareness of industry participants who seek to provide this personal financial management know-how. If industry participants do not increase their knowledge, awareness and ability to meet the needs of their clients, consumer/investors will likely turn elsewhere for the help that they will need.

I believe that the future for industry participants who seek to provide personal financial management know-how to their clients lies in positioning themselves to benefit from a more educated consumer/investor who is ready to make independent decisions, who will feel increasingly competent and confident to do so and whose ability to do so will be greatly enhanced by the ready availability of, and access to, low-cost technological help and service providers.

As noted in Section 2.02 of the 1995 Report, the changes that are occurring,

> “will require significant investments in education, systems, training and back office operations and the modification of compensation structures to focus their base on assets under management rather than exclusively on commissions generated on

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[87] The expression “wrap account” is used as being descriptive of and as a part of a generic class of fee-based money management products which include in-house broker-managed discretionary accounts, traditional multi-adviser/menu-driven wrap accounts, trust company individually managed accounts (IMAs), some investment counsellor segregated or pooled managed accounts, wrap mutual funds, broker-owned/managed funds, asset allocation products and traditional mutual funds.

[88] The lack of awareness of consumer/investors to the fees and charges that they are paying and to the impact that these fees and charges have on their total return and on their ability to meet their goal of lifetime financial self-sufficiency is a major contributing factor to this. The recommendations in Sections 9, 13, 14, 17 and 18 should result in a more knowledgeable consumer/investor. However, whether consumer/investors will use this knowledge and awareness to produce better value for themselves remains to be seen.

[89] See Sections 9 and 14 of this Review.

specific transactions as has been the traditional basis. From the regulatory point of view, it is my opinion that it will be necessary to ensure that the regulatory system is designed to reflect the increased requirements in respect of educational requirements, training, systems and back office operations to support the shift to an advisory relationship."

So far, there has been little evidence of fundamental change in any of the areas referred to in the above quotation.

Currently, the recognition of the need to be able to offer a broad range of advice and services, with the ability to utilize a broad variety of products and services to implement a plan, is being addressed by firms and their sales representatives obtaining dual or multi-licenses. In addition, an increasing number of sales representatives who are licensed only to sell "single products" like mutual funds or life insurance are taking the necessary courses to be licensed to sell a full range of securities products plus the necessary courses that will give them a financial planning designation. Some industry participants (such as financial institutions) are encouraging their employees (or making it mandatory) that they take courses that will provide them with the necessary knowledge base to facilitate the provision of a full range of financial planning and investment advisory services to customers/clients. Some professional firms are establishing investment advisory firms that are licensed to provide investment advisory services. Various courses have been supplemented by adding an advisory component but they all start from the firm/product oriented base of the particular sectors of the financial services industry.

However, there is a need:

(i) to take a fresh look at these courses in the light of the changed environment;

(ii) to move beyond the firm/product oriented base of the particular sectors of the financial services industry and the courses offered by these sectors; and

(iii) to make sure that they are designed to produce the needed competencies and skills to reflect the broad range of advice and service that is now being offered.

This need applies both to entry-level courses and to the specialized courses that lead to a financial planning designation.

15.3. Growing Awareness of Need for Change

There are signs of a growing awareness that the continuation of the status quo is not sustainable. These signs (some of which have been discussed earlier) are seen in the concerns listed below that were expressed to me by industry participants.

Level Playing Field Concerns

1. The lack of a level playing field with some products, services and industry participants being regulated under securities legislation, some products. services and industry participants being exempt from compliance with the requirements of securities legislation, and some products, services and industry participants being subject to less onerous requirements under other legislation or to no requirements, while nevertheless competing at the same time with each other for the same consumer/investor dollar.

2. The lack of awareness on the part of consumer/investors that redress mechanisms vary depending on who the consumer/investor deals with and the type of product or service that is acquired.

3. The lack of awareness of consumer/investors to product-category bias, product bias and/or firm-category bias depending on which industry participant is consulted.

4. The different rules of fair practice and business conduct standards being applicable to industry participants and to the products and services that they offer.

5. The number of regulatory bodies and self-regulatory bodies that an industry participant must deal with or be licensed or registered with or become a member of.

6. The uneven standards of regulation, supervisory oversight and enforcement.

Competency and Standards Concerns

7. Concern about the sufficiency of the educational and proficiency standards for entry level courses in the securities industry and life insurance industry and the lack of entry level courses in other sectors of the financial services industry. These concerns center on the fact that most of these course were designed for a transaction-related sales activity rather than for the provision of the ongoing financial planning and investment advisory services on a continuing basis that industry participants now hold themselves out as providing.

Financial Planning Concerns

8. Concern about the unregulated use of terms such as “financial planner”, “financial consultant”, “financial adviser”, “investment adviser” and other terms designed to imply expertise in financial planning and investment advisory services. These concerns are combined with a concern about the lack of standards to be met by firms and individuals before being able to offer, or to identify themselves as offering, financial planning and investment advisory services.

9. Concern about the sufficiency of the educational and proficiency standards for advanced courses leading to a “financial planer” designation.

10. Concern about the unregulated practice of financial planning and investment advisory services by professionals such as lawyers and accountants.

In summary, most of these concerns fall into two categories. These are:

(i) concerns about standards and competency (of which financial planning concerns are a subset); and

(ii) concerns about the adequacy of the current regulatory and supervisory system,

to meet in each case the needs of consumer/investors and of industry participants.

15.4. The Reasonable Expectations of Consumer/Investors

Consumer/investors expect (and should be entitled to expect) that when they turn to a financial planner/investment adviser:

(i) the advice they get will be based on a full client-needs assessment;

(ii) the financial planner/investment adviser will have the capability to make that assessment;

(iii) the financial planner/investment adviser will be able to (and will) provide them with advice that is in their best interests;

(iv) this advice will be based upon a full range of money management services and products being available to implement the plan; and

(v) the ability to carry out transactions to implement the plan and to provide ongoing monitoring and reporting services is and should be ancillary to the foregoing.

If this is not what the “service offer” to the client is, then there should be unequivocal, up-front, full disclosure to the client so that there is no question about the limited service offer that is being provided.

What these reasonable expectations add up to is the need for a fresh approach to educational courses and proficiency requirements and to registration requirements.[90]

15.5. Recognition of the Economic Interests in the Status Quo

The environment has not been conducive to taking a fresh approach to educational courses and proficiency requirements despite the need to do so. While each of the course providers has made substantial investments in, and improvements to, their courses during the last four years, the separate courses still center, for the most part, around the product categories that were reflective of the era before financial deregulation. During this period, each of the “four pillars” established its own educational and proficiency courses. With the exception of the trust industry,[91] these product-oriented courses still continue to be offered by the respective educational arms of the former “four pillars”.

These separate courses are a major source of revenue for the industry associations that sponsor them. Accordingly, sustaining these courses and the need for them is of major economic significance to the industry associations. Unfortunately, the underlying desire to protect this revenue source has been the predominating, unspoken factor in ongoing discussions about the need to adopt enhanced education and proficiency standards as well as a contributing factor to the relatively sudden formation of the Financial Planners Standards Council of Canada ("FPSCC”) and to the subsequent negotiations that took place to settle the disputes over the right to use the CFP (Certified Financial Planner) trademark in Canada.

It is important to keep these basic economic interests in mind when considering whether the FPSCC as it is currently constituted adequately addresses the need for a recognized financial planning standard for Canada.

Before discussing the FPSCC’s role in establishing a recognized financial planning standard for Canada, it is important to identify what we are seeking when we talk about a “recognized financial planning standard for Canada” and how to go about obtaining it.

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[90] Elements of the suggested fresh approach are set out in the balance of this Section 15 and in Sections 16 and 17 of this Review.

[91] The courses offered by the Trust Companies Association are merged with those offered by the Institute of Canadian Bankers.

15.6. Confusion of Issues

It is very easy when talking about “financial planning” (or any variation of that term) and about “financial planners” (or any variation of that term) to confuse the issues. This is particularly so when talking about what the education and proficiency requirements relating to this subject should be. The reason for the confusion is because there are several aspects to the issue of education and proficiency requirements. These aspects relate to:

- What is the activity that the education and proficiency requirements are designed to equip people for?

- Are we talking about being a “generalist” or a “specialist”?

- Are we talking about entry-level education and proficiency requirements or about advanced-level education and proficiency requirements?

- Are we talking about entry-level education and proficiency requirements for a “generalist” or about advanced-level proficiency requirements for a “generalist”?

- Are we talking about entry-level education and proficiency requirements for a “specialist” or about advanced-level proficiency requirements for a “specialist”?

One could endlessly debate these questions and their permutations and combinations. However, given the evolution of the marketplace that has taken place, I think that the “activity” for which we need to be designing education and proficiency requirements is the “activity” of being able to meet the reasonable expectations of consumer/investors that are outlined in subsection 15.4 of this Review.

Because this “service offer” was not the focus when the current education and proficiency requirements were developed, the existing courses need to be reviewed and, where necessary, redesigned. Some work in this respect is currently under way.

I think that given the “service offer” that the public expects, the entry-level courses need to be designed to equip the industry participants who take them with the ability to provide the financial planning and investment advisory services and the services related thereto which are referred to in subsection 15.4 of this Review.

This will probably mean that the graduates of these courses will be “generalists” in financial planning and investment advisory services. As outlined in the observations referred to in subsection 15.9 of this Review, the “generalist” courses should probably be tiered.[92] A suitable descriptive term should be found to describe this entry-level “generalist” state and should be required to be used uniformly throughout the industry to avoid confusing consumer/investors.

If this recommended shift in educational and proficiency requirements is made, I do not think there is a need for separate stream of training for a “specialist”. It seems to me that the model used in the medical profession which builds specialized training and practice requirements on top of general training and practice requirements should be sufficient and should avoid confusing consumer/investors. Again, a suitable descriptive term should be required to be used uniformly throughout the industry to describe the areas or levels of specialization.

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[92] See Appendix C to this Review.

What I am suggesting is another example of addressing the need to integrate, simplify and streamline regulatory requirements to serve the needs of the marketplace and of consumer/investors better.

15.7. Additional Confusion

The controversy surrounding the establishment and the ongoing operations of the FPSCC has been another factor that has tended to confuse, and perhaps inadvertently to obscure, the basic issues about financial planning. This controversy culminated in the Canadian Securities Institute and the Institute of Canadian Bankers withdrawing from the FPSCC in the spring of 1998.

These withdrawals were perceived by some as not being in the public interest. The withdrawing organizations received a lot of criticism for their actions. They are being urged to reconsider the matter of their withdrawal. Most of the criticism has centered around the view that it would be desirable for there to be only one “financial planner designation” and for this designation to be the “CFP”. There was a lot of talk about the undesirability of continuing to have an “alphabet soup” of designations.

With respect, I think the criticism misses the substantive issues that underlie the valid objectives reflected by this view. These objectives (with which I agree) are that:

1. There is a need to establish a recognized financial planning standard that everybody who calls themselves a financial planner (or uses any other term that implies financial planning and investment advisory expertise) must meet and comply with on a continuing basis.

2. It is desirable that there be a designation of the professional status of the individual as a financial planner/investment adviser that is clearly recognizable by the public.

The area of my disagreement relates to what the appropriate starting point is for establishing a recognized financial planning standard for Canada. The critics have started from the assumption that the requirements for obtaining and maintaining the CFP designation is the appropriate starting point to satisfy the abovementioned objectives. I think we need to examine whether their assumption is correct. To do so, we need to take a close look at whether in fact the FPSCC requirements do constitute the appropriate financial planning standard for Canada in light of today’s needs. Legitimate questions have been raised about this matter by respected industry educators. These questions deserve to be addressed.

In doing so it needs to be kept in mind that the CFP standards were developed in the days prior to financial deregulation taking effect and prior to the industry shift from a transaction-based approach to a client-needs based approach. In addition, some of the courses that have been accredited by the FPSCC have an inherent product-category bias and were designed from the perspective of a transaction-based service offer rather than today’s integrated client-needs, advisory-based service offer.

I think that before we endorse any standard, we need, as discussed in subsection 15.4 of this Review, to take a fresh approach to the requirements for educational courses and proficiency training and to adapt the requirements to meet the public’s current expectations of financial intermediaries.

In the interim, a moratorium should be placed on the use of the term "financial planner" and like terminology which has become very misleading.[93] I recognize that it is easier to say this than to actually do it. Therefore, we need to expedite the basic work that needs to be done.

15.8. Establishing a Financial Planning Standard

I wish to emphasize that I am not saying that the CFP standard adopted by the FPSCC could not be found to be an acceptable standard for Canada or that it could not be adapted so that it would be. I am simply saying that until we go through a rigorous process to determine what an acceptable financial planning standard for Canada is, it is premature to be looking at the FPSCC standard and its proprietary CFP designation as being the exclusive financial planning designation for use in Canada.

It was a recommendation of the 1995 Report that a process of the nature that I am again suggesting here be engaged in. The organizations that have withdrawn from the FPSCC have also recommended that a process of this nature be engaged in. I believe that at least some of the other members of the FPSCC would also support such a process.

Non Partisan Identification of Financial Planning Key Competencies

The starting point is to identify the skills or the competencies that people providing financial planning and investment advisory services to others need to have in order to meet the integrated needs of their clients.[94]

I think we need to put in place a process similar to the one I suggested in subsection 14.2 of this Review in connection with identifying the competencies that consumer/investors need to have to help them achieve their objectives and with respect to designing the curriculum for learning programs aimed at producing such competencies.

Here, I think we need to bring together a non-partisan group of key people[95] (including people from the education field, from business and industry, from governments and the regulatory world, and from the Canadian public) whose initial task would be to identify:

(i) the key competencies that are needed by the client-contact professionals who will provide financial planning and investment advisory services to others; and

(ii) the indicators that will measure such competencies.

Once this is done, it should be a relatively simple task to design, or to modify and/or supplement existing, education programs to ensure that the people who emerge from these programs do so with the necessary set of professional skills to equip them to provide financial planning and investment advisory services to others. The process of doing so will involve starting with the entry level programs and working through them and through the current "financial planning programs".

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[93] The unregulated use of this terminology is very distressing to the industry participants who have earned their financial planning designations.

[94] As noted in subsection 14.2 under the subheading, *Identification of Needed Competencies*, competency is a term that is used to refer to the skills that are required to put knowledge to work to achieve a result. It is the catalyst that is needed to make effective use of information.

[95] This group could form the Non-Partisan Standards Council referred to in subsection 15.10 of this Review and undertake the additional activities described in subsection 15.10.

Again, this need to review the sufficiency of the entry-level courses was identified in the 1995 Report. The 1995 Report recommended that the current industry education and proficiency requirements be adapted to reflect the industry's change in approach from a transaction-based one (with the advice being ancillary to the transaction) to a relationship-based one focused on the provision of ongoing financial planning and investment advisory services (with the transactions being ancillary to the advice).

Some of the background work has been done or is in the process of being done. This work should provide a useful starting point and should make the task less daunting.

15.9. Observations Relating to Education and Proficiency Programs for Industry Participants

A lot of the same observations that are made in Section 14 of this Review in connection with requirements for effective consumer/investor education apply equally to the requirements for effectively equipping industry participants with the competencies and skills necessary to engage in financial planning and investment advisory services. Some additional observations have been made by industry participants and should be taken into consideration as well. These observations are listed in Appendix C to this Review together with some additional observations of my own.

15.10. Need for a Non-Partisan Standards Council

There is a need for a non-partisan standards council ("Non-Partisan Standards Council") made up of a group of key people (including people from the education field, from business and industry, from governments and regulators and from the Canadian public) that will oversee the ongoing development of the financial planner/investment adviser standard that results from the process identified in subsection 15.8 of this Review and the modifications that are necessary to keep it current. The activities of the Non-Partisan Standards Council would include:

(i) identifying the requisite competencies and skills;

(ii) identifying the indicators of these competencies and skills;

(iii) developing the prototype curriculum;

(iv) accrediting the respective courses;

(v) performing the same activities for the continuing education programs; and

(vi) overseeing the examination process.

Other possible activities could include:

(i) regulating the descriptive terms relating to the provision of financial planning and investment advisory services;

(ii) identifying best practices;

(iii) developing an industry-wide code of ethics and business conduct that persons who provide financial planning/investment advisory advice are required to adhere to; and

(iv) identifying the circumstances that would lead to the withdrawal of the ability to use the designation and accreditation and overseeing the procedures relating to such withdrawal.

These last four activities would depend on what the status of the Non-Partisan Standards Council is and would depend on its relationship with the Single SRO described in Section 16.

Status of the Non-Partisan Standards Council

I do not think that there is any need for the Non-Partisan Standards Council to be a separate self-regulatory organization for the reasons outlined in Section 16. I think Non-Partisan Standards Council should be independent of but linked to the Single SRO and thereby subject to regulatory oversight and supervision. In management terms, it would be an independent part of the Single SRO with a "direct report" to the Regulator. More thought needs to be given to how this would be made to work and what the Non-Partisan Standards Council's interaction with the Single SRO would be.

Regulatory and Supervisory Role of Regulators

I think that the role of securities and other regulators should be confined to ensuring that there is a responsible non-partisan standard-setting process in place and working. The accrediting of courses relating to proficiency and educational requirements would become the function of the Non-Partisan Standards Council. The accreditation procedure would involve ongoing review by the Non-Partisan Standards Council to assure that the accredited courses continue to meet the standards and objectives of the Non-Partisan Standards Council.

Common Standard but No Monopoly

There is no question that it would be desirable to have a common standard throughout Canada for financial planning and investment advisory practitioners. This can be achieved very simply and directly and without conferring a monopoly on what in effect is a commercial enterprise, by requiring that everyone who engages in financial planning and investment advisory services obtains the CFP designation. No other country has done this and there is no reason why Canada should when there are other means available to achieve the desired objectives.[96]

15.11. The FPSCC and the CFP

It should be kept in mind that the "CFP" is only one of several financial planning designations that are used in various countries. There is fierce competition among the different designations in other countries as well as in Canada. Questions have been raised in other countries about the sufficiency of the CFP requirements as well as in Canada.

It should be kept in mind that the FPSCC simply imported the financial planning concept that was developed in the United States in 1985 by the Denver-based Certified Financial Planners Standards Board. The Denver organization registered the "CFP" designation as its trademark for its concept around the world. The Denver organization enters into franchise arrangements with organizations in other countries granting the right to use the CFP concept and trademark in such countries and it charges fees for the privilege of doing so including an annual licensing fee. The Denver organization provides an outline of 175 topics that the teaching programs should cover. This outline serves as the accreditation framework for the teaching programs outside the United States. The Denver organization also requires that the franchisee administer a certifying exam and that each of the CFP licensees adheres to a code of ethics as well as commits to thirty hours of continuing education per year.

[96] See subsections 15.8 and 15.10 of this Review.

The national franchisee in Canada is the FPSCC. The FPSCC is responsible for protecting against trademark infringements, collecting and remitting a portion of the licensing fees to the Denver parent group, accrediting teaching programs, developing and administering qualifying exams and monitoring compliance with the code of ethics and the continuing education prescriptions.

Critics of the FPSCC Standard

Critics of the FPSCC standard observe that it is an imported standard - a standard that was developed for a system that is not evolving as our system is. It is a franchise. It doesn't take into account the state of evolution of our financial system or its evolution for the future. The critics observe that the US origin of the standards comes from the insurance industry and that the curriculum is designed to sell products - and not to advise. The curriculum is fixed. It cannot be changed. The curriculum simply specifies the topics to be covered rather than the topics with the indicated learning outcomes. The critics criticize the exam process saying that the whole exam is multiple choice. The exam reflects only knowledge-based memorization questions and does not test, or adequately test, the ability to apply the knowledge to solve the kinds of problems that financial planners and investment advisers are required to deal with in their day-to-day practice. The critics observe that the examination process that is used is efficient if you are just trying to "roll in the bucks for minimal costs". They say that the FPSCC is a marketing game rather than a standards council.

The critics of the FPSCC query how much work the FPSCC has done in trying to identify and design a financial planning/investment advisory standard based on meeting client needs. They allege that there is no transparency in the program accreditation procedures and that accreditation was basically granted in exchange for the agreement to become a member of the FPSCC.

Concern has also been expressed about the governance procedures of the FPSCC and its lack of resources to do an effective job. In addition, concern has been expressed about regulators using their powers to make a commercial interest viable by forcing industry participants to become licensees of the FPSCC. Concern has also been expressed about the substantial outflow of the licensing fees to the Denver organization.

Consumer/Investors and Industry Are Not Well-Served by a Monopoly

These concerns and criticisms aside, neither consumer/investors nor industry participants are well-served by a monopoly being granted to any organization. There is a less intrusive way to arrive at the objectives that are outlined in subsection 15.7 of this Review which are to establish:

(i) a publicly-recognized financial planning standard, and

(ii) a publicly-recognized designation of the professional status of a financial planner/investment adviser.

Consumer/investors and industry participants deserve the independent, competency-focused perspective that a Non-Partisan Standards Council of the nature described in subsection 15.10 of this Review would bring to the issues. It is important that neither they nor the regulators be misled by the use of the word "Standards" in the name of the FPSCC and that people look behind the name to what it is in fact.

16. THE RIGHT TO DEAL WITH THE PUBLIC

16.1. Registration and Licensing Requirements

Registration is one of the two cornerstones on which our current securities regulatory and supervisory system is based. The term "registration" covers matters such as suitability for initial and ongoing registration, regulatory capital requirements, insurance and bonding requirements, education and proficiency requirements, know-your-client/suitability requirements, advertising requirements, fair dealing requirements, record-keeping requirements, financial reporting and audit requirements, requirements relating to internal systems and controls, customer protection fund participation, and various other requirements. These requirements are sometimes referred to as conditions of registration.

Persons and firms who deal in securities or who provide advice about dealing in securities are required to be registered under applicable securities legislation to do so. Persons who sell insurance are required to be licensed under applicable insurance legislation. The requirements for registration or licensing must be met initially and on an ongoing basis.

Section 16 of this Review deals with issues relating to registration or licensing.[97] It contains proposals for changes in the current multi-registration requirements to create an integrated registration system centered around advice-giving/distribution activities. This registration system is a core part of the integrated regulatory structure recommended in Sections 10 and 12 of this Review that could be achieved by agreement among all levels of government.

16.2. Simplification of Regulatory Requirements for Registration

The evolution of the marketplace which has resulted in function, product and advice blurring and fusing provides a unique opportunity to take a fresh approach to the requirements that must be met by all intermediaries who deal with the public.

Here again, requirements can be simplified, streamlined and coordinated to eliminate the need for multi-registrations, for multi-regulators and for multi-self-regulatory organizations while at the same time providing for adequate, uniform and functional oversight, supervision and regulation.[98]

This simplified approach to registration is consistent with, and is a fundamental part of, the recommendations that I have made in Sections 10 and 12 for an integrated regulatory and supervisory system to reflect the combination, within each of the "four pillars", of the respective separate functions to which each pillar formerly was restricted prior to the deregulation of the financial services industry.

Today's marketplace would be better served by a registration system that reflects the integration of function, product and advice that has occurred and that centers around advice-giving rather than product-licensing. The continued maintenance of the current registration requirements with separate regulatory bodies, centered around product distribution, is no longer necessary, appropriate or desirable.

The proposals in Sections 10 and 12 of this Review for centralized, coordinated, streamlined and functional regulation would include the elimination of the separate registration requirements

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[97] The terms "registration" and "licensing" are often used interchangeably in the industry.

[98] The burden of multi-registrations with conflicting and overlapping requirements cannot be overestimated. One organization advises that it is subject to regulation by more than 85 regulators in Canada. See Footnote 47.

with separate regulatory and/or self-regulatory bodies. The need for such separate registrations and memberships is becoming increasingly problematic for the industry and its regulators given the integration and consolidation that is occurring in the industry.[99] As noted in Section 10, further work needs to be done to develop the framework for the proposed integrated regulatory system that would focus on:

(i) prudential and solvency concerns that relate to various activities (such as, for example, banking, insurance and liability trading) of the respective institutions; and

(ii) the advice-giving/distribution activities of the intermediaries; specific product knowledge would be subsumed under the framework of the advice-giving/distribution activities.

The framework for the registration requirements relating to the advice-giving/distribution activities is outlined in this Section 16.

16.3. Registration Framework

The registration framework that I propose centers on two concepts:

(i) requirements for a single registration with the Regulator; and

(ii) requirements for a single membership in the Single SRO;.

The term “Regulator” refers to the integrated regulator contemplated by the proposals contained in Sections 10 and 12 of this Review.

The term “Single SRO” refers to the single self-regulatory organization (described in this subsection 16.3) that would be recognized by the Regulator for the purpose of mandatory membership.

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[99] One example of the integration and consolidation that is occurring on the distribution side of the industry is reflected in the reported entering into of a letter of intent respecting the acquisition by Equinox Financial Group Inc., a Toronto-based distributor of insurance and other financial products, of a controlling stake in Trillenium Investors Services Inc. (See Shirley Won, The Globe and Mail, July 30, 1998, *Equinox to take stake in Trillenium*.) In this article, the Chairman of Equinox Financial Group Inc., in explaining the reason for the acquisition is quoted as saying:

> “About half the 1,400 financial advisers associated with Equinox make mutual funds available to their clients, but they do so now through arrangements with other dealers. … The Trillenium investment means that Equinox’s complete network of advisers will be able to easily add mutual funds to their range of offerings. … The mutual fund area is a very large, growing area. It’s another product line that we must have available. Since we didn’t have that access, they had to go out and make their own separate deals with another broker-dealer. …There is an awful lot of consolidation going on in the insurance industry and among networks of mutual fund dealers.”

Another example of the integration and consolidation that is occurring is seen in the announcement of the proposed acquisition by First International Asset Management Inc. of a 49% interest in Beutel Goodman and Co. Ltd. (See Susan Heinrich, The Financial Post, July 31, 1998, *First International buys Beutel stake*.) Michael Simonetta, chief operating officer of First International is quoted in the article as saying, “We’ve now accomplished [our] objective”. The article indicates that this objective is to own a piece of a company that operates in each of the asset management areas and that he was referring to mutual funds, pension fund and high net-worth investment counselling. The article states that First International has also purchased a 100% interest in Groupe Financier Concorde Inc., of Quebec City and a 60% interest in Toronto-based financial planning franchisor, Money Concepts (Canada) Ltd.

The registration framework contemplates that all intermediaries who are involved in advice-giving and distribution activities would be required to be registered with the Regulator and to be a member of the Single SRO. No other registrations or memberships would be required.

The Single SRO

The Single SRO would operate on a national basis. The membership requirements of the Single SRO for such matters as capital, insurance and bonding, education and proficiency, contingency fund participation, maintenance of books and records, supervisory procedures, and so on would be tiered. These requirements would be based on what the members of the Single SRO ***actually*** do. It should be possible to reduce the number of different categories of registration and membership without adversely affecting consumer protection.

In this respect there would be fundamental basic provisions that apply across the board relating to matters such as entry-level education and proficiency requirements, basic good faith requirements, rules of fair practice and business conduct, financial and other reporting requirements, advertising, client confirmations and reporting, audit requirements including surprise audits, compliance reviews, and enforcement proceedings.

The provisions for basic entry-level requirements, including those for education and proficiency, could take into account "equivalency" requirements that other self-regulatory professional bodies like The Law Society of Upper Canada and the CICA have. These equivalency requirements could satisfy some of the Single SRO's requirements although in some cases, such as in the case of insurance and bonding requirements, there would probably be a need to arrange for additional coverage.

The objective should be to make the requirements of the Single SRO and of the bodies regulating the practice of law and accounting complementary to each other rather than duplicative or conflicting.

The objective of the exercise would be to ensure that it does not make a difference to consumer/investors (at least from the perspective of adequate regulatory oversight and supervision) with whom they deal in terms of there being minimum requirements that must be adhered to or minimum redress remedies available in the event of problems.

Membership by intermediaries in other industry organizations would continue to be voluntary. The functions of these other organizations would be confined to those of an "industry" association.

However, the stock exchanges would continue to perform their market regulation role and organizations such as The Law Society of Upper Canada and the CICA would continue to perform their respective roles relating to the legal and accounting professions. Coordinating protocols would be entered into to provide for cooperation in the case of oversight and supervision activities, including compliance and disciplinary matters.

A key factor in bringing about the Single SRO would be to provide for an appropriate governance structure. Proposing a governance structure is beyond the scope of this Review. However, the experience of the last four years indicates that it is important - at least from a psychological perspective - to establish a new organization into which the self-regulatory role of the existing self-regulatory organizations could be rolled as opposed to requiring people who are non-members of an existing self-regulatory organization to join such organization.

The focus on financial planning and investment advisory functions of the intermediary as being a basic primary part of the services provided by the intermediary, with the range of products to implement the intermediary's services as being ancillary, enables a rationalization of the intermediation process that reflects what has occurred in the marketplace and enables the entire process to be integrated within the ambit of a single strong effective self-regulatory organization that will operate on a national basis with all participants being a member of it.

It is important to recognize that a failure to rationalize the regulatory and self-regulatory system will involve real and immediate costs (both in the short-term and in the long-term) which ultimately will be paid for by consumer/investors. All businesses transfer their costs to their customers. If we continue to maintain separate "product silos" and to center regulation on "product knowledge" instead of centering it on advisory relationships that are based on the assessment of a client's integrated need, the impact on consumer/investors of advice remaining tied to product-bias will be negative both in terms of direct costs and in terms of lost opportunity costs. There is no reason to permit this to happen.

16.4. Alignment of the Compensation System

Hand-in-hand with rationalizing the regulatory and self-regulatory system to enable a better matching of client needs, is the need for the industry to redesign its reward systems. For the most part, the current systems reward product sales as opposed to rewarding the ability to meet the client's integrated needs. Part of the re-alignment of the reward system needs to focus on ways to encourage referrals when this is the appropriate thing to do from the client-needs perspective. Otherwise, the normal tendency of the intermediary will be to select whatever reflects the particular niche of the intermediary, including a tendency to select (or be tempted to select) the product that will offer the highest revenue stream to the intermediary.

In the current system, what the client ends up with depends to a large extent on who the client first approaches. This occurs even in the case of a fully-informed client who has a plan. Most people do not appreciate that the advice they get may be skewed by their entry point or by how the individual's compensation is structured within the firm or institution. Even when the reward system is based on the productivity of units within firms or institutions, there is still a bias to serve the client needs through the particular entry-point unit.

When you have a system that requires all intermediaries to be registered, it should be easier to develop a reward system that encourages referrals when that is the appropriate thing to do from the client-needs perspective. The parameters for the reward system need to be developed and these parameters need to include ensuring that there is clear disclosure to the client of the revenue stream that will flow to or for the benefit of the referring firm and representative.

The reward system is a systemic problem that needs to be addressed by the industry. If it is not addressed, a major credibility gap between the industry and its clients is likely to occur. This credibility gap is likely to increase as clients become increasingly knowledgeable and aware.

16.5. Problems with the Current Registration System

There are some serious problems with the way the current registration system is operating.[100] Despite the fact that registration of the persons and firms who deal with the public is one of the two cornerstones[101] on which the securities regulatory system is structured, very limited regulatory

[100] The comments in this Section relate only to the registration system under the Securities Act (Ontario). While I have been told that there are similar problems under other legislation of the Province of Ontario such as insurance legislation and under securities and other legislation of the other Provinces, I have not been able in the time constraints applicable to this Review to follow-up on these comments to gain an understanding of whether there are problems and, if there are, the magnitude of any such problems.

[101] The other cornerstone is disclosure.

resources have been directed to registration. One consequence of this has been that delays in registration have plagued the industry and its regulators for years. The problems have been exacerbated as the number of applications have increased.

Because of the legitimate concern about the impact of the delay in processing applications for registration on people's livelihoods, the pressure to streamline the processing of applications for registration has increased. One of the means of dealing with this pressure has been to adopt, as an administrative practice, the practice of registering virtually everyone who applies for registration unless someone comes forward and demonstrates beyond a reasonable doubt that the applicant is not suitable for registration or continued registration. This administrative practice has now become the prevailing regulatory perspective.

This regulatory perspective to registration regards an applicant as being entitled as of right to be registered and to remain registered under the Securities Act (Ontario) unless and until someone can demonstrate that the registrant is not suitable or that the registration is objectionable. This approach to registration changes the current statutory onus under the Securities Act (Ontario) which requires regulators, before granting registration, to determine that the applicant is suitable for registration and that the proposed registration or amendment to registration is not objectionable.

This current approach to registration is problematic from the perspective of consumer/investors and the industry. It is problematic because it subsumes the interests consumer/investors (who are encouraged by the industry and the regulatory structure to place their trust and reliance in a registrant to act in their best interests) to those (albeit a minority) who would abuse such trust and reliance. It subsumes the interests of the vast majority of honorable firms and individuals who merit the trust and reliance of consumer/investors to those who tarnish the industry through their abuse of trust.

There are current proposals to amend the Securities Act (Ontario) to reverse the statutory onus that is contained in Section 26 of the Act to determine the suitability of an applicant for registration and that the registration is not objectionable ***before*** granting registration.[102] These proposals raise substantial public interest concerns. The fact that the proposed amendments may be in line with current administrative practices or with the legislation in other Provinces does not address the concerns that exist.

There is a need to identify better ways than we currently have to determine suitability for registration and continued suitability for registration. This should be the focus of ongoing work.[103]

Failure to address the issue of suitability for registration helps no-one. When problems arise, it brings the whole regulatory system and the whole industry into disrepute despite the fact that the problems center around a relatively small number of people and firms. However, for the consumer/investors who are affected by the actions of these firms and people, this is no comfort. Their problems are devastating.

[102] See Section 17 of An Act to amend the Securities Act - Draft. Notice of the proposed amendments to the Securities Act (Ontario) was published in the August 14, 1998 OSC Bulletin at (1998) 21 OSCB 5078. The text of the proposed amendments appears at (1998) 21 OSCB 5149.

[103] One suggestion that was made is to increase the onus on the sponsoring firm to determine suitability for registration, to monitor suitability on an ongoing basis, and to be accountable if it turns out that the person in question is not suitable.

16.6. Specific Concerns

Several concerns that center around registration matters and the related administrative procedures have been expressed by industry participants and consumer/investors. These concerns all give rise to questions about how effective the registration provisions are to provide for the protection of consumer/investors. The concerns which have been expressed by industry participants and/or by consumer/investors include the following:

Suitability for Registration

1. Concern (as noted above) has been expressed that issues relating to the suitability of the person or firm to deal with the public get caught up in regulatory expediency. The view has been expressed that the registration focus is on administrative processing[104] rather than on dealing with the substantive issues of determining the suitability of the firm or person for registration to deal with the public and determining that such registration is not objectionable.

2. Concern has been expressed that the criteria for determining suitability for registration and for determining that the registration is not objectionable are not evident. In this respect, industry participants and members of the public respectively question how people can be registered and re-registered in the face of situations that most people regard as making an applicant unsuitable for registration. These situations include:

   (i) a history of financial difficulties including bankruptcy;

   (ii) prior regulatory or professional disciplinary proceedings that have resulted in a reprimand or suspension or revocation of registration;

   (iii) pending regulatory or professional disciplinary proceedings;

   (iv) prior or current proceedings involving fraud or breach of fiduciary obligations;

   (v) misappropriation of assets or other wrongdoing relating to the handling of money, the trading in securities and the provision of advice;

   (vi) mental illness; and

   (vii) substance abuse.

Termination for Cause

3. Concern has been expressed about the speed with which people who have been terminated for cause by one registrant are re-registered with another registrant without there first having been an investigation or hearing to determine the suitability for re-registration. The concern is that this procedure, which permits ongoing registration while an investigation is conducted, presents a risk to the public. There is evidence from reported cases and disciplinary proceedings that the regulatory rationale for this procedure (which is based upon the legitimate objective of regulators not wanting to get into the middle of a commercial dispute) ignores the risk to the public and exposes the public to risk. This regulatory rationale of not wanting to take sides in what regulators regard as a commercial dispute, combined with the regulatory preoccupation of

[104] See also the concerns noted in this subsection 16.6 under the sub-heading "*Administrative Processing*".

not wanting to deprive people from earning their livelihood in the securities industry, often has the unintended result of facilitating further wrongdoing by the registrant in question.

4. Concern has been expressed about the seeming lack of understanding at the regulatory level of just how bad ***some*** situations are even when clearly documented problems are brought to their attention. The tragedy of a failure to take prompt action is that members of the public are often hurt by what the registrant does in the interim. Further hardship results from the fact that by the time regulatory action is taken, the registrant often has either absconded with investors' assets or is in financial difficulty.

5. Concern has been expressed about the lack of support provided by regulatory authorities to dealers who terminate a sales representative for cause and report the matter to the regulatory authorities. Responsible registrants find themselves having to justify their actions to the regulatory authorities who question whether the registrant did in fact have cause to terminate and who then expedite the transfer of the terminated sales representative's license to another registrant without first investigating the situation to ascertain the facts of the matter. This often leaves the registrant who is responsible for the representative's wrongful acts that were committed while in the employ of the registrant in an extremely difficult position. The registrant may find that it is denied access to the necessary books, records and premises to verify client positions and the magnitude of problems. Often the representative that is terminated for cause institutes legal proceedings against the registrant hoping that a settlement can be negotiated that will let the representative off the hook. In one situation (which was described as being the worst the registrant had ever seen) the fact of re-licensing by the securities authorities was argued as proof that there was no cause for termination and that the representative had been wrongfully dismissed.

   The combination of the regulatory attitude and the likelihood of ensuing legal actions as described above results in a reluctance by registrants to terminate a "bad rep" for cause in order to avoid having to report the circumstances and be caught up in a process fraught with problems. This result puts the public at risk and seriously undermines the effectiveness of registration as a key factor in consumer protection.

Close or Onerous Supervision Orders

6. There is concern about the regulatory practice of using "close supervision" or "onerous supervision" terms and conditions and orders as a proxy for the required statutory determination that the registration in question is suitable and not objectionable. Experience has shown that:

   (i) these terms and conditions and orders are not always complied with;

   (ii) there is either no follow-up or monitoring of compliance with these terms and conditions and orders or there is inadequate follow-up or monitoring;

   (iii) the public and other registrants are often not aware of the existence of these terms and conditions and orders; and

   (iv) the public often suffer losses that are not recoverable as a result of transactions that were effected after (as well as before) re-registration.

7. Another concern expressed about the regulatory practice of using close supervision or onerous supervision terms and conditions and orders as a proxy for the required statutory determination that the registration in question is suitable and not objectionable is that courts sometimes view the fact of re-registration or continued registration as evidence that the regulatory authorities

have reviewed the substance of the matters and have determined that the matters complained of are not serious enough for the regulatory authorities to revoke the registration. Where the courts conclude, rightly or wrongly, that the regulatory authorities did not think there was anything wrong with what the registrant did, the courts tend not to sustain the consumer/investor's action for redress. From the perspective of the consumer/investor seeking redress for matters arising out of a registrant's wrongful acts, it would be better if the registrant's registration is suspended so that improper inferences are not drawn from the fact of continued registration.[105]

Experience has shown that there is a wide gap between the regulatory authorities' expectations of a registrant's obligations under a close or onerous supervision order and the reality of such close or onerous supervision.[106] The misery that can occur as a result of a registrant's continued registration is extreme.[107]

Independent Contractors

8. Concern has been expressed about the licensing of sales representatives who operate as independent contractors without adequate provisions being made to ensure that their activities and those of their employees are subject to adequate oversight and supervision. There are a variety of issues that flow from this including the issue of the name in which the representatives carry on business. In some jurisdictions, the dealer name is not required to be used. In other jurisdictions, the dealer name is required to be used. I believe that at best the situation is confusing. At worst it is misleading. From the public's perspective, the situation is unsatisfactory. It is compounded by the fact that regulatory approach differs from province to province.

Other problems in connection with the licensing of sales representatives who operate as independent contractors without adequate oversight and supervision relate to the maintenance of trust accounts, record-keeping, access to books, records and premises, insurance and bonding and capital requirements.

Education and Proficiency Requirements

9. Concern has been expressed about the tendency to grant exemptions from educational and proficiency requirements based on experience that is not truly a proxy for the educational and proficiency requirements. This occurs mainly when people seek to be recognized as an investment counsel in the category of a portfolio manager.

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[105] The concern that has been raised illustrates how issues that get caught up in regulatory expediency can often backfire. A regulatory decision to issue an onerous supervision order instead of suspending registration often reflects a decision of expediency from the perspective of the regulatory authorities. The regulators know that the order will not be challenged by the registrant and they assume that the order will have the effect that they want - namely, that no-one in the industry will employ the person because the terms and conditions are so onerous. Accordingly, everything should be just fine but in actual fact the result often operates to the prejudice of the consumer/investor who is harmed by new or recurring wrongful acts.

[106] See for example the Order and Settlement Agreement *In the Matter of the Securities Act R.S.O. 1990, c. S.5, As Amended and In the Matter of Dino P. DeLellis, William R. Kennedy and The Height of Excellence Financial Planning Group Inc.*, (1997) 20 OSCB 4327.

[107] See for example the Decision and Reasons *In the Matter of the Securities Act R.S.O., Chapter S.5, As Amended and In the Matter of Dino P. DeLellis, William R. Kennedy and The Height of Excellence Financial Planning Group Inc.*, (1998) 21 OSCB 305.

10. Concern has been expressed about the adequacy of the educational and proficiency requirements to provide people with the skills and competencies that they require both at the entry-level and as a specialist, and on a continuing basis. These concerns and the recommendations for dealing with them are the subject of Section 15 of this Review. However, one concern that is not addressed in Section 15 is the concern about people who leave the industry for a period of time and then seek to return to the industry. Such people are currently permitted to do so within certain time frames. There are current proposals to reduce these time frames, to bring them into line with the less onerous requirements of the self-regulatory organizations.

I believe that in a rapidly changing environment, there is a need to ensure that after being away from practice for a period of time, people's skills are refreshed before they are again permitted to deal with the public.

I believe that it is particularly important to address this issue in view of the transition that has taken place from a sales transaction-focused business to a client-needs focused financial planning/investment advisory service business as the skills set and the issue of the currency of the skills set differ substantially from that which is required in a sales transaction-focused business. In addition, the constant introduction of new instruments adds to the need to ensure that people's skills are updated before they are again permitted to deal with the public.

Inadequate Systems and Controls

11. Concern has been expressed about the fact that registration is granted without there being any assurance that the registrant has an adequate infrastructure in place to run the business and to provide the services that the registrant intends to provide. There are no requirements that the registrant have the necessary technology, systems, controls and procedures in place before commencing business. There is no requirement to ensure that operating and monitoring procedures sufficient to meet the registrant's obligations to the public and to the regulatory authorities are in place before commencing business. Experience has shown that sometimes there is a lack of understanding of what a "trust" account is and of how to ensure that trust accounts are properly established. This state of affairs seriously undermines the consumer protection measures that registration requirements are intended to provide.

Administrative Processing

12. There is a perception that the regulatory focus is on "pushing the paper", collecting the fees (which constitute a major expense for the industry and a major source of revenue for regulators) and reducing the complaints about the time it takes to process an application. People view with concern the system of administrative processing of registration applications that assigns applications to review officers based on alphabetical order according to the name of the applicant rather than grouping the applications according to the type of application in question. They view this mechanical approach as tending to produce less than an optimal assessment of the substantive matters that are involved in the applications. They also view with frustration the business process system inefficiencies that require the issuance of separate cheques in payment of multiple registration fees instead of being able to make an omnibus payment.

13. There are complaints about the lack of helpfulness on the part of regulators in terms of providing guidance to the registrant about how to comply with standards that are expected to be met.[108]

It is important to note that the foregoing matters are ones that industry participants and/or consumer/investors have raised.

16.7. Industry Standards for Intermediaries

The matters outlined in subsection 16.6 reinforce the fact that the current fragmented regulatory and self-regulatory system and, in particular, the provisions relating to registration requirements are not functioning as effectively as they should in order to deal with the needs of consumer/investors in the reality of today's marketplace. In fact, in some cases, the interests of consumer/investors are adversely affected

Suggestions to Deal with Registration-Related Concerns

Here are some suggestions designed to improve the situation. These suggestions (which are intended to flesh out the proposals previously made for restructuring the regulatory and supervisory system) would produce the most effective results if they were to be made a part of such proposals. Even if the restructuring proposals were not to be implemented., the suggestions would also help improve the current system

The suggestions are intended only to be indications of what could be done and are not intended to be an exhaustive set of principles. More work is required to be done in this area. The suggestions reflect my own views and those of a cross-section of industry participants who are supportive of initiatives that would result in a simplified, streamlined, integrated regulatory and supervisory system that is not product-centered but enables a broad range of products to be made available to satisfy client-needs.

Structural

1. Establish the Single SRO described in subsection 16.3 of this Review.

Initial and Ongoing Registration and Membership Standards

2. Adopt standards that all intermediaries are expected to meet as a condition of initial and ongoing registration and membership in the Single SRO. In addition to standards of good conduct and fair practice (which would include adherence to a rigorous code of ethics) these standards would include basic operating standards and procedures.

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[108] This concern may in part be related to, or be a consequence of, the concern which is noted in this subsection 16.6 under the subheading, "*Inadequate Systems and Controls*".

I note that in October of 1997, the OSC published two reports prepared by its Compliance Team. The purpose was to inform mutual fund dealers and their advisers of the types of deficiencies noted by the OSC in performing compliance examinations in the hope that the incidence of non-compliance would decline. The first report is entitled "Deficiencies Identified in OSC Compliance Examinations of Mutual Fund Dealers". The second report is entitled "Deficiencies in Regulatory Filings of Registrants Who Are Not Members of a Self Regulatory Organization". These reports are contained in the materials for "Dialogue with the OSC" - October 20, 1997.

3. Do a better job of screening intermediaries before they are accepted into the industry aimed at ensuring that the intermediaries will deal honorably with the public.[109] There should be a duty of care on member firms to screen, monitor and report on unsuitable intermediaries.[110]

4. View registration and membership in the SRO as a privilege and not as a right. Applicants should be required to establish their suitability for registration and membership. Perhaps a practical way of doing this would be to identify factors that will give rise to questions of suitability.[111] Where these factors exist, applicants would have to establish why registration should be granted. The onus would be on the applicant to establish suitability in the face of the existence of factors that give rise to questions of suitability. A high level of "proof" would be required to satisfy this onus in the face of these factors.

Where there are no questions as to suitability and the applicant meets the other requirements for registration and membership in the Single SRO, the application could be granted.

Similar requirements would apply to transfer applications.

Where there is any question as to whether an applicant has been terminated for cause, no transfer should be processed until the matter has been fully investigated and the applicant has satisfied the onus of proving suitability for re-registration.

Appropriate procedures for dealing with these requests for transfer in a timely manner should be developed.

If close/onerous supervision orders are used,[112] they should be used only when the firm assuming the obligations in question has provided a secured guarantee or a performance bond adequate to cover the risks to the public of permitting the person who is subject to the close/onerous supervision order to continue to deal with the public. The funds derived from the secured guarantee or performance bond should be available to reimburse the public for losses incurred as a result of wrongful acts of the person who is subject to the close/onerous supervision order.

If close/onerous supervision orders are used, the terms and conditions of these orders should be made public and clients should be informed of their existence both at the time they are made and by noting the existence of the orders in confirmation forms and account statements.

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[109] Many people expressed the view that the strength of the industry will be in the quality of the advisers and how well they are equipped to deal with the public. The recommendations here and in Section 15 of this Review are aimed at enhancing the quality of the advisers - the intermediaries.

[110] It was observed that the registration or licensing of intermediaries is the first line of consumer protection and that licensing involves screening. Monitoring the actions of intermediaries is the next line of defense. Disciplinary action is the last line of defense.

[111] Examples of circumstances that give rise to questions of suitability are set out in subsection 16.6 of this Review under the subheading, "*Suitability for Registration*".

[112] A threshold question that needs to be addressed is whether close/onerous supervision orders should be used at all. There are serious questions about these orders. Firstly, if the situation merits a close/onerous supervision order being issued, there is reason to question whether the individual or firm should be dealing with the public at all. Secondly, as noted in subsection 16.6 of this Review under the subheading, "*Close or Onerous Supervision Orders*," there is reason to question not only whether these orders work at all but whether they result in unintended consequences. Perhaps consumer protection and industry integrity merit a zero tolerance attitude comparable to what exists in other industries (such as the airline industry) where public safety is at risk.