2017 Annual Report of the Ontario Securities Commission's Investor Advisory Panel

April 2018

Introduction

Members of the Investor Advisory Panel (IAP or the Panel) are pleased to present our 2017 Annual Report outlining our activities, submissions, consultations, and meetings during the calendar year. Since its formation in August 2010, the Panel has been an important channel connecting Ontario investors with the policymakers tasked with protecting them. We have worked with the Ontario Securities Commission (OSC) to ensure investor concerns and perspectives are represented in its rule and policy-making process.

During 2017, five Panel members reached the end of their respective terms. Seven new members joined the two remaining members, increasing the Panel membership from seven to nine.

Investor protection in Canada, as we noted in our 2016 Annual Report, is at a crossroads. At that time, we envisaged the potential for transformational improvements in investor protection based on the OSC and other regulators collaborating on the implementation of a best interest standard and the elimination of embedded fees. Regulatory efforts to advance the aforementioned agendas have not been without headwinds and we eagerly await the proposed framework from the regulators.

The proposed Cooperative Capital Markets Regulator (CCMR) in its current form, which excludes large jurisdictions such as Quebec and Alberta, also excludes an explicit mandate for an investor advisory element comparable in nature to the OSC's Investor Advisory Panel.

At this time, we are left with many of the same questions for investor protection around best interest, embedded fees, and the future of the evolving Canadian regulatory governance structure. This year, the Panel again calls for the satisfactory and timely resolution of these issues.

The IAP provides input to the OSC at three critical stages in the regulatory process:

Stage 1 - Issues Identification

We bring emerging investor trends and concerns to the OSC to inform policymaking at the earliest stages, sharing insights through face-to-face meetings with OSC staff. When needed, we follow up with concrete recommendations to add necessary context and clarity on the issues.

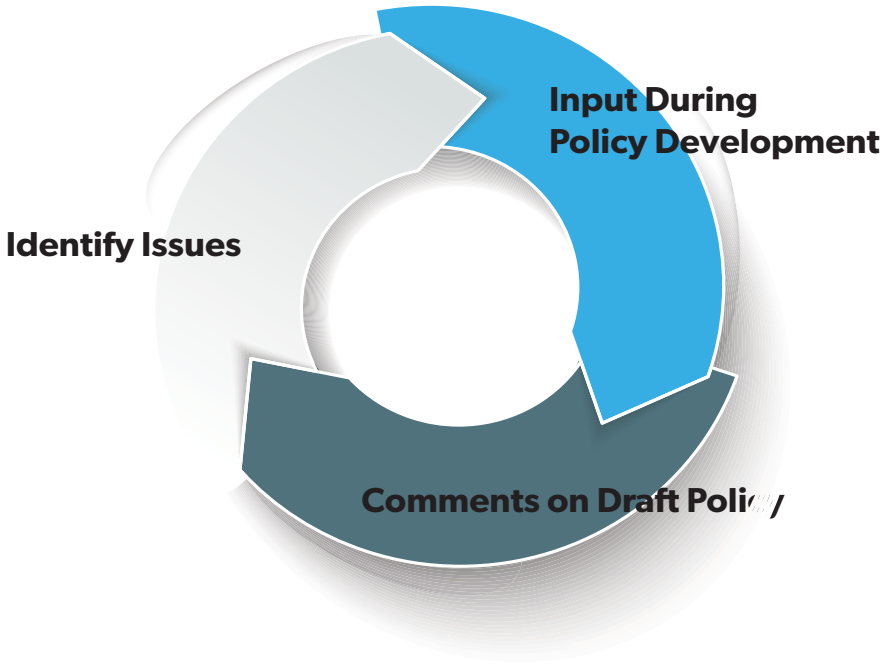
Stage 2 - Input on Policy Development

We provide the OSC an investor view on regulatory policy as it takes shape through face-to-face meetings and in follow up communications. Through ongoing discussions with OSC staff we offer a forum for constructive and thoughtful dialogue regarding investor issues.

Stage 3 - Policy proposals and Discussion Papers

We regularly provide input on policy once it has been released for comment to ensure the investor voice is reflected in the final version.

How the IAP Engages with the OSC



Key numbers for 2017

11 Meetings

11 Submissions to the OSC/CSA

3 Submissions to other bodies

2017 in Review

Throughout the year, the Panel directed its efforts towards advancing investor protection initiatives with the OSC and other key policymakers. To do that we focused on a few key issues that would have the greatest impact on improving protection for investors in Ontario and across Canada.

Key themes for 2017

Discontinuing Embedded Commissions and other Forms of Conflicted Compensation

Investors are entitled to independent, objective and professional advice. The IAP has consistently stated that embedded commissions paid by product manufacturers to registrants who sell their products create conflicts that ultimately harm investors. The Canadian Securities Administrators (CSA) commissioned research provides compelling evidence that embedded commissions and other forms of conflicted compensation undermine investor returns from mutual funds.

In providing our commentary on the CSA Consultation Paper 81-408 – *Consultation on the Option of Discontinuing Embedded Commissions*, we expressed our strong support for a ban on embedded commissions paid by third parties on the sale of all securities, not only on mutual funds, non-redeemable investment funds and structured notes. We also called for the prohibition of any compensation or embedded commissions that put the interests of firms and advisors ahead of clients or create a conflict of interest between firms or advisors and investors.

The Panel also noted its concerns with the CSA, the Investment Industry Regulatory Organization of Canada (IIROC) and the Mutual Fund Dealers Association of Canada (MFDA) (collectively, the SROs), Reports on Firm Compensation Practices which looked at direct and indirect compensation practices at six MFDA firms, eight IIROC firms, select exempt market dealers and portfolio managers (CSA Staff Notice 33-318 *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*, MFDA Bulletin #0705-C *Review of Compensation, Incentives and Conflicts of Interest*, IIROC Rules Notice 16-0297 *Managing Conflicts in the Best Interest of the Client - Status Update*). The reports revealed 18 different kinds of systemic, firm-wide practices that put firms' and advisors' commercial interests ahead of those of their clients'.

As we noted in our response, *"the CSA, IIROC, and MFDA reviews paint a disturbing picture of widespread, indeed endemic, firm non-compliance with current conflict of interest rules. While firms are only required to manage conflicts rather than avoid them, the evidence is clear that they are not managing them at all – they have instead established compensation programs that actually create conflicts."*

Best Interest

During 2017, policymakers remained focused on turning CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives toward their Clients* into a set of new rules. This did not stop the IAP from calling for a best interest standard that would bring Canada in line with recognized standards for consumer protection in G20 countries: *"[f]inancial services providers and authorised agents should have as an objective, to work in the best interest of their customers and be responsible for upholding financial consumer protection… the remuneration structure for staff of both financial services providers and authorised agents should be designed to encourage responsible business conduct, fair treatment of consumers and to avoid conflicts of interest."* (OECD: High Level Principles on Financial Consumer Protection).

We had the opportunity to express our view that a best interest standard would provide the necessary environment for investors to access more sophisticated products such as over-the-counter derivatives. In our response to CSA Notice and Request for Comment

– Proposed National Instrument 93-101 *Derivatives: Business Conduct and Companion Policy*, we again urged regulators to enact a best interest standard that would provide the appropriate environment for employing derivatives to improve outcomes for investors and ensure that anyone giving personalized investment advice does so with the proficiency and integrity required of a professional and not a salesperson.

Risk Profiling

In 2015, the Panel released independent research conducted on its behalf by PlanPlus Inc. The paper, Current Practices for Risk Profiling in Canada and Review of Global Best Practices, made an important contribution to our collective understanding of an issue that is at the very foundation of a successful investor-advisor experience – risk profiling. This research revealed a critical gap in this area: regulators offer little guidance on how firms and advisors should determine a risk profile and 83% of the risk profile questionnaires reviewed by the researchers were "not fit for purpose."

To dig deeper into the issue, the IAP hosted a 2016 roundtable to encourage additional dialogue among investors, industry, regulators and other stakeholders. The Risk Profiling Roundtable Facilitator's Report was published in January 2017.

The IAP also turned its attention to the growing area of robo-advice, consulting directly with both the OSC and providers of online advice services to better understand this new business model and to comment on how this growing channel for investment advice could consistently evolve to better serve the needs of investors.

Since that time, we have continued to meet with researchers and industry participants to identify ways to improve the current state of risk profiling in Canada. To date, a way forward has yet to be identified and like most issues work is ongoing.

SRO Oversight

During 2017, members of the IAP met with senior management of both the MFDA and IIROC to share our concerns about gaps in investor protection within their purview. We shared perspectives on their challenges and promoted opportunities for them to pursue to better serve investors in the future.

The IAP also responded to IIROC's Consultation on Order Execution Only Services and Activities and how they apply to the discount brokerage model. The IAP submission noted concerns about IIROC's proposal to revisit the definitions of "recommendations" and "advice", which could affect the competitive balance between full service and discount brokers and could negatively impact the availability and nature of advice for Canadian investors.

The Panel also provides comments on annual oversight reviews of IIROC and the MFDA as it did in this submission expressing concerns about the MFDA's use of warning letters in cases where stronger penalties were warranted. The findings in the oversight report raised questions about why a letter would be considered a suitable alternative to tougher measures to deter unacceptable behaviour and whether or not the use of letters in such cases undermines the enforcement regime.

OBSI

During 2017, the IAP voiced renewed concerns about OBSI's challenges and the urgent need to give OBSI binding decision making power. We met directly with OBSI senior executives and senior management to discuss their plans to address these problems and to follow up on the six core recommendations that the IAP had highlighted to the Independent Evaluator.

The IAP reiterated its longstanding view that if regulators fail to give OBSI the powers it needs, it cannot, in turn, give investors what they need and deserve in terms of a fair and independent resolution of their complaints. We also note that too few investors in Canada seek the support of OBSI once an issue has been identified and question the

potential for conflicts of interest with the option of conflict resolution offered via an internal "ombudsman".

The Panel will continue to petition regulators to provide OBSI the tools it needs to carry out its role in Canada's investor protection framework.

Cooperative Capital Markets Regulator (CCMR)

The Panel raised concerns about the future of the investor voice in the rule-and policy-making process in Canada, once the OSC is eliminated to make way for the CCMR. As currently proposed, the CCMR does not incorporate the OSC's investor-friendly governance structures (namely the Investor Office and the IAP) and only a few of its newer practices are designed to improve investor protection. The IAP was able to voice these concerns in our meeting this year with Kevan Cowan, the designated Chief Regulator of the Capital Markets Regulatory Authority and also in a letter to the Ontario Finance Minister Charles Sousa.

In the IAP response to OSC Notice 11-777 – *Statement of Priorities – Request for Comments Regarding Statement of Priorities for Financial Year to End March 31, 2018* we acknowledged that the OSC has raised a high bar for other regulators in Canada with regard to investor protection and noted that *"the Panel cannot support Ontario's participation in any regulatory framework that undermines investor protection. Doing so would be a significant step backward and would eliminate the progress that has been made by the OSC to date."*

In our response to the OSC's 2017 Annual Report we stated that "*The Capital Markets Regulatory Authority, as currently proposed, lacks investor representation and includes no provisions for an Investor Office or an Investor Advisory Panel. Moving forward with a new securities regulator that lacks mechanisms for meaningful investor input and participation in securities regulation would be a significant step backward for Ontario savers and investors."*

This submission also restated our belief that "*Investor representation is a fundamental tenet of securities regulation and it must be in place before this project proceeds, not just for the sake of investors in Ontario, but for the sake of investors throughout Canada."*

The year ahead: 2018 focus and initiatives

In 2018, the IAP will continue to support some key priorities such as the broad adoption of a best interest standard and the elimination of embedded commissions.

In addition, the IAP plans to turn significant attention to identifying how to establish and resource a viable national investor forum that will be able to promote and sustain a high level of investor empowerment to address the chronic imbalance between industry and investor influence in the regulatory environment.

Best Interest (Targeted Reforms)

The Panel will continue to encourage the OSC and other regulators to implement a best interest standard as soon as possible. We will focus on how best interest is defined and how it is likely to be interpreted by the courts, given that many advisors are apprehensive about potential legal liability.

Discontinuing Embedded Commissions

The Panel will continue to call for a policy decision to have embedded commissions prohibited at the earliest possible date and we await the OSC's proposal on this issue.

Risk Profiling/KYC (Targeted Reforms)

The Panel will push for regulated standardized definitions for Risk Profile, Risk Tolerance, Risk Capacity, Risk Perception, Risk Attitude, and Risk Composure; and (Minimum) Standardized Assessment requirements/questionnaires, e.g., a relatively small number of core questions based on best practices such as psychometrics; and upgraded advisor proficiency for interpreting questionnaires.

Proficiency and Titles

The Panel will call for the revision of current proficiency requirements and titles to upgrade professionalism, clarity, and eliminate investor deception.

Cooperative Capital Markets Regulator

The Panel will continue to call for the adoption of investor protection and investor-friendly governance features prior to the CCMR coming into force later in the year.

Complaint Handling

In 2018, the IAP will call for a transparent and user-friendly national complaint handling regime that provides investors access to redress/restitution.

Investor Empowerment

The Panel intends to address the current imbalance between industry and investor influence by fostering national, broadly representative, and well-funded investor advocacy in Canada that would be in a position to participate in an effective and sustainable manner with government, regulators (including the new CCMR and the SROs) and industry in the development and articulation of future regulatory policy.

The IAP in 2017

Consultation – External Organizations

- **Frank Allen,** Executive Director – FAIR Canada
- **Paul Bourque**, President and CEO – Investment Funds Institute of Canada (IFIC)
- **Sarah Bradley**, Ombudsman and CEO – Ombudsman for Banking Services and Investments (OBSI)
- **Shawn Brayman**, President & CEO, PlanPlus Inc.
- **Randy Cass**, CEO, Nest Wealth
- **Kevan Cowan**, CEO, Capital Markets Authority Implementation Organization (CMAIO)
- **Shaun Devlin**, Senior Vice-President, Member Regulation, Enforcement, Mutual Fund Dealers Association (MFDA) and other executive managers
- **Jan Dymond**, Vice President, Public Affairs – Investment Funds Institute of Canada (IFIC)
- **Andrew Kriegler**, CEO, President and CEO, Investment Industry Regulatory Organization of Canada (IIROC)

- **Karen McGuinness**, Senior Vice-President, Member Regulation, Compliance, Mutual Fund Dealers Association (MFDA)
- **Marian Passmore**, Director of Policy and COO – FAIR Canada
- **Marlene Puffer**, Partner – Alignvest Investment Management
- **Laura Tamblyn-Watts**, Senior Fellow, Canadian Centre for Elder Law
- **Tom Trainor**, Managing Director, Hanover Private Client Corporation
- **Mark Wright**, Director, Strategy + Stakeholder Relations – Ombudsman for Banking Services and Investments (OBSI)

Consultation – Ontario Securities Commission Staff

The following topics were discussed:

- CSA Climate Change Disclosure Review Project
- CSA Consultation Paper 51-404 *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*
- CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions*
- CSA Staff Notice 33-318 – *Review of Practices Firms Use to Compensate and Provide Incentives to their Representatives*
- CSA Staff Notice 33-319 *Status Report on CSA Consultation Paper 33-404 Proposals to Enhance the Obligations of Advisers, Dealers, and Representatives Toward Their Clients*
- IIROC Oversight Report
- MFDA Oversight Report
- OBSI
- OSC Launchpad
- OSC Seniors Strategy
- OSC Notice 11-777 *Statement of Priorities*
- Proposed NI 91-102 *Prohibition of Binary Options and Related Proposed Companion Policy*
- Robo-Advisors
- Enforcement
- Online Advisors

The IAP met with the following OSC Branches and Offices:

- Compliance and Registrant Regulation
- Corporate Finance
- Derivatives
- Enforcement
- Investment Funds and Structured Products
- Investor Office
- Market Regulation
- Mergers and Acquisitions
- OSC Launchpad

Submissions and Letters:

- December 27, 2017: Response to CSA Consultation Paper 52-404 *Approach to Director and Audit Committee Member Independence*
- December 11, 2017: Report on Vulnerable Investors: Elder Abuse, Financial Exploitation, Undue Influence and Diminished Mental Capacity
- November 13, 2017: Response to the OSC Annual Report 2017
- August 22, 2017: Proposed National Instrument 93-101 *Derivatives: Business Conduct*
- August 3, 2017: FAIR/CCEL Consultation on Vulnerable Investors
- July 25, 2017: CSA Climate Change Disclosure Review Project
- July 13, 2017: CSA *Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*
- July 6, 2017: Proposed National Instrument 91-102 *Prohibition of Binary Options*
- May 31, 2017: CSA Consultation Paper 81-408 *Consultation on the Option of Discontinuing Embedded Commissions*
- May 23, 2017: Ontario Securities Commission Notice 11-777 *Statement of Priorities*
- April 12, 2017: 2016 Annual Report of the Ontario Securities Commission's Investor Advisory Panel

- April 12, 2017: CSA, IIROC, MFDA Reports on Firm Compensation Practices
- February 2, 2017: Comments on IIROC's Guidance on Order Execution Only Services and Activities (OEO)
- January 19, 2017: MFDA Oversight Review Report

About the IAP

The IAP is an independent advisory panel to the Ontario Securities Commission.

Our Mandate

Our mandate is to solicit and represent the views of investors on the Commission's policy and rule making initiatives. In order to fulfill our mandate, the Panel:

- Advise and comment in writing on proposed rules, policies, concept papers and discussion drafts, including the Commission's annual Statement of Priorities;
- Consider views representative of a broad range of investors through consultation with and input from investors and organizations representing investors in formulating its advice and written submissions to the Commission;
- Bring forward for the Commission's consideration policy issues that may emerge as a result of the Panel's investor consultation activities and comments on the potential implications for investors posed by those issues; and
- Advise and comment in writing on the effectiveness of the investor protection initiatives implemented by the Commission.

Our Membership

The Panel is comprised of 9 members appointed by the Chair of the Commission following a public application process and on the advice of a selection committee consisting of two Commissioners and a Vice-Chair. Members of the Panel are appointed for terms of up to two years, with possible reappointment for one additional term. (See Appendix A for Bios of panel members)

How We Operate

The Panel meets monthly, either in person or by conference call. During the 2017 calendar year, we met 11 times. We maintain frequent contact between meetings to develop our written submissions and to share and exchange views on developments in securities law and other relevant matters. During our meetings, we discuss upcoming submissions and plans for future outreach, research and consultation.

Our work plan is set to a large extent by the Commission's priorities and current developments in the investment industry. Our meeting agendas often will focus on specific Commission initiatives, including its annual Statement of Priorities and business plan, policy and rule proposals, and ongoing or under-development investor protection initiatives.

Independent

The Panel conducts its activities without direction or influence from the Commission.

The OSC Investor Office serves as the general liaison between the Panel and the Commission and serves as Secretary to the Panel. The Office provides administrative support to Panel activities and facilitates Panel requests for staff briefings or research information conducted by, or available to, the Commission on specific policy and rule making initiatives.

Transparency

Transparency of our work is important. We provide regular reporting through our Investor Advisory Panel website, through our published reports, submissions, letters to the Commission and our Annual Report. We publish all meeting agendas on our website.

Consultations

To assist us in fulfilling our mandate, we regularly consult with organizations and financial and legal experts, industry associations, and investor advocacy bodies.

Appendix A: Member Biographies

Jacqueline Allen

Jacqueline Allen brings 25 years of experience in capital markets and financial services including tax, accounting and risk management. Her professional career spans from New York to Toronto with roles at KPMG, SK Group, and Bank of America Merrill Lynch. Ms. Allen most recently served as the Head of Portfolio and Electronic Trading Sales at Bank of America Merrill Lynch Canada, with a focus on institutional asset managers, pension funds and mutual funds investors.

Ms. Allen holds an MBA from the New York University Stern School of Business.

Larry Bates

Larry Bates has spent 30 years in the fixed income markets, holding key positions at major financial institutions in both Canada and the United Kingdom. He has recently shifted his focus to investor advocacy with the launch of his website, wealthgame.ca, focused on providing Canadians with a better understanding of investment basics.

Mr. Bates is the creator of the 'T-REX' score, which is a value used to express an investor's total investment gain after all fees are paid.

Paul Bates

Paul Bates has been a lawyer for over 30 years, with a diverse legal practice concentrating on complex commercial litigation, including securities litigation and claims against financial advisors and portfolio managers. He currently focuses on investor protection from the point of view of retail and institutional investors.

Mr. Bates has volunteered as a member of both the Consumer Council of Canada's Board of Directors and the Financial Services Tribunal's Legal Advisory Committee.

Patti Best

Patti Best is a former senior executive in the investment industry, bringing over 40 years of experience from client-facing senior-level positions with brokerage firms, mutual fund dealerships and investment fund companies. She has a diverse background in client relations, investment product operations and administration, as well as systems and product development.

In 2016, Ms. Best retired from her position as Senior Vice President, Client Experience from Mackenzie Investments.

INVESTOR ADVISORY PANEL

Letty Dewar, Chair

Mrs. Dewar has been active in the financial industry since 1984, and has a thorough understanding of the mutual funds sector and capital markets. Her experience includes financial planning, Group RSP product design, compliance and operations. She served as Chief Compliance Officer for a major mutual fund company. Subsequently she was the Chief Operations Officer for a portfolio management group that managed approximately $19 billion of mutual fund assets.

Mrs. Dewar was a member of the CFA Society Toronto's Portfolio Management Committee from 2009 till September 2017 (Chair September 2014-16). She is a member of the CFA Institute, the CFA Society Toronto and the Genesis Club of Toronto.

Mrs. Dewar holds the CFA designation, a M.B.A. from York University and a Bachelor of Commerce degree from the University of Toronto.

Neil Gross

Neil Gross is the former Executive Director of the Canadian Foundation for Advancement of Investor Rights (FAIR Canada) and a lawyer with over 30 years of experience, focusing on investor protection issues. He currently runs Component Strategies, a strategic consulting firm focused on public policy issues, responses to capital markets regulation and developing bi-partisan initiatives that benefit the investment community.

Malcolm Heins

Malcolm Heins is the former Chair of the Ontario Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives, and the former CEO of the Law Society of Upper Canada. He is currently a director of Lawyers' Professional Indemnity Company, the Ontario Municipal Insurance Exchange, Cancer Care Ontario and a lawyer with over 40 years' experience, over which he has received numerous awards for his contribution to the legal profession, including the Law Society Medal from the Law Society of Upper Canada and the Metro Toronto Lawyers Association Award of Distinction.

Harvey Naglie

Harvey Naglie holds over 40 years of experience in both the public and private sectors, with a focus on financial services. He is a former Senior Policy Advisor for the Ontario Ministry of Finance's Financial Services Policy Division, where he participated in developing and implementing policies related to securities regulation and investor protection.

Mr. Naglie holds an LL.M. in securities law from York University, an MBA from the University of Western Ontario Ivey School of Business and an MA in economics from Johns Hopkins University. Mr. Naglie was recently appointed to the Consumer and Investor Advisory Council of OBSI.

Louise Tardif

Ms. Tardif was an investment advisor for 22 years until her retirement in 2008 from National Bank Financial, where she was also manager of their Ottawa branch. She currently sits on several boards including the Board of Trustee of OP Trust, a pension plan with over $20 billion in assets. Ms. Tardif also chairs the board of the Youth Services Bureau of Ottawa and just ended a mandate as a Governor of the University of Ottawa where she chaired the Finance and Treasury Committee. Ms. Tardif has a Bachelor of Commerce and a M.A. in Religious Study from the University of Ottawa. She is currently a PhD. candidate at the same institution.

Outgoing members

We would like to acknowledge and thank the following retiring members for their contributions and service on the Panel.

Connie Craddock

Harold Geller

Ken Kivenko

Alison Knight

Ursula Menke