The TAMRIS Consultancy

POINT OF SALE DISCLOSURE AND REGULATORY FAILURE IN CANADIAN RETAIL FINANCIAL SERVICES

September 2010

FSA CEO outlines new conduct regulation strategy – March 2010[1]

"A regulator must be willing to place themselves between consumers and harm. We will only achieve this by taking a proactive stance."

Excerpt Fair Dealing Model Concept Paper – January 2004

"The OSC continues to regulate dealers and their representatives through the products they sell, based on an ***outdated assumption that transaction execution is the primary reason people seek the services*** *of the financial services industry. In today's financial markets, advice is what most people seek, and what most firms emphasise in their marketing messages".*

[1] http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/044.shtml

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Introduction

It is extremely difficult to frame criticism of the CSA POS disclosure regime in an appropriate context without addressing wider regulatory and industry issues. To do so would appear to lend credibility to what is a flawed and narrowly framed regulatory system.

In 1999 two major initiatives were set in place by Canadian Regulators: the project which became the current Point of Sale disclosure project and the project which became the Fair Dealing Model, which became the Registration Reform Project, which became the Client Relationship Model project. The POS project finally re-emerged in June 2010 while the CRM project, which had appeared in April 2009, has for the moment disappeared from public view. Both projects are running into their 12th year.

Other countries' regulators, notably the UK and Australia, have long since moved ahead with much more comprehensive and wider reaching (*wider frame*) point of sale disclosure (*the UK implemented such in 1995*), client relationship model type documents, higher standards of accountability, suitability and responsibility similar to those proposed in the Fair Dealing Model. These countries are now even proceeding with plans for the elimination of commission in the retail financial services industry.

Canadian securities regulators are perhaps 15 to 20 years behind the best global standards[2], are distanced from the retail financial services market place (*SROs are responsible for regulating the retail market place*) with key initiatives of the last 10 years or more seemingly having been toned down and delayed by what would appear to be SRO and industry deliberation (*note the FDM and the Registration Reform Project committee reports on the FDM which, for anyone who wants to read them, clearly show strong representation of industry interests*). Not only are the CSA behind with respect to such issues as Point of Sale disclosure, the frame of reference for such initiatives are also much more restricted and narrowly framed.

Canadian regulation is still stuck in a transaction mindset (*possibly not even truly aware of the extent of the narrow perspective*) and the very limited nature of suitability that goes with it; it is this fixation on the limited nature of the transaction, the lack of disclosure with respect to such, and the investor's responsibility for the transaction decision (*and effectively the suitability process*), based on this limited framework, that is at the heart of Canadian investor protection issues.

Point of sale documentation internationally may well be focused on market failure, but the heart of the matter in Canada is regulatory failure *(neglect*), and the regulatory gap that exists between what is regulated and what is represented contractually. Between the minimum standards of the KYC and the actual representation being made in the market place lies a largely unregulated market place, a gap which could justifiably, in the absence of explanation, be ascribed to neglect and regulatory failure.

Given the wider picture, the CSA's decision to proceed with the implementation of mutual fund point of sale disclosure, without a strong supporting foundation needed to protect investors[3], raises significant concerns about the structure, attitude and vision of regulation in Canada: the OSC has, for a long time, failed in implementing effective and appropriate investor protection initiatives; it has failed in implementing effective disclosure with regard to relationships and products, in setting up truly independent and effective consumer panels, and it has failed to develop any initiative of substance that would aim to raise standards in an industry which is clearly no longer one predicated on the transaction, but which can rely on the minimum

[2] Dates for implementation of consumer panels, independent ombudsman, key facts/features documents, initial disclosure (service or client relationship management documents) for the UK support this statement.

[3] This supportive foundation is found in other jurisdictions (UK/Australia) that already mandate point of sale disclosure.

standards of such[4]. Canada remains a high cost industry: an industry delineated by products and transactions and its lumbering antediluvian frame needs to be dismantled and rebuilt.

Erroneously, Canadian Regulators have used international research to back up the introduction of the Mutual Fund POS disclosure system while ignoring the framework in which international POS documents are delivered and the direction regulation is moving in. In Australia and the UK, client relationship management documents already exist as do higher standards for communicating and supporting suitability of the recommendation.

Apparently the proposed CSA POS documentation is intended to provide "*investors with more meaningful and effective disclosure*[5]" and to"*make more informed investment decisions*[6]*"*. But just what "effective", "informed" and "investment decisions" mean is, if you just rely on regulatory communication, unclear and undefined. You need to go back to the basic regulatory framework, which regulates the transaction, to come up with workable definitions of intent, which fall woefully short of what the CSA state "***is a significant investor protection initiative"***.

Back in 2004, the Fair Dealing Model Concept Paper expressed a clear and reasonable vision for the future of the retail financial services industry in Canada. Since then regulators have walked off into a veritable visionless wilderness. In terms of investor protection and a competitive market strategy, where have Canada's regulators disappeared to these last seven years?

Instead of praising the current initiative we need to focus on what this initiative effectively papers over: flawed, visionless, lifeless, narrowly framed regulation that fails to protect investors and fails to promote an efficient and competitive retail financial services market. But what if the direction of regulation since 2004 is partly a reaction to the threat posed by the FDM in 2004? What if the intent of regulation has been to provide more robust regulation of the transaction under minimum standards?

One of the things I have consciously done in this report is to discuss and provide examples of what standards are globally: the OSC always refers to international research but never (as far as I can find) support their arguments with any specific references that bear in mind the regulatory structure of those markets. To do so would risk bringing attention to the significant differences between global best practises and Canadian minimum standards.

I find no support from Australian and UK research for what is happening in Canada: based on the information at hand, it is disingenuous to suggest that international research supports the stance taken by Canadian regulators. I do refer to an area of UK regulation in the report dealing with a very basic advice structure for stakeholder products, that is more or less the Canadian regulatory structure in a nutshell: stakeholder products in the UK are a set of very low cost products and the regulators and government have implemented the scheme to provide public access to cheaper products. Only limited information about the investor is required to sell these products.

Based on my own experience, regulators in Canada appear to rarely feel the need to provide rigorous support of their statements. This document is not just an argument about Point of Sale Disclosure and Regulatory failure but an attempt to set a more rigorous standard for regulatory debate. Many people talk about rogue advisors, but I think it is time we became more concerned about our regulators.

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[4] It is worth noting that an enforcement of a contract is based on representations and consideration made between two parties at the time: the FDM concept paper pointed out the gulf between common law interpretations of such contracts and regulatory interpretations. Failure to regulate such a gulf could be considered regulatory failure.

[5] http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20100618_81-319_status-pos.pdf

[6] http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20100618_81-319_status-pos.pdf

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1. Executive Summary

The report argues that issues relevant to the POS document project, how the retail financial services industry in Canada is executed, its transaction business model, its transparency and how it is regulated in Canada are more important than the POS document itself.

Section 2 addresses the fundamentals of the current regulatory framework and the regulatory gap between what is being regulated and what is being represented. It provides an explanation of the transaction model and its parameters that are used to regulate the transaction. Suitability in the Canadian transaction model is based on a limited number of parameters recorded by the advisor, but for which the investor could be interpreted as being responsible (based on minimum standards) for determining: these parameters are used to define product suitability and hence product sales.

Under current regulation of minimum standards, investors are effectively responsible for a suitability process they are not equipped to understand (this framework is not transparent to the investor); the actual suitability process is not what most investors think they are receiving in terms of service, and is not what is being represented in advisor and firm communication.

All this was clearly explained in the January 2004 Fair Dealing Model concept paper which recognized the limitations of regulating the transaction, and that the industry was often promoting a higher level of service, that was not regulated, that was contractual in nature and that this gulf was being recognized by the courts.

As such, regulators have been in possession of information that has been material to the decisions of investors, for some time, yet have chosen not to act on it, thus impairing transparency and competition in the market place.

Section 3 looks at other regulatory frameworks in which POS disclosure documentation is already delivered and their supporting regulatory frameworks. Both Australia and the UK provide disclosure over services and suitability, something that does not exist in Canada, as well as much wider application of point of sale disclosure. Suitability standards are also much higher in these countries and specific research is provided from UK FSA reports on this issue: Canadian standards could even be interpreted as bad practice in the UK, based on UK research and FSA commentary on suitability.

Regulatory objectives for Point of Sale disclosure are also much more clearly enunciated in Australia, and in particular the UK, when compared to the Canadian objective "aimed at providing investors with more meaningful and effective disclosure"[7].

The Canadian parameter to parameter framework is close to what the UK regulators term "Basic Advice", where some "pre scripted questions about income, savings and other circumstances" are used to identify a suitable stakeholder product.

Section 4 looks more deeply into point of sale disclosure and its relationship, or lack of, with the overall suitability process. It argues that an informed decision cannot in fact be reached via the basic parameter to parameter limited suitability standards found in Canada.

- It discusses in detail the main components of advice driven suitability processes and that disclosure of each component is integral to investors making informed decisions.

- Responsibility for the suitability process would appear to shift to the consumer in a transaction based process with low suitability standards such as the Canadian system.

[7] http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20100618_81-319_status-pos.pdf

- Under the Canadian transaction based system there is no advisor sign off with respect to the suitability process itself.

- The Point of Sale document is a regulatory mandated communication between a product provider and the client and not a communication between the client and the advisor.

- Point of Sale documents appear, internationally, to be driven by a goal to enhance investor protection and market competition (lower costs) by addressing informational asymmetry in financial decisions and aiding informed choice amongst different products.

- The objective of Canadian regulators appears to be to provide a limited set of information "to make informed decisions", without the goal of improving market efficiency (lower costs and more competition): market failure will not be addressed.

- In a transaction model with low regulated suitability standards, where the investor is deemed responsible for the investment decision, where the parameters of the KYC determine suitability, where there exist no other disclosure documents, where the advisor has a limited role in defining the parameters of the KYC (not always the case), the POS could be considered a consumer sign off to the suitability/transaction process.

- In advisory based regulatory and business models, the advisor suitability process is where the accountability lies.

- As a sign off to the suitability and transaction process, the current POS in a transaction based model with low suitability standards (consumer effectively responsibility for suitability), poses a real and significant risk to investor protection and market competition by endorsing the existing framework.

Section 5 analyses the proposed mutual fund point of sale disclosure document. It argues that whether a POS disclosure document helps investors make informed decision depends on the following:

a) the suitability standards regulated and processes used

b) the transparency of both to the investor,

c) the information provided in disclosure,

d) the overall disclosure framework and

e) the expertise and knowledge of the consumer and the sophistication of their own internal suitability processes.

Canadian regulatory standards fail with respect to (a), (b), and (d) while the point of sale disclosure fails with respect to (c): the information provided in the proposed POS disclosure document is insufficient to support an informed decision by an investor where the basis of the decision is a constrained parameter (KYC) to parameter (POS) framework. That the POS disclosure is meant to represent the parameters needed to make an informed decision represents a leap of faith on behalf of regulators.

Section 6 provides a very brief look at some of the stakeholder comments made with respect to the POS disclosure project.

Section 7 looks at disclosure and the major areas of disclosure with respect to wealth and portfolio management.

Section 8 assess some of the claims made by the CSA in their staff notice 81-319 "Status report on the implementation of point of sales disclosure for mutual funds" with respect to consumer protection and finds them lacking while ignoring the regulatory gap.

Section 9 provides a brief assessment of the transaction business model and questions the rationale for current regulatory support: maintenance of the status quo is hampering much needed change and improvements in retail financial services processes and productivity.

Section 10: provides a set of recommendations needed to improve disclosure, raise standards and regulate the actual services being offered in the advisory based retail financial services..

Section 11: If, and only if, investors did initiate all transactions, if optimal suitability could be determined on a transaction by transaction basis using simple parameters provided by the investor, then a Point of Sale disclosure "might", if appropriately structured, help investors make informed decisions.

The FAIR Dealing Model concept paper of January 2004 recognised the regulatory gap that existed in the market place, yet Canadian regulators have ceased to consider this gap as an important regulatory omission over the last seven years. Such omission is not only regulatory failure (some would say malpractice) but it has placed the Canadian retail investor at significant risk. How much longer will regulators fail to close this gap?

2. Suitability fundamentals & the regulatory gap

When we are told that advisors are required to make sure that recommendations provided to investors are suitable to the investor's needs, risk preferences and investment objectives, we would be forgiven for feeling well protected: note that "well protected" is just a feeling, since most investors are unaware of the technical details, subtleties and difference behind the various contexts in which suitability is determined; in other words the promise may sound MORE substantial than it actually is.

When we see all the promises made by industry and advisors, we would be forgiven for feeling well served, and if anything goes wrong, we should be well protected by regulators and firms, who, of course, are here to enforce suitability and service promises. But the reality is different: the "suitability" that is regulated is not the suitability many investors have in mind and much of that which is promised, as a service, is not regulated.

Into this mire is about to be shoved the POS disclosure document which, if you believe the hype, will help investors make informed decisions; but this disclosure is not meant to improve the suitability process or regulate the wider promise. Investors need to be clear just what the regulated minimum standard of protection they are being afforded and just what regulators mean when they discuss "informed" and "investor protection."

Parameter to Parameter Suitability Process

"I am an investor looking for a transaction to fit the capital I have to invest; I know what I am looking for from an investment in order to fit into my portfolio; I am not looking for portfolio management, just a recommendation for the money I wish to invest; the investment advisor/broker needs to make sure that he or she has a clear idea as to my risk profile, time horizon and investment objectives for the capital before he or she makes the recommendation. But these are my parameters and the advisor does not need to educate me or guide me in my assessment of them."

> "*Client risk tolerance, investment objectives and time horizon noted in the KYC information give direct information regarding what is suitable for a client ….*[8]"

Once the Know Your Client parameters have been agreed, the broker looks to his or her product array and selects one appropriate to the parameters. "I still need to make sure that the product meets my risk profile, time horizon and investment objectives, but since I understand my suitability parameters this should not be a problem: I could cross reference this information to a point of sale document, if one was available, but I will have to make do with the prospectus, to make sure that it fits. I am responsible for this!"

> *"Knowing the product is not the flip side of the know-your-client coin, she says: "**It's the first side of the coin. You have to know what you're selling when clients come. You have that menu of options. How can you comply with your suitability obligations if you don't?**""* Investment Executive *q*uote from Karen McGuinness, director of compliance at the Mutual Fund Dealers Association - May 2005 -[9]

This parameter to parameter scenario works where the investor is genuinely not looking for overall investment advice and de facto portfolio management, where there is no expectation of anything other than a recommended transaction (compliant with the parameters of the request) from the broker, and where the investor is able to make an informed judgment about the security and as to where the security fits into a given portfolio.

But, what if the investor is not coming to the broker with a clear set of specific parameters: that is, the investor is

[8] http://www.mfda.ca/regulation/notices/MR-0069.pdf

[9] http://www.investmentexecutive.com/client/en/News/DetailNews.asp?id=28947&IdSection=30&cat=30&BImageCI=1

not able to make the type of portfolio judgment needed to properly define the parameters of the transaction needed to make sure the investment fits the portfolio, or where the expectation is that the advisor is responsible for defining the parameters and for determining where in the portfolio the asset should fit, but in fact is not. What if, the advisor is representing that they do something more than the parameters of a simple KYC or New Account Application form alone implies?

A point of sale document in this instance has little relevance unless there is a) transparency over the real relationship and the real service (alerting the investor to what is and is not provided) and b) the information provided in the point of sale document is capable of providing the information that will allow the investor to fit the transaction within the portfolio, providing they can interpret and apply such information. The investor needs to know this, in order to make the decision: "I can do this, or I cannot and want someone to make these decisions for me".

The following are quotes taken from the Registration Reform Project committee reports on the FDM in 2005.

> "*Client relationships are currently governed by common law, the civil code in Quebec and statutory and SRO requirements regarding KYC and suitability rules. These rules are account and transaction-by-transaction focused. As a result of this regime, a portfolio view of the relationship and suitability in the context of the total portfolio is not fostered.*"

> "*Framing "education" as a regulatory requirement creates regulatory liability for a process over which a firm or its advisors have no control. The WG* (working group*) agreed that investor education information should be provided, but the degree to which clients are successfully educated should not be regulated*"

These comments reaffirm the intent of the industry to support the transaction based suitability process and to limit the educational remit to factors which will not impact the recording of KYC parameters: in other words the client comes with clear parameters; the advisor does not influence these parameters; a transaction is recommended that fits these parameters; end of process. It is worth noting that "investor education information" discussed above (RRP project) was not defined in terms of detail, scope, content and medium or at what point during the suitability process it was delivered and to what extent this information was considered important in shaping and defining KYC parameters. Indeed, there seems to be no critical appraisal of the Canadian retail suitability process by regulators: it is taken as being a fact of life, **without question**.

> Einstein: *"If I had an hour to solve a problem and my life depended on it, I would use the first 55 minutes to formulate the right question because as soon as I have identified the right question I can solve the problem in less than five minutes*"

If you are not responsible for educating the client, then the components of the KYC suitability process are limited to defining the parameters as understood by the client, and the investor is largely responsible for the main components of the suitability process; all the advisor is responsible for, essentially, is to know the product, and even this requirement could well be interpreted as being subsumed to some degree via a proposed point of sale disclosure.

Parameter to Parameter and the POS

If each parameter of a simple KYC could be matched with a simple parameter on a POS disclosure document, regulators focused on the transaction would have a de facto game winner: check risk matches; check objective matches; check suitability; see costs; buy fund, suitability confirmed, responsibility for decision accepted. But this relies on the simplifying assumption that investors have adequate internalized suitability processes that are able to determine the parameters and relate the parameters to their overall financial position and existing portfolio of assets. It also assumes that there is no other representation of the service, and that there is transparency of the transaction based service and awareness by the investor of the processes needed to derive suitability parameters. This is would be yet another leap of faith.

Optimal suitability

The information collected in a KYC is limited to broad parameters, designed only to facilitate know your client requirements for transaction delivery. Actual portfolio construction that personalizes asset allocation (and security selection) to client risk preferences, profiles and financial objectives as well as the disposition of existing financial assets, requires a higher level of information and a much greater allocation of time to determining the profile of the client and where the client fits in the advisor's investment universe. It also requires an educational process: educating the client about how the advisor formulates and manages suitability. Risk profiling, portfolio construction, planning and management are much more involved than the simple transaction focused KYC would suggest.

Regulation and the transaction

For an industry dependent on product transaction remuneration, regulation based on the transaction, with minimum standards regarding KYC and education, results in a relatively low compliance, lower cost (low levels of training for sales persons), and a less sophisticated business model (processes needed to construct plan and manage personalised portfolios are not necessary). Such a business model is not structured to deliver the kind of personalised solutions that many investors may think they are getting. And regulation structured to monitor this business model is not structured to regulate higher suitability advisory based services.

Such a business model is also more likely to result in higher turnover (remuneration comes not from advice but trades) and higher costs: investment advisors/sales persons are more likely to be on the look out for reasons to initiate transactions than businesses based solely on fees or funds under management; high costs and high levels of turnover are more likely to lead to under performance and an industry model that is weighted towards industry interests: in other words, the industry is more likely to operate against investor interests and be less competitive, resulting in less efficient allocation of capital (reduced capital market efficiency).

The actual market place

In fact, the actual market place is predominantly one of investors (naïve, ignorant, unrealistic, and inexperienced to varying degrees) looking for advice and recommendations as to how they should invest their money to meet their financial needs over time; this also means guidance on the realities of risk and return and a strategy and recommendations that meet their risk profile, financial needs and overall financial situation.

In this context, to meet this expectation, the advisor would need to be responsible for the following:

- direction and guidance that helps assess and select the risk profile;
- determining the overall investment objective and for fitting each component within a portfolio;
- researching and selecting products that best meet those needs;
- making sure that securities and asset class allocations continue to be relevant to the client's financial needs and risk profiles and the stated investment discipline that is used by the advisor to manage risk and to which the investor uses as a benchmark to understand risk and their risk profile.

The above is still an advisory based model, but the advisor and firm are responsible for the processes that underpin suitability.

Much is made of the regulation of the advisor's responsibility for making suitable recommendations, when in fact, all that is being mandated is the general suitability of a transaction within a framework for which the investor is implicitly deemed responsible. The difference is subtle, and was one that was understood by the OSC in its Fair Dealing Model concept paper: comments from that paper are provided below.

Fair Dealing Model Awareness of the Issue

Investors are unlikely to fully appreciate the subtlety of the regulatory situation with regard to investor responsibility and the nature of the transaction service being offered.

The Fair Dealing Model (concept paper 2004), and the thinking at the OSC at the time, recognized the limitations of regulating the transaction, the differences between a product recommendation and advice based securities recommendations and the conflicts between the two. It also recognized that the industry was often promoting a higher level of service, that was not regulated, that was contractual and that this gulf was being recognized by the courts.

Regulators have been in possession of information that has been material to the decisions of investors, for some time, yet have chosen not to act on it, and to withhold it, thus impairing transparency and competition in the market place; in other words, acting against the public interest.

Why are regulators holding investors to higher standards than their advisors, and why are they preventing the true nature of the regulated relationship from being communicated to investors in advisory relationships?

The following are comments taken from the January 2004 Fair Dealing Model concept paper that support the argument that regulators have been aware of the regulatory gap for some time:

> *"The Fair Dealing Model is the Ontario Securities Commission's proposal for renewing our regulatory regime to bring it into line with the industry's current advice-driven business model, and to ensure consumer expectations match the services provided"*
>
> *Having undertaken to advise someone, a representative has a general duty to advise carefully, fully, honestly, and in good faith. The appropriateness of individual transactions will be evaluated in the context of the investor's overall portfolio.*
>
> *We continue to regulate most registrants on the basis of the products they sell, even though investors, firms and the courts consider the relationships formed and the advice given to be far more important than the actual sales transactions. The regulations allow an unacceptable lack of clarity which contributes to many of the problems in relationships between investors and advisers.*
>
> *Most retail financial services, including investment advice, are delivered by firms registered as dealers and their individual representatives. But the OSC's regulations only focus on advice as a business activity for a limited number of portfolio managers, investment counsellors, and newsletter publishers. For the majority of financial services providers, Ontario's existing product-based regulatory model has become outdated, yet we continue to tack new regulations onto it.*
>
> *..the Securities Act regime regulates most financial services providers through the products they sell. In its original form, the Act sought to prevent fraud by regulating trading, on the assumption that transaction execution is the primary reason people seek the services of the investment industry. This remains the basic thrust of the Act and its regulations*
>
> *Another way to appreciate the limitations of product-based regulation is to consider what it does not do. Most significantly, it does not concern itself with advice. Most advice provided to investors is treated as secondary or incidental to the trade, and therefore remains exempt from any clear, concrete standards.*
>
> *When people select a financial services provider, what they usually seek is expert knowledge and advice, not merely an ability to execute transactions.*
>
> *By starting from the flawed premise that investments are simply products, and that we can protect consumers by regulating "sales practices", we have limited our regulatory tool kit.*
>
> *The "know your client" (KYC) form currently prescribed is believed by many to give inadequate*

treatment to issues such as risk tolerance and investment policy, the nature of services offered, and the responsibilities of each party.

Under our current model, final decision making responsibility rests on investors, but the regulations fail to ensure they have adequate tools to make effective choices. In particular, investors lack clear information about the performance of their investments and the risks they are facing.

The net effect of current reporting requirements is that investors are not seeing the complete picture of their own account performance. Their ability to raise red flags for results that fall short of agreed objectives, or to evaluate the effectiveness and value of their adviser's recommendations, is hindered.

In addition to past performance, informed investors need to be aware of the risks they face going forward. We need not look back any further than the last stock market bubble for a reminder that the concept of risk is not well understood by large segments of the investing public (to say nothing of advisers). But other than general business risk disclosure in prospectuses and a implied reference to client risk tolerance in the suitability rule, the regulations do not mention or contemplate risk concepts. To make the decisions they are expected to make, investors need a better understanding of the risks of their overall portfolio and of individual securities, both at the point of sale and through their account statements.

A more general question is how people can be expected to become literate about investments in the first place. Government bodies such as the OSC have a mandate to deliver investor education materials to the general public, but no one currently bears that responsibility at the individual client level. Even an adviser who has a personal relationship with a client and is paid to make recommendations and provide advice to him is under no obligation to provide him with educational information. Advisers are required to determine an investor's sophistication level – but this is done for suitability and KYC purposes, not to help clients improve their knowledge.

There is extensive research data available showing that many investors are not well equipped to make the transaction decisions they would be expected to make, albeit with assistance, in an advisory relationship.

It is no longer acceptable to regulate advice as though it were merely incidental to a sale. People need to be assured of getting fair treatment from their adviser.

The investor is responsible for making the final decision on any trade. But in making these decisions, it is assumed that the investor is relying on the representative's opinions, and therefore, the representative must meet a certain standard of care. Most importantly, any advice must be appropriate for the client's financial needs and objectives as described in the Fair Dealing Document. Advice must also be unbiased. A firm could be held responsible for investment losses if a court determined that its representative failed to meet the applicable standard of care or breached a fiduciary duty.

To make the decisions they are expected to make, investors need a better understanding of the risks of their overall portfolio and of individual securities, both at the point of sale and through their account statements.

No further open discussion of the shortcomings of the transaction based system has come from regulators since the initial concept paper. Just what are the CSA's and provincial regulators' current views?

Transaction need not be in client's best interest – POS conflict

Within a basic transaction driven regulatory framework, as long as an investment/product fits into the framework defined by the KYC form, it will be considered suitable, and the investor will be responsible for the investment decision and the suitability process. The trouble is this: the transaction may not necessarily be in the client's best interests for a number of reasons (see points below), which conflicts with the objective of the POS disclosure to help make informed decisions.

As a consequence of the minimum standards governing the transaction, the recommendation need not necessarily be in the client's best interests, and it may be difficult for the investor to determine such; this has relevance to the ability of a point of sale disclosure document in aiding an informed decision.

- A solution does not have to be cost effective: investors are not provided with the information which will allow them to assess either the value of the product to their overall investment position or the value of the service.

- A recommendation does not need to be the most appropriate solution: a mutual fund dealer or insurance salesperson may choose a product which fits the suitability profile but may not be the best solution because of costs or product structure; the industry is still to a large extent demarcated by product and regulated as such.

- The recommendation may not fit in with their existing assets or be appropriate to their overall financial position: the KYC information noted in the MFDA suitability guidelines does not cover this requirement.

Indeed, there is much room to provide an unsuitable and inappropriate recommendation within a transaction and product based regulatory framework, especially one regulated according to product lines. The only safeguard the investor has is limited to the confines of the KYC, with no other form of disclosure with respect to service, responsibilities and processes currently mandated.

The advisor/salesperson/registrant only has to fill in a KYC that matches the product they wish to sell, whereas the investor is responsible for making sure that the product is appropriate and suitable with respect to their real needs and assets, risk preferences and the exigencies of the market and economic environment. It would appear that under the current transaction based regime that the investor is held to a higher standard than the advisor.

Regulatory gap

Advisory based services it would appear are allowed to make a number of claims with regard to their services which would, in the opinion of this report, lead investors to believe that they are being provided with an advisory service that exceeds the minimum regulated standards as laid down by Know Your Client requirements. At the same time, the language is also interposed with wording that might conceivably keep their service offerings within the context that it is the client that is initiating the request and it is the advisor who is helping the client transact.

The following is a list of comments taken from on line web pages, over the last few years, which provides examples of such duality.

BMO Nesbitt Burns

At BMO Nesbitt Burns, our Investment Advisors are committed to gaining a thorough understanding of your financial goals, evolving life circumstances and investment preferences to proactively address your financial interests and stay on top of your wealth management plan. Having trained and qualified according to some of the most comprehensive standards in the Canadian investment industry, they draw upon their extensive experience, expertise and one of Canada's broadest selections of wealth management solutions, in order to ensure you develop a wealth management strategy that's appropriate for you. You'll benefit from their insight as you work together to build a personalized program that is tailored to your financial needs.

Through the combined resources of BMO Nesbitt Burns and BMO Financial Group, our Investment Advisors can work with you to address all your financial needs, including estate planning, insurance and private banking. And as you move through life and your financial circumstances and goals evolve, you can rely on our Investment Advisors to continue to be a valued resource and driving force behind your wealth management plan.

[15] http://www.bmonesbittburns.com/personalinvest/default.asp

To begin with, we rigorously train our Investment Advisors to assure an understanding of available products and services and how to assemble them in planning and developing client portfolios. Our advisors also draw upon the best investment knowledge and market expertise including top-ranked equity research. BMO Nesbitt Burns independent mutual fund research further sets an industry standard for depth and breadth.

RBC Dominion Securities

"Your relationship with us starts with your personal Investment Advisor. A dedicated professional, your Investment Advisor devotes time to fully understand your financial situation, life goals and tolerance for risk when creating a strategy that is right for you…. Develop thoughtful solutions tailored to your objectives, drawing from a wide selection of world-class products and services…… your Investment Advisor is able to provide the solutions you need—today and tomorrow. Working closely with you, your investment Advisor will help you define and achieve your investment objectives with a custom-designed portfolio that reflects your personal objectives".

TD Waterhouse

"TD Waterhouse Private Investment Advice is a premier full-service brokerage ideal for investors who want a one-on-one relationship with a dedicated and professional Investment Advisor. You will receive comprehensive and personalized investment advice while staying involved in the key decisions about your portfolio."

"TD Waterhouse Investment Advisors can give you -

- *Sound financial advice through all life's stages*
- *Personalized advice that reflects you and your family's unique needs and goals*
- *A customized investment and retirement strategy"*

Investment Planning Counsel of Canada

"Our team can help you to create an understandable saving and investing strategy designed to provide a favourable retirement outcome."

Scotia Mcleod

"Partnership Plus - At ScotiaMcLeod, we understand that each investor is unique. We recognize the importance of creating differentiated solutions. We invite you to experience the long-term commitment and access the investment expertise that are the cornerstones of Partnership Plus.

Your ScotiaMcLeod advisor's top priority is gaining a comprehensive understanding of your needs, so that he or she can develop a strategic plan to help you reach your goals."

Wellington West

"Whether you and your family choose to work with one of our full-service investment advisors or one of our financial planners, we will provide a personal, thoughtful and intelligent strategy, delivered by a highly-qualified professional you can trust.

We provide *innovative investment ideas, with a full offering of managed investment solutions as well as expertise on individual security selection including equities, fixed income, currencies, mutual and exchange-traded funds, alternative investments and hedging strategies."*

BMO Nesbitt Burns

"You can trust in our expertise to help you build a wealth management strategy uniquely designed to achieve your wealth management objectives."

CIBC Wood Gundy

"Do you want to go it alone? Or do you want to get expertise on your side to help you devise an investment strategy that can work for you – no matter what you're investing for?"

Canaccord

"…we give our Investment Advisors the freedom to match your investment needs with the most appropriate investment alternatives available in the marketplace.

Canaccord also has a full array of proprietary products and services, any of which may be suited to your wealth management strategy. Our Investment Advisors, however, are under no obligation or pressure to recommend them unless they feel they are appropriate to your financial goals. "

Assante

"Our advisors work closely with the investment management and wealth planning professionals at our sister-company, United Financial Corporation, to deliver customized investment solutions and integrated wealth plans that meet the diverse financial needs and goals of our clients."

Shades of grey in a competitive market place

There will be those clients who can make their own suitability decisions and be responsible for their transactions, but these investors are more likely to transact online than through a more expensive full service broker.

There will be those individuals who can make their own suitability decisions and are capable of making informed decisions with respect to product transactions, but do not wish to spend the time getting know products and who may wish to continue to use the traditional broker for recommending products and securities that match their profiles.

But there is a large area of the market place that needs expert advice and management of a large number of the key components of the suitability decision, but who would continue to operate on an advisory basis. An advisory basis in this context is where the advisor is taking a fiduciary responsibility with respect to the component processes of suitability, with the investor, via communication of the fundamentals, the recommendations and strategy made. The investor is responsible for the decision, but the advisor is responsible for making sure that the processes that lead to the suitability decision are robust, relative to the service promised.

In fact, many discretionary investment services are not what one would consider fiduciary relationships given that the investor is required to accept the risk profile, the asset allocation parameters and the investment discipline as well as costs being recommended. All that is different is that the client only has to make this determination at infrequent intervals: a good discretionary portfolio manager would make sure that the IPS or plan remains in keeping with the client's financial position and risk preferences.

Fewer investors nowadays would want the total fiduciary relationship, where the manager makes all decisions.

Without regulation that acknowledges these different profiles and market segments, the industry is likely to be challenged with respect to innovation and delivery of cost effective and competitive wealth management solutions that more realistically mirror the demands of the market place (consumer needs and capital market

needs). Much higher levels of innovation, automation and integration of education into advisory (as well as discretionary) processes are required.

Narrow framing, KYC parameters and regulation

The narrow framing of the KYC parameters and the limitations of the focus on the transaction poses risks to the management of risk and the delivery of suitable wealth management solutions. These risks include but are not limited to:

- Incorrect risk profiling and unrealistic expectations leading to inappropriate product recommendations
- The accumulation of securities that result in inappropriate asset allocations that may not match client financial needs and risk profiles, which are complex.
- Excessive and unnecessary transactions
- The influence of conflicts of interest that stem from transaction remuneration
- Covert and overt manipulation of KYC to place parameters into advisor's preferred products/transactions and manipulation of range of investment objectives to encourage much higher risk and higher transaction turnover strategies (note aggressive growth options in some new account application forms).
- Solutions that are suitable within the parameters of a KYC may not be suitable in terms of the ability to deliver the premise on which an investment is sold: note the impact of costs on risk and return.

A focus on distribution of the product and those who distribute the product leads to higher costs which in many circumstances invalidate the precepts on which investments are ultimately sold[10]: high costs absorb return and increase risk and allocate capital away from the consumer to product providers and sellers.

Allowing an industry to maintain a transaction based model with low suitability standards, without regulating transparency over those standards is protecting industry interest at the cost of consumer interests.

Narrow framing of regulation, impacts narrow framing of retail financial services solutions, resulting in uncompetitive market for financial advice, sub optimal solutions, high costs and poor value to consumers.

Manipulation of KYC and NAAF

There is a wide range of investment objectives in many New Account Application forms, with the less risk averse and more aggressive options often allowing for aggressive trading and very high risk investments.

Investors risk being pushed into more aggressive allocation profiles without being fully aware of what the profiles actually mean in terms of long term transaction costs, risk and return, and asset allocation.

NAAFs and KYCs do not actually provide risk/return profiles relevant to the stated investment objective: what is the risk profile of the security or strategy that an advisor would consider appropriate for that actual profile and how would it affect the overall risk and return profile of the client's assets? Indeed, once you study the NAAF and KYC, you find them incomplete with respect to the transparency of what the advisor is actually going to do for you. Combine this with little or no feedback on the relative risk and return and relative performance of accounts, and you find that the advisory segment of the industry is open to abuse and

[10] The higher the inducement to sell the more attractive a product is to someone who is remunerated by commission. If this embedded cost cannot be

manipulation at a most fundamental level: regulate the transaction, and ignore the wider service and representations made.

The narrow frame of the current regulatory system is open to abuse and the average investor is not sophisticated enough to negotiate representations made and regulation of the transaction based industry.

Summary

Regulators in Canada appear fixated on the transaction alone while ignoring other representations of advisory based services. Unfortunately regulation and recognition of these services holds the key to the competitive development of the market place.

The Canadian regulation of the retail financial services industry is well behind global best standards and has allowed a regulatory gap to develop between what is being regulated and what is being promised, at the same time protecting an industry that is widely acknowledged as being expensive relative to international standards and one that has been allowed to operate under much lower standards of suitability. This is regulatory failure: failure to regulate the actual market place, failure to protect consumer interests in a wider market place, failure to promote competition (which is restricted by regulation and industry structure), choice and lower costs and an efficient allocation of capital.

NAAF and other issues

Some of those who have reviewed this document commented on the lack of discussion over the weaknesses of the New Account Application Form: if you are looking to provide personalised advice and investment recommendations that match the size and timing of financial needs, risk preferences and existing assets, you need a fact find that records the specifics of an investors financial needs and assets and complete a risk assessment profile that educates the client over the way in which risk preferences impact portfolio structure. Present NAAFs cannot do this, and since the focus of this document is not on the detailed specifics of portfolio construction, a specific focus on the NAAF has not been provided. Suffice to say, if regulation focussed on services providing personalised wealth management solutions, with the advisor responsible for the suitability process, the current NAAF format would be insufficient: you can only provide narrowly framed transaction recommendations with a typical NAAF. Many advisors collect much more information than the NAAF, but they also provide services whose remit exceeds current regulation.

3. Regulatory framework for Point of Sale: International comparisons

Before we look at Point of Sale documents per se and the CSA's Mutual Fund Disclosure document in particular, it is worthwhile looking at the structures in which Point of Sale documents are delivered in other countries.

Australian framework

In Australia the POS documents are supported by an FSG (Financial Services Guide) and an SOA (statement of advice). According to the Australian Securities regulator[1112]:

Statement of Advice ("SOA") is to be prepared by the financial adviser who will provide personal advice. It must contain information about the personal advice so a retail client can make an informed decision about whether to act upon that advice. An SOA includes information such as:

(a) a statement setting out the advice and an explanation of the basis upon which it was given, including a warning if the advice is based on incomplete or inaccurate information;

(b) who has provided the advice;

(c) any remuneration or other benefit that a service provider or an associate may receive in connection with the advice that could influence the service provider;

(d) any other interests of the service provider or an associate that could influence the service provider; and

(e) any associations or relationship between the service provider or an associate and product issuers that could influence the service provider.

According to the Australian regulator, "the two primary goals of the PDS (product disclosure) requirements are to:

(a) help consumers make better decisions; and **(b)** make it easier for consumers to compare financial products.

http://www.asic.gov.au/asic/pdflib.nsf/LookupBFileName/fsr4pds.pdf/$file/fsr4pds.pdf

Based on the above, there are three key differences between Australian and Canadian structures supporting POS disclosure: the existence of a client relationship document (FSG), the existence of what is effectively written communication defining the suitability of the recommendation (SOA), and a point of sale document whose aim is not just to make better decisions but to enhance product comparison.

UK framework, regulation and research

UK regulation of the retail financial services industry differs in many respects from Canadian regulation. There is an altogether higher level of responsibility accorded to advisors in determining suitability of products and securities, and a structured framework and a longer history of doing so: this is supported by a number of excerpts taken from FSA documents which clearly show a different suitability framework than the Canadian parameter to parameter.

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[11] http://www.asic.gov.au/asic/pdflib.nsf/LookupBFileName/fsr4pds.pdf/$file/fsr4pds.pdf

[12] http://www.fido.gov.au/fido/fido.nsf/byheadline/Standards+for+financialblue345i675+services?openDocument

Key facts documents, which apply to most products and not just mutual funds, were introduced in the UK in 1995, and there already exists documentation regarding services provided and relationships as well as a requirement to provide a suitability letter for recommendations made.

United Kingdom Know Your Client requirements are also subject to higher standards than Canada: note excerpts from the FSA document regarding good KYC practises and the FSA Conduct of Business, Chapter 5, Advising and Selling.

> *The adviser taking account of the customer's future goals and aspirations including plans for the future e.g. having children, paying for further education etc. They would then assess the customer's current circumstances including income, expenditure, protection, retirement plans, savings, investments etc. and compare this against what the customer feels they will require over a period of time, e.g. what they want to do in retirement and therefore how much pension income they would require to do this*[13].
>
> *Information collected from a private customer should, at a minimum provide an analysis of a customer's personal and financial circumstances (a) leading to a clear identification of his needs and priorities so that, combined with attitude to risk, a suitable investment can be recommended. In assessing whether a private customer can afford an investment, due regard should be given to that customer's current level of income and expenditure, and any likely future changes to his income and expenditure*[14].

In a parameter to parameter framework future goals and aspirations are not explicitly part of the KYC, neither are detailed income and expenditure information or details on protection, retirement plans, or indeed likely future changes to income and expenditure. It is the advisor that must do the analysis that clearly identifies the needs and priorities.

Note also the following excerpts from FSA enforcement decisions:

> *"Firms must ensure that the products they recommend are suitable for an investor's individual circumstances and that any potentially unsuitable sales are identified. The procedure and controls to achieve this need to be especially rigorous where medium or high risk products are being offered to inexperienced investors."* [15]
>
> *Six files contained insufficient information to establish how the clients' attitude to risk had been reached; In three files, the suitability letters were not adequately tailored to the individual client;*[16]

Within a parameter to parameter framework, individual circumstances are not clearly identified by the broad parameters used. In the Canadian framework it is also not necessary to record how attitude to risk is reached and suitability letters and tailoring are not mandated.

Note the following excerpt from the FSA's March 2010 report, "Investment advice and platforms: Project findings":

> *..failing to consider the overall impact of the charges – product, platform and adviser – and failing to recommend a lower cost solution that would have been suitable for the clients' needs;*
>
> *…firms remain responsible for correctly assessing the client's ATR (attitude to risk) when using a risk profiling tool. Therefore it would be unwise to use risk profiling tools without clarifying and confirming*

[13] FSA document regarding good KYC practises

[14] FSA Conduct of Business, Chapter 5, Advising and Selling

[15] http://www.fsa.gov.uk/Pages/Library/Communication/PR/2003/098.shtml

[16] http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/116.shtml

results with clients…. In some cases the results of the tools did not match the individual clients' circumstances and views and hence unsuitable investments were recommended… We found several cases where the risk profiling tool appeared to over-rate the client's ATR on the basis of their answers to the questions. This has given us cause for concern about these tools more generally and we intend to undertake further work on this. In the meantime we recommend advisers, when using risk profiling tools, use the results as a basis for discussion with the client to ensure the correct ATR is recorded, rather than viewing the results as a definitive assessment.

inappropriate use of model portfolios held on platforms; for example, failing to adapt portfolios suitably for individual client circumstances.

The client lost benefits (including guarantees) or incurred a financial loss because their adviser recommended a new investment to replace an existing one with no good reason to incur the loss. This includes additional costs going forward.

We expect advisers to review existing investments in the light of the client's circumstances, needs and objectives and to recommend a switch only when it is in the client's best interests. This review should include (but not be limited to) the investments' charges (including surrender penalties), performance, benefits and options.

…failing to demonstrate suitability in many cases by not undertaking any research into existing investments….

We expect firms to ensure their advisers are competent to provide the advice and services they offer, and to demonstrate good standards of ethical behaviour.

Consideration of charges (costs of the product) are not part of the suitability process in Canada. In the UK, firm's are responsible for assessing risk profiles and discussing them with clients, not merely recording them; even model portfolios must be suitable for individual clients and adapted if need be. Within a basic parameter to parameter framework, transactions do not have to be in the client's best interests, nor does a review of a transaction have to consider the wider factors noted above. Indeed, in the parameter to parameter Canadian transaction model, the implication is that the client initiates the request, whereas in the UK it is acknowledged that advisors initiate many requests.

Note the following from the FSA's "new conduct regulation strategy[17]":

It signals the end of 'reactive regulation' where, historically, the FSA waited for clear evidence that a product had been mis-sold and consumers harmed before it took action and relied principally on risk disclosure information at the point of sale to avoid mis-selling occurring.

The UK regulators are looking to pre-empt bad practices and by doing so are attempting to stand between the consumer and harm whereas Canadian regulators appear to be standing behind the industry.

Note the following comments made in the FSA's Distribution of retail investments: Delivering the RDR (Retail Distribution Review) consultation paper:

We are proposing changes to make it easier for consumers to distinguish between the different forms of advice on offer to them……Our rules and guidance will ensure that firms that describe their advice as independent genuinely do make their recommendations based on comprehensive and fair analysis, and provide unbiased, unrestricted advice.18

[17] http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/044.shtml

[18] http://www.fsa.gov.uk/pubs/cp/cp09_18.pdf

We plan to raise the minimum level of qualification for investment advisers, and to institute an overarching Code of Ethics and enhanced standards for continuing professional development.

*….firms that provide independent **investment advice** to retail clients will be expected to consider more than just packaged products for their clients.*

One of the challenges for independent advisers will be to ensure they have sufficient knowledge of all of the types of products which could give a suitable outcome for their clients. The rules do not mean that we expect to see all advisers recommending products such as structured investment products, for example, as a matter of course. But, we would expect that if a structured investment product would best meet the client's needs and risk profile, then an independent adviser should have sufficient knowledge of these products to be able to recognise this and make a recommendation to buy this product.

We are aware that few independent firms constrain themselves to looking at packaged products only…..

However, to the extent that ETFs can be a cheap and transparent way to invest in a particular market, even under our current whole of market requirement, these products should be considered when deciding which products are suitable for a retail client.

***Simplified advice processes (advised guided sales):** Simplified advice processes are streamlined advice processes that provide the consumer with a suitable personal recommendation based on an assessment of their needs. Simplified advice processes are regulated as advice under our current rules. The concept of 'guided sales' was originally introduced in the April 2008 Retail Distribution Review – Interim Report, where it was described as an information providing non-advised process. Its purpose was to allow consumers to make simple, straightforward choices. However, it became clear that it would be difficult to develop a commercially viable non-advised guided sales model. The general view of the industry is that without either an explicit or an implicit personal recommendation there will be insufficient take-up of products to make the process commercially viable – and the inclusion of a personal recommendation means it constitutes advice.*

With Basic Advice, the consumer is asked some pre-scripted questions about their income, savings and other circumstances to identify the consumer's financial priorities and suitability for a stakeholder product, but a full assessment of their needs is not conducted nor is advice offered on whether a non-stakeholder product may be more suitable. While many consumers choose to buy investment products on an advised basis, consumers can also buy investment products through non-advised services, commonly referred to as execution-only services. Execution-only services do not provide the consumer with advice or a recommendation to buy a product; instead, they allow the consumer to purchase a product that the consumer has chosen

The FSA clearly include "comprehensive and fair analysis" as part of the advisory spectrum they regulate and demand that firms providing (independent) advice provide more than just packaged products, and, indeed, they must be able to assess the universe of products. The Canadian parameter to parameter framework is close to what the UK regulators term "Basic Advice", where some "pre scripted questions about income, savings and other circumstances" are used to identify a suitable stakeholder product. It is difficult to believe Canadian regulators when they say they are meeting best global standards, as stated in the recent CSA staff notice on the POS disclosure project.

In a 2006 report by the FSA, *Quality of advice process in firms offering financial advice: findings of mystery shopping research – August 2006* - http://www.fsa.gov.uk/pubs/consumer-research/crpr52.pdf

Where advisers did not sufficiently assess customer needs, for example by failing to adequately establish their customer's attitude to risk or to explain the implications of limiting their advice to the customer's objectives, the advice process was deemed to be inadequate.

This is because an inadequate assessment of client needs poses a significant risk to the provision of a suitable recommendation.

Attitude to risk was not explained to the customer and the adviser just stated it was measured on a scale of 1-10 and that the customer was probably 'about half way'. Since the customer's attitude to risk was not adequately established the adviser could not be sure that the recommendation had met it; therefore the recommendation may not have been suitable.

***Good practise:** Adviser **K** asked the customer if she wanted a full financial review or to limit advice to a particular objective. The customer decided to have advice solely in relation to her investment objective. The adviser proceeded to do a full fact-find (covering areas such as pension provision, protection and mortgage) and made it clear to the customer that the advice was limited to investments but that shortfalls had been identified in other areas, which were explained. The customer was advised to revisit these areas as soon as it was practical and affordable. Therefore, even though the advice was limited to investments, the adviser still examined other areas of financial planning for the customer to make her aware of further needs and collected information that enabled a well-informed suitable recommendation for the customer's investment objective.*

***Good practise:** Adviser **L** asked the customer to explain his requirements, which were to invest a lump sum of money for retirement planning. The adviser proceeded to obtain KYC information on all areas of financial planning. After completion of the KYC process the adviser recommended that income protection should be a priority for this customer. The adviser confirmed the customer's objectives prior to making the recommendation enabling the customer to reconsider his priorities and come to an informed decision as to how to proceed. The adviser was able to identify other areas of need (deemed to be a higher priority) which may otherwise have been overlooked if the advice process was limited to one particular objective.*

Bad practise**: The adviser's KYC questioning and recommendations **concentrated solely on the investment of the customer's £50,00**0. The fact-find did cover other areas including protection and pensions provision but in no depth. …….The lack of pension provision and income protection was not investigated nor addressed. The fact-finding and KYC process were inadequately conducted as the adviser appeared only to want to investigate what he could do with the shopper's £50,000 in investment terms. **The weak fact-finding process meant that KYC information was limited to the areas that the adviser wished to discuss.** And although the adviser was purporting to offer this service to the customer, the lack of holistic financial planning appeared to leave the customer with an inaccurate picture of his financial status and needs**.

At the initial stages of the discussion establishing attitude to risk, the customer stated that they were risk averse and did not want to lose any money. Adviser O stated "if you want a better return you need to look at slightly higher risk". After discussions they agreed on a 'modest' attitude to risk (defined by the adviser as 'low to medium'). However, the adviser stated in the suitability letter that the customer's attitude to risk was 'medium'. The adviser did not seem to accept the true risk profile of the customer and persuaded him to increase it and the final attitude to risk recorded by the adviser was not consistent with discussions with the customer.

***Firm's KYC procedures and methodology should be robust enough to identify the most suitable recommendation for their customers and to eliminate the risk of not understanding or omitting to consider all factors relevant to an individual.** Either of these could result in the customer receiving a recommendation inconsistent with his true risk profile which would be unsuitable*

***Good practise:** The customer had a lump sum to invest and an outstanding mortgage. Adviser **R** explained that if the customer was going to use the money to invest the return would have to be greater than the mortgage interest to make it worthwhile and that this would involve some degree of risk. The adviser established that the customer had a cautious attitude to risk so the he recommended paying the lump sum towards the mortgage rather than investing it, and using the money saved from the monthly mortgage payment for investment. This advice seemed to be in the*

best interest of the customer and in line with customer's cautious attitude to risk. This also demonstrated that the advice was not driven by commission, or limited to one area of financial planning.

Bad practise: *The risks and benefits of the recommendation were explained to the shopper in such a way as to lead the shopper into the investment.*

To paraphrase: ***failing to adequately explain risk or of limiting advice to investment objectives leads to an inadequate advice process which leads to the significant risk of an unsuitable investment***. This sounds like a critical assessment of Canadian minimum industry standards. Comments noted in the bad advice sections could easily be applied to Canadian parameter to parameter regulatory standards, while good advice clearly show the importance of the advisor in the process and the responsibility of the advisor for determining suitability.

Regulatory Objectives POS

In Canada Point of Sale disclosure is "aimed at providing investors with more meaningful and effective disclosure"[19], but as discussed, this is shrouded in the very limited transaction based industry framework and narrow regulatory frame of reference.

Note the following obtuse comment by the OSC in their most recent statement of priorities which suggests that consumers are the driver behind the transaction: "investor demands and needs differ depending on whether an investor is researching potential investments, executing an investment transaction or protecting security holder rights once an investment has been made[20]. There is no mention of investors actually seeking advice and the need for them to be able to rely on the advice provided by advisors, because technically speaking advice that does not relate specifically to the product is not regulated and therefore enforcing the integrity of such advice is not part of its mandate.

The UK FSA objectives for point of sale disclosure are much clearer and more pointedly directed towards investor protection and competition in the market place as noted in its 1999 report, Comparative information for financial services

Our policy objectives for a Comparative Information Scheme are therefore as follows:

- *….help to address the information imbalance which exists within the financial services market by providing information which will enable consumers to shop around more effectively and make better informed decisions; and*
- *…..that the provision of comparative information should seek to encourage a more competitive financial services market which, in turn, will benefit all consumers.*

According to economic theory, the participation of informed advisers in the market should be an efficient outcome. They can charge consumers for providing advice and acting as informed and impartial agents on their behalf ***– it is cheaper for consumers to buy the services of an expert than it is for them to learn about the financial markets themselves.***

*But where advisers are remunerated through commission payments, their direct incentive may be to maximise their receipt of commission. And since it is still difficult for consumers to see whether or not they have been****…..even knowing the charges and product characteristics of what is on offer does not allow consumers to have much idea whether a product's charges are high or low, or***

[19] http://www.osc.gov.on.ca/documents/en/Securities-Category8/csa_20100618_81-319_status-pos.pdf

[20] http://www.osc.gov.on.ca/documents/en/Publications/sop_fiscal_2010-2011.pdf

characteristics good or bad, because they have nothing with which to compare them.

This imbalance, or asymmetry, of information between provider and consumer can prevent a market from functioning effectively. In any ordinary market if a provider drops the price of his product below that of his competitors, his sales will increase. But in a market where consumers are unable to compare prices, the normal competitive process is impeded. Providers might have little or no incentive to provide low cost or high quality products because consumers would not be able to identify what was good or cheap.

Financial services firms compete hard on distribution, brand awareness and loyalty, relying on the fact that there is little incentive to compete on price or quality because consumers are not in a position to judge these. [21]

"It is cheaper for consumers to buy the services of an expert: you are not paying for the transaction, but for the advice. "..even knowing the charges and product characteristics.." argues that the simple POS document being prepared by the CSA is not going to help unless advisors provide them with comparable information. High charges in the Canadian market place for products are reflective of the fact that those who distribute products are more important than the clients, and industry structure and regulation support this.

Also from the "Proposed product specifications for Sandler "stakeholder" products: consultation" – February 2003 -.

"But deep-seated continuing problems need to be recognised. Information asymmetries, with the provider knowing a great deal more than the consumer, are still pervasive. This means consumers find it hard to act in the market. As a result they don't send out clear signals to providers about their needs. A consequence of this is that competition in the market is often for distribution rather than consumers. The destructive legacy of mis-selling, again a consequence of a market in which the provider knows far more than the consumer, continues to impact negatively on the market. And though the sector serves those with high-income levels relatively well, the needs of those on lower incomes are less well met.

Since 1997, the Government and the regulator have taken a number of measures to address these problems using four tools: regulation, stimulating competition, providing information, and promoting consumer education.

In the UK the support and rationale for disclosure initiatives are clearly in favour of addressing imbalances in industry structure and operation that work against consumer choice and price competition. There is no such pointed and clear communication in Canada.

Product comparison

The use, definition and content of a POS document also depend on how it is to be used: where a consumer may be faced with a number of product choices (note that in the UK consumers can buy direct from the company), the POS should be a document that allows them to compare different products. The following is taken from How consumers use Key Features: a synthesis of research on the use of product information at the point of sale – November 2000.

- *"The FSA has found that consumers lack the necessary information and understanding to behave as active and discerning purchasers in two main areas.*

- *First, many are confused by the range of products on offer and do not understand which sort of product might be most appropriate for their needs.*

[21] http://www.fsa.gov.uk/pubs/cp/cp28.pdf

- *Second, consumers lack clear, meaningful information on the key characteristics of products of a particular type so that, once they have decided what sort of product they need, they can take better informed decisions about which particular one might offer them the best deal (FSA, 1999)."*

- *In the UK point of sale disclosure was introduced "to provide consumers with key information which could be used to compare products, thus enhancing competition and encouraging price competition".*

- *"The research provides only limited evidence on the incidence of shopping around. Nevertheless, it does suggest that, typically, consumers do not shop around and this is an extremely important factor which limits the effectiveness of KFDs in financial decision-making. There is little evidence to suggest that consumers use KFDs to choose a provider and consumers often only see one KFD for each product. The documents, therefore, have* ***a limited role in helping consumers compare products and make informed financial decisions****…The few consumers who do shop around comprise a minority of those consumers who go directly to a provider."*

It is interesting to note that the above report states that without the ability to provide effective product comparison, Point of Sale disclosure has a "limited role" in helping consumers "make informed financial decisions". If the advisor is making a product recommendation based on KYC parameters, the consumer is only going to be able to make an informed decision if they request a number of different similar products with different cost, performance and other characteristics. Only then can they compare products, a key stage in making an informed decision. Unfortunately, individuals who view their advisors as providing advice and recommendations are unlikely to do so and advisors who rely on commission may limit the choices provided to clients to higher remuneration products. Ergo, in Canada, POS disclosure is unlikely to lead to better more informed choice.

Key points Canada/UK comparison

The Canadian/UK comparison is interesting because of the large body of research carried out by the UK FSA and the transparency of UK regulatory communication.

The main differences as far as Point of Sale disclosure is concerned, is that such disclosure has been mandated for 15 years in the UK and a more robust regulatory framework exists to support POS documentation – mandatory suitability letters and disclosure of service, client advisor relationships and costs support the point of sale disclosure.

Also of importance is the fact that suitability requirements are much stronger in the UK: the Canadian KYC is much more like the basic guided sales process discussed in the FSA's Distribution of retail investments: Delivering the RDR and Canadian minimum standards for transaction business would be considered bad practise in the UK if you refer to the FSA report, *Quality of advice process in firms offering financial advice: findings of mystery shopping research – August 2006*.

The above is important given that many communications from Canadian regulators state how they are competitive with global regulatory standard, when in fact they are in many instances decades behind such best practices.

US disclosure and proposed changes to regulatory framework

"The mutual fund industry portrays fund investors as diligent, fairly sophisticated, and guided by professional financial advisors. The SEC paints a more cautious portrait of fund investors, though touts improved disclosure by the fund industry as a sufficient antidote. However, an extensive academic literature finds that fund investors are unaware of the basics of their funds, pay insufficient attention to fund costs, and chase past performance despite little evidence that high past fund returns predict future returns. These findings

suggest that policymakers should rethink current regulatory policy. Disclosure may not be enough[22]*.* From "**Mutual fund investors: sharp enough?", Palmiter and Taha, the Capco Institute.**

US regulation most closely mirrors Canadian regulation: different standards apply to broker dealers than registered investment advisors (IIROC refers to registered investment advisors in one of their documents): broker dealers are only required to provide suitable recommendations while RIAs are held to a higher fiduciary standard; broker dealers are regulated by FINRA while RIAs are regulated by the SEC (depending on assets under management).

A common complaint by those who advocate better standards in the US is that both branches of the investment provider landscape (broker and RIS) essentially provide the same services, yet one is regulated according to much lower standards than the other. A recent US survey[23], based on the sample questioned, found that the majority of individuals questioned were not aware that different standards applied to broker dealers: "76 percent of investors are wrong in believing that "financial advisors" –a term used by brokerage firms to describe their salespeople --are held to a fiduciary duty."

The US has also been involved in developing better mutual fund disclosure and has only recently started to implement summary prospectus disclosure. What is different from Canada is that the US is now seriously addressing higher standards regarding duty of care for broker dealers, which might entail introducing a fiduciary like duty of care. The US market is also much more competitive and US consumers can buy mutual funds direct at a fraction of the cost that Canadian investors are able to. However, just like Canada, regulation of broker dealers is the responsibility of an SRO and unlike authorities such as the UK's FSA, there is a dearth of objective consumer orientated research.

It is likely that Canada's slow pace of regulatory change with respect to investor protection has been helped by similar US standards, but Canadian regulators clearly now look to be lagging pretty much ever regulator of note.

[22] http://www.capco.com/files/pdf/684/02_Management/04_Mutual%20fund%20investors,%20sharp%20enough.pdf

[23] http://www.hastingsgroup.com/fiduciarysurvey/docs/091510%20Fiduciary%20survey%20report%20FINAL2.pdf

4. Point of sale analysis

A point of sale analysis would appear to have the following main objectives.

- Every investor needs to understand the products being recommended: the POS document needs to be simple enough to be understood by the vast majority of investors.
- To provide information about key risks and characteristics that might be relevant as to whether the product is suitable and to which the consumer can use to better understand an advisor's recommendation.
- To provide information on features and costs that would allow consumers to shop around: research suggests that investors, with the exception of sophisticated investors, do not do this.
- To mitigate the risks associated with market failure in the sales process and to be the regulator's presence at the point of sale.

Regulatory impact and regulation

In order to understand the regulatory impact and to effectively apply and monitor point of sale disclosure, you need to be clear about the advice/transaction process and regulation of that process. You also need to understand the importance of suitability in that process and who is responsible for the components of the process.

One country's regulation and process and accountability for the components of the process may be different from another. Merely focusing on the point of sale disclosure without understanding the business model and regulatory model differences will result in erroneous conclusions being drawn about shape, form and application of POS conclusions from different locations: case in point, Canadian regulation and Canadian implementation of POS documentation.

Informed decision and responsibility for the decision

There is much to be said for key information being provided to the consumer about risk, risk profiling, the suitability process and the portfolio construction planning and management process, and key facts about the investments used, but there is little to be said for providing any one piece of information in isolation of the other.

The best investment decision is one based on all the factors that impact the portfolio construction planning and management process; this is where, for most investors, the expertise of the financial services industry should come in. But, it is debatable whether product key features/key facts documents, on their own, - whether these are mandated pre or at the point of sale – can actually help the consumer make an informed decision about the overall integrity of the recommendation itself, given that the integrity of the recommendation is dependent on the integrity of each of the components of the process.

It is possible that isolated key features documents lead to less informed decisions, or confusion as to who is actually making or is responsible for the decision (if the regulators are not clear as to the regulatory intent of the document for both parties), or indeed as to what constitutes an effective process for determining an optimal solution.

The work of Dr Daniel Kahneman, with respect to Prospect Theory and narrow framing, is clear in this regard: narrow framing is where an isolated decision is based on a small set of facts and results in sub optimal decisions. The regulatory bodies are also to a large degree narrow framing with respect to their limited regulation of the transaction and product lines. Keeping the industry within a transaction comfort zone is not going to enhance wealth management efficiency!

There is no doubt that consumers need to be informed in order to decide, and to be responsible for that decision. But to what extent they need to understand, and as to what they are responsible for, are clearly important issues. Canadian regulators seem to want to mandate key facts about a product but not key facts about the service and suitability process and regulation of that process, which, surely, are just as important.

- The more the consumer is responsible for validating the integrity of the suitability process and for making decisions with respect to each component of the suitability process, the far greater the information required about the security/product.

- The more someone else (advice based process or transaction with high suitability standards) is responsible for the selection and the process, the less information about a specific recommendation an individual needs, but the more information that is needed about the process and its rationale.

In order for the consumer to make an informed decision in an advice based system - where the advisor is responsible for the integrity of the suitability process - they need to understand the basic parameters of the service being offered, the fundamentals of the investment discipline, the asset allocation, risk/return and asset liability reasons for the recommendation, as well as access to the basics of the investments being recommended. It is therefore the responsibility of the advisor, and the firm, to make sure that the processes used to determine suitability are effective and appropriate to the service offered, and that information regarding these is communicated to the client.

Consumers informed of regulatory and business model

It is important for regulators to communicate to the consumer just what business model is being regulated and the responsibility they the consumer have towards the investment decision (product and suitability).

It is clear that different international regulators have different views and objectives with regard to this. If investors are not clear as to what service they are receiving and the protection they are being accorded, then they will not be able to make an informed decision about the service and protection they want. Better services, more efficient processes, better wealth management and regulation of such would be the consequences of greater transparency in this area. “I want someone who knows what they are doing to take responsibility for the processes that provide the recommendations and risks I have to accept…”:

There is a large element of “the regulators and industry know what is best for the consumer”, which is akin to taking a fiduciary position with regard to the choices individual investors are faced with. In this context, is the POS really about choice, or has it more to do with maintaining, or fully establishing the position of the consumer within the transaction based industry? It could be that regulators currently view regulation of the transaction based industry as being ineffectual because the consumer lacks the product disclosure necessary to establish their investment decision. This is a competing school of thought to that laid out in the FDM concept paper.

One could be forgiven for thinking that the regulation of the last seven years has been one focused on protecting the transaction industry from the type of change that the FDM would have brought into play. In other words, this may not be a vision of investor protection, at all. The FDM and current ideology are actually totally opposite visions of the future: the one evolutionary, the other reactionary.

Suitability process

There are three components to an effective suitability process:

- **The risk profiling, fact finding and educational requirement components of the process**; which vary in accordance with the sophistication of the process and the standards employed. Risk profiling and the education of the basics of investment will provide the background to the generic risks of the investment being recommended and allow the client to relate to the risk ratings of the product being recommended. The more detail, the more likely the solution will match the risk profile and needs of

the client and fit with their existing investments. The less detail, the greater the risk that recommendations will not be personally suitable.

In a minimum standard transaction based process, the risk profiling collapses to recording of client risk preferences, and fact finding to recording basic parameters such as income and net wealth and time frame and education has no role.

- **The suitability component of the process: portfolio construction, planning and management**. Backed by a written explanation of suitability and the processes and disciplines used, the investor will have the reasons for why the investment is suitable: time frame, financial needs, risk preferences, existing asset allocation and an explanation of how the investment fits in with the portfolio. This component also requires disclosure over the service and the client advisor relationship.

  In a minimum standard transaction based process, the suitability component looks only to fit the transaction to parameters selected in a) and does not consider overall suitability.

- **The demands of due diligence with regard to security and product research and selection**: if you are providing advice (and effectively management) with respect to all an investor's assets, fund/product/security selection would be focussed on ensuring the asset meets a specific role within the portfolio. The role of the asset would be passed in written or verbal communication with guidance directing the investor to further sources of information that will help them understand the investment.

  In a minimum standard transaction based process, with no requirement to look at the overall suitability of the transaction, with limited training and expertise required to sell, with no requirement to offer the lowest cost option, the most appropriate option, and often restricted to product lines, due diligence with respect to product research and optimal security selection would not be as thorough and would have different objectives. You only need to know your product.

In an advice based system the advisor and firm have responsibility for all three components: failure to disclose these components of the process will limit the effectiveness of the decision made by the investor. In the Canadian transaction based system, the investor, more or less, would appear to have responsibility for all three components and the advisor for making sure their recommendations fit the consumer profile as defined by the KYC parameters.

As discussed in fundamentals, responsibility for the suitability process effectively shifts to the consumer in a transaction based process with low suitability standards and a limited number of KYC parameters, given that it is they who are assumed to have provided the suitability parameters and initiated the transaction request. In this case, outside of an appropriate suitability process, the focus of the Point of Sale disclosure on the lowest common denominator (a set of limited the key facts of the investment) limits the effectiveness of the communication on which the client must make their decision. Only part of the picture is being provided! The decision to show only part of the picture is partly the regulators and partly the service or transaction provider.

In an effective advice based suitability process, by the time the client gets to the POS, he or she should have gone through in greater depth the factors communicated in the POS. There should therefore threads relating the POS to the suitability process and service provided by a firm and advisor.

Therefore, in an advice based process, all the POS should be doing is to check*, "do you understand the main characteristics of the investment";* the reasons as to why "*we consider it suitable and why you accept that these reasons are clear and sufficient are dealt with separately*." Note that under the Canadian transaction based system there is no clearly recorded advisor sign off (apart from the transaction) with respect to the suitability process itself: there is no mandated suitability letter (UK) or statement of advice (Australia).

Clearly, a POS document designed for an advice based suitability system should be different from that for a transaction based system with low suitability requirements.

It is the view of this report, that the POS document, based on its limitations (discussed in section 5), cannot be expected to provide sufficient information for the consumer to conduct due diligence on their own, to make their own suitability assessment of the investment or ultimately to make a purchase decision. All it can provide are a number of key generic facts that must relate to parameters recorded by the advisor in the KYC. Such a process, when consumers believe they are receiving advice, is absurd.

Simple POS documents are therefore dependent on the substance of an advice based process, or a transaction process founded on higher suitability standards, for its effectiveness. Canadian regulators have adopted the recommendations of international regulators without adjusting for their own differing regulatory structure. Why there is no analysis of this is unclear.

Where due process has been followed with respect to an advice based suitability process (or transaction based with higher suitability standards), where the client can relate the key facts in the POS to other detail and communication (and if not, to loop back to that detail with the help of the advisor), and where the key facts do not misrepresent the true nature of the investment, the investor can ultimately take responsibility for accepting the transaction, but only as long as the integrity of the underlying process remains intact.

Place within the suitability process

A POS document is not a complete process in itself: it only provides summary information on key facts/characteristics of an investment. As it (the POS) is not a complete process in itself, then on its own it cannot be used to support or justify an investment recommendation by an advisor or a decision by an investor.

In an advice based process, or a transaction process with high suitability standards, the other components of the decision process should have been communicated. In a transaction model with low suitability standards, where the consumer is deemed to have initiated the transaction based request, the consumer is responsible for the suitability process (defining the parameters).

Unfortunately, most consumers do not possess the expertise needed to take responsibility for the suitability process, which is why, one would assume, many international regulators place a much higher level of responsibility for the suitability of the transaction on the advisor/salesperson in advisory relationships.

So, just what is a POS document, what is it intended to do, why does it exist, what are its limitations? The answer is really it depends: it depends on the regulatory regime, the structures' (regulatory and business models) supporting regulation, and it depends on the suitability process used by the advisor.

Interpreting the intended meaning of POS documentation with respect to suitability is often difficult in any particular jurisdiction, especially when there is little direct explanation as to the place of POS documentation within the complete suitability process itself (particularly in Canadian documentation).

In the UK, suitability standards are much higher (see section 3), and disclosure is required with respect to service and the advisor's reasons as to why the product is suitable. The POS is just another part of the regulation of the transaction process. In the UK, the POS document would be invalid without the suitability letter.

From "***Informing consumers: product disclosure at the point of sale" – FSA Consultation Paper 170 - February 2003***

- One of the key problems in the current regime is the fact that consumers do not read the KFDs (Key Facts Documents) they are given. ***Many rely on what the are told by advisers***, or they confuse the KFD with marketing material and dismiss it.

- …***a significant aspect of making an informed choice is understanding what factors influence the suitability of a product. This issue is also central to our design of the new regime***.

- The new rules make clear that we ***do not expect the new document to include all possible information about a product (whether in terms of subject matter in some cases or level of detail in others) that a***

***firm should disclose to consumers*.**

- So firms should not develop the key facts document content beyond a moderate, consumer-orientated level of detail about the issues. Where necessary, they should signpost where more can be found on topics not covered in the key facts text.

- So we intend to ***continue to require the delivery of a suitability letter***, but will give guidance to the effect that it should be provided as soon as possible after the recommendation. But we have added to the required content to give consumers ***a wider understanding of the factors that may have influenced a recommendation***.

- (Product disclosure) it represents the final opportunity in the sales process for us to ***help*** consumers understand precisely what it is they are committing to.

The first point confirms that the objective of the POS document is to provide information separate to that provided by advisors and separate to that provided by marketing materials (it lies outside the sale's process). The second point confirms that the POS document should deal with factors that affect suitability, which presumably should relate to the points made in the suitability letter, which is not supplanted by a POS document (5th point). Finally, the POS document is the last opportunity in the sales process to help consumers understand what they are committing to, which is an admission of the existence of market failure.

Market failure – informational asymmetry, price discovery, choice

Point of Sale documents appear, internationally, to be driven by a goal to enhance investor protection and market competition by addressing informational asymmetry in financial decisions and aiding informed choice amongst different products - the divergence between a Canadian system determined to protect the transaction and international systems determined to prise dependence of the transaction away from the process is striking.

Informational asymmetry relates to 3 areas:

- Key facts about an investment, that may not be communicated by the advisor and which the consumer might benefit from knowing.

- The suitability of an investment to an investor's risk profile, existing assets and financial needs, which the advisor may have incorrectly assessed.

- The features of the product, including costs, which may make it more or less desirable than other similar products.

In other words their aim is to address market failure, primarily in transaction business models in key areas:

- Investors may not read or understand the mutual fund prospectuses and even in the UK, the longer key fact documents (introduced in 1995/1997) are not being read as intended.

- Advisors in a transaction model may fail to communicate key product features that would help consumers make better and more informed choices.

- Advisors may recommend products that might not be suitable.

If the objective is to aid price discovery and comparative assessment of performance and or product features then a point of sale disclosure document needs to provide the information that would allow comparison. If the objective is to mitigate the sale of unsuitable investments, then attention also needs to be focused on the suitability process and accountability and responsibility within that process.

Will POS disclosure on its own enhance product understanding, investor protection and market efficiency? In the UK and Australia research has effectively said no.

If the objective is merely to provide a limited set of information "to make informed decisions", without the goal of improving market efficiency (lower costs and more competition), and there is minimal regulation of suitability and representation of other advisor/client communications, then just how will POS disclosure aid investor protection and help investors make informed decisions.

If market failure is not addressed, then this must also be a regulatory failure.

POS – a communication outside of a suitability process

The Point of Sale document is a regulatory mandated communication between a product provider and the client and not a communication between the client and the advisor. As such it really lies outside the suitability process and therefore cannot be confirmation, on its own, of the suitability of the recommendation.

POS as a sign-off

What a POS document means depends on the regulatory structure and business model and how effective it will be in terms of protecting investors will depend to a large extent on other regulatory measures.

- In a transaction model with low regulated suitability standards, where the investor is deemed responsible for the investment decision, where the parameters of the KYC determine suitability, where there exist no other disclosure documents, where the advisor has a limited role in defining the parameters of the KYC (not always the case), the POS could be considered a consumer sign off to the suitability/transaction process.

- In advice based regulation and business models, the POS documentation is a final chance for the investor (not the regulator) to mitigate the risk of market failure with respect to suitability and comparability, but it does not represent accountability for the suitability process: the integrity of the suitability process underpinning the advisory model is where the accountability lies.

- Even in a transaction model with higher suitability standards (note the UK model), the POS disclosure would appear to be the last point at which the regulators can help the consumer make an informed decision; but the emphasis is on the word help; the suitability letter and other disclosure remain important components of the entire process. Again, while the POS may be the end point of the process, it is not a sign off to the entire process itself; there are numerous other sign offs.

There is a very big risk, in Canada, that the POS document will be interpreted by regulators (compliance departments and SROs[24]) as a sign-off to the entire suitability process. Regulators have not clarified the regulatory intent of the POS disclosure document within this context, but then again they are also unwilling to make the true nature of the advisory relationship known to the public.

As a sign off to the suitability and transaction process, the current POS in a transaction based model with low suitability standards (consumer effectively responsibility for suitability), poses a grave risk to investor protection and market competition.

There are only two situations in which the POS document could be considered a sign off to the suitability and transaction process.

[24] And to a lesser extent organisations like OBSI which are outside the regulatory process and may be able to bring wider contractual context into the assessment of suitability.

- An optimal outcome: where the consumer is not reliant on an external suitability process; in this context the POS document (which would need to be more detailed than that proposed) would provide the information required to integrate the recommendation into the investor's portfolio.

  Most investors lack the skills to conduct their own suitability process even if there were sufficient information to make an informed investment decision within the POS itself.

- A sub optimal outcome: where the consumer is reliant on an external suitability process, but it is made known that the sales person is only providing a recommendation within a very narrow suitability process, that the service is the transaction and not advice relating to the transaction to their overall financial position or of providing advice for the management of that asset over time and that the POS document only provides a summary of key facts and not all the information an investor may need to make an investment decision.

With regard to the latter situation, the salesperson would need to communicate (and underline) the importance of the document; they would also need to point out the relationship between the KYC parameters and the suitability parameters noted in the POS document.

The sales person would also need to disclose that they are remunerated by product transactions and that this is the cost of the service, but that if the client wished to avoid these costs they would need to buy from other available services. Salespersons are unlikely to choose lower cost products with lower levels of remuneration: it is up to the investor to decide whether or not they want to pay for the service. Without this information, the investor would not be making an informed decision about the product transaction/recommendation. Unless the advisor communicates the option with respect to choice of transaction route, the consumer is also restricted in terms of making an informed decision: note that the UK FSA considers the ability to compare key facts, such as costs, key to the intended outcome of POS disclosure.

In other words, only in a pure transaction based service process, where the consumer initiates the transaction, where the sales person records the KYC parameters and recommends a suitable transaction, could the POS document even be considered a sign off. As soon as advice starts to click in, other areas of responsibility which require a sign off start to enter the equation.

Without disclosure of the nature and limitations of a transaction based service, where the advisor does not provide advice outside the transaction, the POS document cannot be considered a sign off or proof that the investor has accepted responsibility.

Transparency of regulatory intent

Why should we be concerned about the regulatory intent of POS disclosure?

The industry often uses the mere signing of a client account agreement (*which is no more than a very limited information gathering and account opening exercise*) to support security selection and strategy. Of course, if the transaction is investor initiated and all parameters are likewise (as well as appropriate[25]), this is a valid action. But, not all relationships (indeed the vast majority) are not of this nature, nor are they represented as such with the transparency would be required to enforce the regulated contract.

Since the key facts document is information specific to the transaction pursuant to a client account agreement or KYC, it is only logical to assume that these documents will likewise be used to enforce an "explicit" acceptance of recommendations made.

[25] Appropriate: in this sense means that the risk profile and objectives are realistic and informed; a process that does not have a responsibility to educate and to assess what is actually in the client's best interests will result in inappropriate outcomes where naivity and ignorance and inexperience (as well as trust) might drive the framing of the parameters.

But just where is the focus on suitability in all this? As discussed, the advisor is not responsible for providing advice, nor is he or she responsible for determining the set of appropriate parameters driving suitability, nor are they responsible for the process that aligns a transaction to the overall personal financial position of the client. Again, as discussed, at the most basic level, it is assumed (effectively) that the client determines the parameters (objectives, risk profile, time horizon, risk profile) and the client accepts the transaction (POS document) and integrates the transaction. As discussed, within this simple suitability process, there is ample room for manipulation

Suitability is a cornerstone of the wealth management industry, but it is a corner that is consistently being cut in the interests of the transaction. The key fund facts documentation is in truth a transaction driven imperative, and not an advice driven imperative, that could be used to reinforce the client's responsibility for the transaction decision[26], as opposed to what should be the institution's responsibility for instituting processes and standards that deliver suitable investment solutions. Where is the regulation that focuses on this issue, where are the CSA/OSC communications and pledges with respect to this?

There are many references to strategy in marketing communications, yet a "key facts" for the suitability of the strategy is non existent! A strategy (defined by the interaction of a suitability process with a firm's investment discipline) is a higher level recommendation that precedes and supports individual recommendations whose sum (funds and other securities) is of far greater importance than the individual parts. Without a transparent and communicated suitability process, the POS will be meaningless to the average investor.

Education and the limitations of POS documentation

Education is one of the most important ways in which the investor can learn about the fundamentals of investment to better understand their own risk preferences, and then use this to relate to the fundamentals of an advisor's investment planning and investment disciplines. It therefore allows them to better understand the options and recommendations (not necessarily to derive them themselves) provided and to accept one they consider best meets their needs and risk preferences. It should therefore be clear that point of sale documentation is not an educational document and should not displace education.

A key fact or key feature document is not an educational document and may only deal with basic generic investments costs (not their impact on risk and return), generic and limited risk and return profiles (very often a simple guide with no absolute or relative reference points), and parsimonious asset allocation data (which is often incomplete) and will not deal specifically with the issue of suitability (apart from a few general pointers) or the wider issues of investment risk and the mitigation of investment risk; all these factors must be addressed if investors are to make increasingly more informed investment decisions over time:

- For those providing advisory services (overall management of assets and liabilities irrespective of whether transaction decision is the investor's), the suitability process should deal with the relevance of the investment to the individual's financial needs, existing assets and risk preferences as well as the advisor's investment planning and management disciplines. While a degree of sophistication of the suitability process should not be mandated, transparency over the nature of the service should be in order to allow an investor to make an informed decision over the service and the suitability process.

- For those providing limited transaction based services, explanation over how the KYC parameters determine security or product selection should be provided.

- Wider issues of investment risk and the methods by which this risk is mitigated are educational communications that allow individuals to accept the rationale for investment and the process in which

[26] The TAMRIS Consultancy believes that investors should be responsible for the decisions they make, but that they can only be responsible where the services being offered are clearly understood and where there is a well defined process governing the generation and implementation of suitability. Trying to enforce responsibility for the transaction onto the investor in the absence of a clearly defined service and suitability process is impossible, inappropriate and unrealistic.

the risk and return profile of the investment are integrated within their overall assets and managed over time. Risk mitigation is normally provided within portfolio constructs (this applies whether constructs are advisory or discretionary) but is not provided within a limited transaction based service.

This is why (perversely if the service has not been represented as such) investors in transaction based services are assumed to be responsible for mitigating the risk of an investment.

- Wider issues of investment risk are dealt with via risk assessment and explanation over the portfolio management and investment discipline followed by the advisor. Within transaction based services, there is no such assessment as the parameters are deemed to be provided by the investor. The provision of education to determine risk aversion might be problematic in determining who was responsible for the parameter.

Optimally, key facts over these issues need to be addressed within a) the suitability and advice process and b) ongoing structured communication and education; such would ultimately benefit the process in which consumers make decisions.

However, within a transaction based service, where suitability is derived by client given parameters, education designed to aid parameter deduction implies responsibility for the suitability process shifting to the advisor and reliance by the client on advisor processes for parameter determination and suitability – in other words we have a fiduciary type responsibility moving into the equation

Additionally, within a transaction based process (the return is on the transaction, not the advice): there is little incentive to provide the type of education that is needed to support informed decision making. Under the current transaction regulatory model, amongst all other risks, there is a risk that the point of sale disclosure document becomes the main educational reference point.

It is worth noting that financial literacy, which is the teaching of the language and fundamentals of personal finance, if delivered by the current regulatory thinking, could well exclude the realities of the transaction based system currently regulated.

Consumer research

None of the consumer research that has been reviewed in compiling this document has attempted to prove that POS disclosure is actually going to help consumers make more informed decisions.

> From "How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?, September 2008": *"To our knowledge, there was no empirical investigation prior to the proposal's release of how the Summary Prospectus would affect investors' portfolio choices."*

But, there is much research that says consumers do not read the documents and do not consider them important, that they rely on their advisors to discuss these issues, and that they do not use them to compare products and shop around.

There is also much research that comments on POS disclosure documentation visual appearance and presentation of the information; that says the facts appear relevant, are easy to read and find; but there is no actual testing as to whether this information provides the type of information needed to make informed decisions. Note the following taken from the Canadian "Research Strategy Group Fund Facts document research report, October 2006".

- *Investors liked and understood the information on companies and industry sectors. It showed them that the fund is invested in solid companies which they often recognize and that it is well diversified by industry.*

- *Many advisers liked the list of top ten companies. They think familiar names reassure clients – 'Brand recognition comforts them.' Some thought their clients would not be very interested in the*

holdings. They liked the pie chart which was clear and stood out – 'Clients like pie charts although it may not mean lots to them.'

- *'The fund's investments will change, sometimes frequently' was usually well received as a useful reminder to clients*
- *Investors agreed that this section is very important to them and that it clearly explains that future performance is not guaranteed. There can be losses as well as gains.*
- *Many advisers liked the section on fund performance, describing it as honest, informative and a good explanation.*
- *Investors welcomed the section on risk and described the legend as easy to scan and understand. For many the expression 'moderate' was meaningful and standard terminology.*
- *Who is this fund for: Seen as useful information by MF and Segregated Fund investors. Some advisers saw this section as useful.* ***They said they could use it to help them uncover the goals of the client.*** *(!)*
- *The table explaining sales charges was visually confusing to some investors and not always immediately understood.*
- *HOW DOES MY advisor get paid: Investors were very interested in this topic, but did not always understand the explanation*.
- ***After reviewing the Fund Facts document, overall both mutual fund and segregated fund investors were very positive about the document stressing –***
    - ***– The ease of reading***
    - ***– The completeness of the information***
    - ***– The relevance of the information to their purchase decision***
    - ***– Its integrity and honesty***
    - ***– Its brevity***
- **Role in Sales Process -** *Investors spread the sheets on the table and easily compared the different funds guided by layout, headings, graphs, and colour. "I'd know consistently where to look for what I want and what to ignore. I would read [all 4 or 5]. It's not overwhelming. Once you're used to it it's easy to pick out the information right away." "If I get several., it would not be onerous. I would look through them to compare…a non-issue." "They would all use the same information so I'm comfortable."*

As is argued in section 5, the POS disclosure documents provide insufficient information to make an informed decision, on its own. That the documents are in colour, brief, well laid out, with the information provided, easily compared with another is meaningless unless the information can be used to make an informed decision about the security and the overall portfolio. In the case of an industry regulated on the presumption of consumer initiated transactions, where the suitability framework is extremely limited, the above comments can in no way suggest that the consumers used in the research possess the internal decision framework needed to assess the transaction. No tests were made to asses what type of comparisons were made, whether such comparisons would actually be effective, nor were any tests made into determining just what type of decision making processes the consumers followed.

On the contrary there is research (referenced throughout this report) to suggest that the average consumer focuses too much on past performance, becomes confused with benchmarks, does not necessarily understand risk and fails to appreciate the impact of charges and fees on performance.

Summary Point of Sale Analysis

A simple point of sale disclosure document may have a number of different objectives: the number of objectives and the extent to which they can be achieved is dependent on the regulatory regime and retail financial services model and structure.

Understanding the suitability process associated with a regulatory regime and business model is also key to interpreting the regulatory intent and investor protection perspective the documents.

Canada regulates advisory based services on the assumption that consumers initiate transactions and determine the parameters on which product suitability is determined. Such an approach means that POS disclosure could be interpreted as a sign off to the transaction process, which poses a significant to investor rights when most of the advisory segment operates on a totally different service model.

In Canada there is not only information asymmetry between advisors and clients, but also between consumers and regulators which needs to be addressed.

There is a lot of research to suggest that, on their own, point of sale disclosure documents do little to help investors make informed decisions and scant analysis on the type of decision key facts documents actually allow investors to make.

Finally, it is unsettling to realize that the last seven years (almost) have to all intents and purposes been spent developing regulation that supports the transaction based business model. This is clearly not about investor protection but about differences of opinion about how business should be run.

5. Proposed Point of Sale Document: Analysis

Whether a POS disclosure document helps investors make informed decision depends on the following:

a) the suitability standards regulated and processes used to determine suitability, and

b) the disclosure and transparency of both to the investor,

c) the information provided in disclosure and assumptions about the level of disclosure needed to make an informed decision,

d) the overall disclosure framework and

e) the expertise and knowledge of the consumer and the sophistication of their own internal suitability processes.

With regard to (a): the suitability standards regulated and processes used to determine suitability

Given Canadian minimum suitability standards, the parameters of the suitability decision are those noted in the KYC, and these are framed to deliver a transaction that reflects those parameters.

A POS document which reflects back the parameters of the fund to the parameters of the KYC could be considered an aid to an informed decision. But this assumes that a) this is the actual service (basic parameter to parameter, in other words a sale) being provided, and that investors are aware of this, and b) that the investor is capable of framing an informed decision with the information at hand and their internal suitability processes.

As discussed (note the FDM concept paper discussion on this issue), the services that many are representing as being provided exceed that implied by regulation of minimum standards. The opinion of this report is that suitability, in order to be effective, needs to address the overall financial position (not narrowly framed parameters) and the disposition (with regard to risk and return) of existing investments, something which the simple KYC parameters cannot possibly achieve.

To reflect the actual services being provided in the market place, a POS document would need to be supported by an appropriate[27] suitability process and transparency over the services being provided; the POS document would also need to have a specific delivery process (re communication of key facts as opposed to simple delivery) to be capable of leading to an informed decision.

With regard to (b): with regard to point a, the disclosure and transparency of both to the investor

This POS disclosure could well be a sign off document to the suitability process (under a simple parameter to parameter suitability process) whose only clue to its importance is "*this document contains key information you should know about….".*

If the documentation is likely to be used against the client in any future complaint against the suitability of the recommendation, then the importance of the document in this context needs to be clearly marked on the front of the document.

[27] Appropriate: its level of sophistication has a close relationship to the level of service disclosed to the client at the start of the relationship and regularly communicated throughout the relationship. The suitability process rationale would also relate directly to the characteristics of the investment.

There is no statement disclosing the fact that it is a regulatory requirement (a statement at the end that says this one of the fund's legal documents does not satisfy this), to what extent the investor must read and understand it, and if he or she does not understand it, that they must ask their advisor for explanation and must not go ahead with the transaction until they do understand it.

There is also no disclosure about the nature of an advisory relationship in the Canadian financial services market place and the minimum standards that govern advisor responsibilities and investor rights. There is also no disclosure about the nature of the transaction based suitability process. If the parameter driven approach to suitability is not disclosed, then the investor will not be able to properly reference the suitability process when making a decision.

The exact nature of the suitability process and the minimum standards associated with regulation of the transaction are therefore examples of asymmetric information: information held knowingly by both regulators and industry which would pertinent to a consumer decision about the relationship, the service and the transaction.

With regard to c: the information provided in disclosure

We cannot assume that the only service being provided is that of the transaction, and we cannot assume that the simple parameter to parameter process is capable of delivering suitable wealth management solutions, and we cannot assume that disclosure of a set of narrowly framed simple facts can lead to an informed decision. When framing policy, intent and regulation we need to assess the universe of services and their representation and the actual frameworks in which suitability is assessed as well as their limitations. Ignoring all the above leads to a regulatory gap and such omission is regulatory failure.

Within a transaction driven framework where the consumer is assumed to initiate the transaction and the advisor uses KYC parameters provided by the consumer to deliver a recommendation, there are only two possible informed decision frameworks.

- The first is where the consumer possesses the suitability processes necessary to interpret the key facts of the recommendation, and where the key facts and the internal suitability processes are sufficient to support an informed decision.

  But does the Point of Sale documentation provide all the necessary information needed to assess the suitability[28] of a transaction recommendation within the context of the client's overall financial and existing asset position? In other words, is the document substantive enough to unequivocally shift responsibility for the transaction to client?

- The second is where the consumer does not possess an internal suitability process, but the simple parameter to parameter suitability model is assumed to deliver a suitable recommendation with certain limitations. In this case, the POS disclosure would be assumed to provide the investor with the opportunity to tick off the KYC parameters against the key facts held in the disclosure. But this also depends on whether information about the parameter to parameter suitability process has been handed to the investor.

In the case of an advice driven framework where the advisor, in communication and discussion with the client, provides recommendations based on their own suitability processes, the level of information needed by the investor is different: it is less than a transaction framework since they do not need to make sure the asset fits in with their overall portfolio, but it is more diverse because they need information on the key facts of the advisor suitability processes as well as the underlying rationale supporting the place of the investment in the portfolio. In this instance an informed decision cannot be met by POS disclosure alone.

[28] In order for the client to accept responsibility for the suitability of the transaction based solely on the Point of Sale documentation they need their own processes capable of generating suitable wealth management solutions.

Note that the more detailed the suitability process, in terms of educating the client and communicating the rationale for the strategy, the less important the POS disclosure and the less information needed by the POS to aid an informed decision: much of the information needed by the client to make an informed decision is already provided by the advisor's own suitability process and communications discussing their process and recommendations.

With regard to d: the overall disclosure framework

As discussed, we cannot assume that the nature of the service and the suitability process as well as its regulation are known, especially where this information is important to making an informed decision. It is absurd to think that we can hide the nature of the vast majority of the architecture surrounding the transaction without adverse consequences for investors.

Full disclosure of service and suitability processes will support the disclosure made in the POS disclosure document. Without such all the client can do is to confirm that they understand the basics of the investment as presented.

In the absence of documentation explaining the limits and responsibilities of the services investors have contracted for (*the nature of transactional service relationships: who is responsible for the decision and what components of the decision is the advisor responsible for*), and a formal confirmation of the rationale for the recommendation (*or suitability letter*[29] *or report*) if more than a pure transaction based service is being contracted, there is a very real risk that the POS document will end up further subverting the integrity of the suitability process; it will lend further credibility to what is no more than a sale, but what is perceived by the investor to be investment advice[30] that suits their overall financial position and overall assets.

A recent article in a well known national newspaper attributed the following quote to a well known securities lawyer: "Relax – approach the adviser like a doctor or a lawyer or any other professional…." Clearly this misrepresents the relationship between advisor and client, the service provided by the advisor and the responsibilities of that relationship.

With regard to e: the expertise and knowledge of the consumer and the sophistication of their own internal suitability processes

Does the client possess the expertise, resources and systems needed to define a strategy and a structure capable of integrating the transactions recommended into a wealth management solution that optimises the management of risk and return given their risk profile and investment objectives?[31]

There are two probable underlying assumptions behind the restricted suitability standards of the Canadian regulatory framework:

a) The first is that the basic parameters of the KYC are all that is needed to provide suitable wealth management: the consumer only needs to know the basic inputs and so does the advisor. The sum of all transactions is suitable and appropriate. In which case all the POS document needs to do is provide information that links the product with the KYC information. Unfortunately there are too many shades of grey with this assumption.

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[29] http://www.fsa.gov.uk/pages/Doing/small_firms/advisers/FAQ/letters.shtml

[30] It is highly unlikely that Canadian regulators will force on Canadian salespersons/advisors a requirement to provide a suitability letter explaining the rationale for their recommendations, which means that for many the POS will be their only source of a rationale for their investment.

[31] The vast majority of investors clearly do not possess this expertise. The large financial institutions do and they promote this fact, which is why investors seek advice from these institutions' advisors.

b) The other is that the basic parameters distil the investor's suitability process that has prompted him or her to initiate the transaction and that this process is responsible for integrating the transaction into a whole that is suitable and appropriate. The investor still needs to assess the characteristics of the fund before incorporating it into their portfolio.

This report believes that a) is inconsistent with reality and portfolio theory and that b) cannot possibly represent the profile of the average investor. Investment services recognise this and market their services in recognition of the fact that investors are looking for expert advice and management.

Comments on investment facts content

The "Point of Sale" disclosure document for mutual funds provides a very brief explanation of the "main objectives" of the fund, the top 10 holdings, the sector allocation and past performance after annual management expenses.

It also provides an undefined reference to the risk of the fund, for whom the fund would be suitable (generalisations which may or may not apply to the client's situation), and information on the range of transaction costs including trailer fees, but not the actual costs the investor will be paying. Aside from the simplicity of the document, there is nothing groundbreaking here.

If all the key facts document was intended to do was to provide a set of very basic facts, to substantiate in simple terms the "recommendations made by their advisors", as opposed to having to read a "Simplified Prospectus", allowing the opportunity for the investor to question simple facts they do not understand, then the document may have some, albeit limited merit.

What does the fund invest in?

The textual explanation of what the fund's objectives and what the fund invests in is likely to be a shortened version of the information provided in the simplified prospectus. At the moment there is insufficient information as to what a fund manager will put into this area of the POS disclosure, but comments over the type of style followed, the area of the market the fund invests and the type of investments it is likely to hold would need to be provided.

The top ten investments may provide a useful snapshot of the top 10 holdings but it does not provide the necessary perspective on the entire fund[32]. Likewise the sector allocation provided has little relevance unless the client can relate it to a benchmark[33]. It is also not clear what will happen with global market funds where market as well as sector allocation is important.

Assessment

1. Is there enough information here to satisfy assumption b of "with regard to e"? If you want to be able to correctly understand the benefits and risks of investing in a fund (or to be able to compare it to another) you need to understand the following at the very least.

   - Where the fund stands relative to the market (or other benchmark) in terms of **sector**, **market cap**, **risk** (standard deviation or beta, or other risk metric), **valuation** (P/E, P/B etc), and **yield**. This can be provided by the fund facts document.

   - Where the fund stands relative to the recommended asset allocation (risk, allocation, valuation profile) of the portfolio and why the fund fits into the portfolio. This cannot be provided by the fund facts document.

[32] The top 10 holdings provide only partial information on the concentration of the portfolio.

[33] Does the client know the sector weightings of each market index and market index component (small, mid, large cap, value, growth)?

- In the absence of the above requirements, the relevance of the document towards acceptance of the suitability of the recommendation is severely constrained. One of the great debates over the last 20 years has been indexing and the value and risks added by actively managed mutual funds. A rationale investor could not make an informed decision about a fund without knowing the position of the fund relative to the index and the impact of costs on relative risk and return. A great many of the funds currently recommended and sold could not be sold to a rationale (retail or otherwise) investor making an informed decision.

2. Is there enough information here to satisfy requirement a (the suitability standards regulated and processes used to determine suitability) with regard to e (the expertise and knowledge of the consumer and the sophistication of their own internal suitability processes): unless the asset allocation and holding information provides an insight into risk, investment objective and time horizon, then no. The information is of little meaning. The asset allocation of the fund and its security selection has to be tied into the risk and return profile of the fund and there is no such guidance: is it more risky than the market, less risky than the market, more yield than the market, more larger safer companies than the market, etc? How will it perform during different circumstances?

Based on limited suitability guidelines (parameter to parameter), the information provided is meaningless in terms of its ability to relate KYC parameters to the product or fund and insufficient for an investor to assess suitability based on an attempt to properly integrate the product into a portfolio: properly allocating a fund means that the risk, yield and asset allocation profile (security type, market cap, sector and market, plus yield) need to be added to the portfolio mix to assess the impact of the fund on the desired asset allocation, yield and risk profile.

How has the fund performed?

"Not all consumers have the ability or knowledge, even when provided with the information, to compare performance or potential growth rates"[34]

The warning over "It's important to note that this does not tell you how the fund will perform in the future" is an insufficient warning regarding the risks of buying an investment on past performance and does not convey the necessary information over the risks of relying on past performance. This warning is important given that there are likely to be other marketing and sales aids illustrating the performance of a fund.

However, what is more important than the performance is the portfolio rationale for including the investment in the first place. With a clear rationale and framework structured to manage the risk of the investment, the influence and consequence of performance on fund selection becomes less important. Again, we are forced back to suitability as being the most important determinant of a recommendation, the key facts of which are not represented in the POS documentation. A basic parameter (KYC) to parameter (product) does not deal with how covariance, liquidity risk and other factors combine to change (reduce or increase) the nature of risk and return, or the value of the performance itself.

Also, the heading ***"average return" should read "historical average return".*** Average return alone could easily be construed as being an expected average return. It is here that the weak warning over relying on past performance may allow an investment to be sold on a strong average annual performance. There is nothing stopping an average annual return (over a period of above average return) from being compared against the current annual returns on lower risk cash and fixed interest investments and there are no warnings in this section to alert the investor over the risks of doing so.

There is also no comparative performance against an appropriate benchmark or a risk adjusted performance figure, important if the client is going to be held responsible for the recommendation and the resulting strategy.

Security selection and portfolio construction, whether the funds and securities are selected within an advisory or

[34] http://www.york.ac.uk/inst/chp/publications/PDF/informeddecisions.pdf

a discretionary service structure, is a complex area and one which the investment advisor and financial institution has considerable discretion. If investors are going to be assumed to have made the investment decisions themselves then they would need to have access to the information that would allow them to do that.

Assessment

Without a benchmark to compare performance, not even the simple parameter to parameter assessment of suitability can be achieved: risk, investment objective and time frame are all impacted by relative as well as absolute performance.

Such an assessment raises the issue of faith in what an advisor, institution, or industry tells you is or is not the case. Investors trust advisors and institutions, and POS documents appear to reinforce the rationale for such trust.

The following excerpts are from the FSA Report "*Standardisation of past performance*" (May 2003):

> *Despite most paying lip service to the dangers of using past performance information as an indicator of future performance, it nevertheless emerged that it was used as an indicator of likely investment returns. Fund loses or gains appeared to have an immediate emotional appeal, with the less sophisticated more likely to use this to forecast future returns than the more sophisticated.*
>
> *The less sophisticated tended to assess and interpret past performance data as a simple check to see whether or not the fund had grown. It provided reassurances when the fund had made gains and prompted caution where it showed a loss. A minority claimed to not to use or seek out past performance at all.*
>
> *Overall past performance information set the tone of consumer expectations in terms of what the potential return might be. Those of low financial sophistication appeared more willing to rely on past performance to forecast future returns than were the higher sophisticated. - i.e. less sophisticated were more apt to link past with future performance.35*

The above raises doubts about the ability of investors to wisely use past performance as part of the informed decision making process. A professional would not rely on the data in this POS document.

The following comments from the same report, "*Standardisation of past performance*", raise the issue of the complexity of the benchmark: while this supports simpler POS documents for the less sophisticated it also supports the claim that consumers are unable to make the type of informed judgement that is needed to make the type of decision Canadian regulators would like to impose on investors. This supports the argument that it should be advisors who are responsible for making sure that they have the research to back up their recommendation (due diligence), and this research should extend beyond the simple "know your product".

> *Firstly, the less sophisticated were initially daunted by what they perceived as an overwhelming amount of information. Here, the benchmark added an extra layer of detail which exacerbated any confusion experienced in the single bar chart.*
>
> *The benchmark itself complicated the chart visually for these respondents. Despite a general (superficial?) awareness of the FTSE, real knowledge of the various indices and the role they play was at best patchy. Interpreting fund performance within the context of the benchmark clearly presented difficulties*

[35] http://www.fsa.gov.uk/pubs/consumer-research/crpr21.pdf

> *Those of medium to high financial sophistication welcomed the benchmark and appeared to understand its purpose and meaning without prompting. Most claimed to be familiar with the FTSE 100 and appreciated being able to make a comparison between the fund and the market.*

How risky is it?

The risk spectrum provided gives no reference points with which the investor can ascertain relative or absolute risks, nor indeed the time frame of the risks.

While the proposed POS disclosure no longer mandates the use of the IFIC risk spectrum, a moderate risk profile as noted by IFIC documentation[36] is equivalent to a 100% exposure to a major market index. A 100% equity allocation to any one market would be considered an aggressive investment stance within most retail (and institutional) portfolio construction methodologies. It would only be a moderate risk within a well structured portfolio: this would imply that the suitability process followed by the advisor/firm should be more sophisticated than one focussed solely on the transaction and disclosure would need to comprise facts underlying the portfolio rationale in order for the investor to make an informed decision.

> If an advisor was working to a high suitability standard, the recommended fund's risk and asset allocation profile will be of greatest importance to the risk and asset allocation profile of the portfolio; we know that by including funds with low relative correlation risk (volatility) is reduced and return for a given level of risk enhanced. The focus on the particular risk of one fund to the exclusion of its impact on the risk and return profile of a portfolio is contrary to accepted financial theory and practise. If you do not understand the impact of a fund's selection on the risk and asset allocation profile of the portfolio then you cannot make an informed decision about its selection. We are back to the basic assumptions about the presumed parameter to parameter suitability process regulated by Canada's regulators: note section "with regard to e".

Whether or not the risk profile recorded on a NAAF/KYC form is directly comparable to the risk spectrum used by the fund facts will depend on the design and application of New Account Application Forms. In this instance there is a risk that the risk spectrum used by mutual fund POS documents may differ from the risk profiles and investment objectives recorded on the NAAF/KYC forms: there may not exist the necessary threads (parameter to parameter) between the advisor's risk assessment process (if there is one) and the POS documents.

Additionally, absence of an explanation of the meaning of the risk notation (and scale) risks the advisor introducing their own, thereby contaminating the integrity of the regulatory communication.

Assessment

The following are excerpts form the FSA's November 2000 report, "*Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale*":

> *"The research evidence suggests that there is a danger in overestimating consumer understanding of terms such as risk (a term which practitioners thought was well understood), inflation, guarantees and other terms and phrases used in KFDs"… There was a high level of awareness of risk among all but the least experienced consumers buying equity products, but it was clear that few really understood the risks involved and there was a tendency to read information as a disclaimer rather than as a warning:.*[37]*"*

The following is an excerpt from the OSC's Fair Dealing Model Concept Paper:

> *"To make the decisions they are expected to make, investors need a better understanding of the risks of their overall portfolio and of individual securities, both at the point of sale and through their account statements….Even an adviser who has a personal relationship with a client and is paid to make*

[36] IFIC Recommendations for Fund Volatility and Risk Classification September 2005

[37] http://www.york.ac.uk/inst/chp/publications/PDF/informeddecisions.pdf

recommendations and provide advice to him is under no obligation to provide him with educational information. Advisers are required to determine an investor's sophistication level –but this is done for suitability and KYC purposes, not to help clients improve their knowledge.. 38."

It is doubtful whether the simple parameter to parameter assessment of suitability as implied by Canadian regulation of minimum standards will actually lead to more informed decisions. The basis of good decisions has to be the expertise and knowledge of the advisor: hoping that a simple set of facts will arm the average investor and put them in the decision making driving seat is far too optimistic.

Who is this fund suitable for?

In terms of the overall portfolio, why an investment is suitable for someone is complex: the size and timing of an investor's financial needs (which include horizon and loss capacity); their risk profile and investment objectives; the style and discipline provided by the advisor and the company; the disposition of their existing investments, and the costs of an investment, will all contribute to which funds are selected and how much of each fund will be purchased. This type of suitability cannot be derived from simple parameters.

A straightforward parameter to parameter suitability process would recommend a fund as being suitable for any client with the same parameter framework, irrespective of the differences in existing investments and differences in personal financial needs. In a way, this simple process should not be held to a higher standard, because to do so would risk liability; but it is nevertheless a standard which needs to be disclosed if it is to be sold.

If an individual investor is initiating a transaction, then the information regarding suitability might be of use as a warning. But it must be noted that the information regarding suitability in this document is at a very, very basic level. In the simplified prospectuses offered by mutual fund companies it is noted that this section is meant as a general guide only and investors are asked to consult their advisors for advice appropriate to their own financial circumstances.

Warnings like "Do not buy this fund if you need a steady source of income from your investment" assume that a fund recommendation is a stand alone decision for a specific lump of capital with a clearly identifiable time frame and investment objective. For most investors, a portfolio will represent a combination of different investment objectives: short term liquidity, immediate dividend and interest income, future growth, medium to long term consumption of capital as a portfolio is drawn down. Any account which has a wider term of reference is going to be compromised by the transaction framework and investors reliant on advice for a portfolio solution. As discussed throughout the document, the wider frame of service needs to be recognised, regulated, disclosed with standards set for the higher level of suitability required.

On the other hand "before you invest in any fund you should consider how it would work with your other investments and your tolerance for risk", is a direct communication to the investor that they need to consider how the fund fits into their overall portfolio. This appears to be a communication to the investor, who has "initiated the transaction", to make sure the transaction fits in with their other assets. This is not something that a simple parameter to parameter process is capable of and requires an investor to have their own internal suitability processes to determine.

How is this section with its questions meant to lead the investor to an informed decision when the suitability process itself (parameter to parameter) is incapable of addressing the wider suitability issues? Again, we are left with partial regulation of the process: no mandated transparency of the suitability decision, process or limitations; no mandated transparency over the service and delineation of responsibilities. We arrive back at the regulatory gap, with the simple parameter to parameter suitability decision that fails to reflect the reality of the market for retail financial services.

[38] Fair Dealing Model Concept Paper - http://www.osc.gov.on.ca/documents/en/Securities-Category3/cp_33-901_20040129_fdm.pdf

Assessment

Unless the investor has initiated the transaction, has their own internal suitability process which has defined the parameters on which the advisor has based the product recommendation, and is aware of the limitations of their process, then it is unlikely the POS disclosure is going to help an investor make an informed suitability decision. There is insufficient information, in this disclosure, to allow a sophisticated investor to make an informed decision and insufficient guidance for any other. If it were to have to a specific objective that could be related back to a KYC, and a risk profile that fitted in with the KYC spectrum, then it might satisfy the simple but flawed parameter to parameter framework (which has not transparency).

How much does it cost to buy?

There is nothing here that specifically asks the advisor to disclose the actual amount they are receiving. This needs to be disclosed by the advisor separately, and, again supports the argument that there is much outside the POS document that is relevant to the decision.

There is no comment here that investors should compare the costs of the fund with alternatives that may have different cost structures: many asset classes can be accessed more cheaply and efficiently. No cost comparison is provided or alluded to in this document: some advisors are limited to mutual funds or segregated funds, while others can sell all including market traded securities.

There is nothing in the key facts/fund facts that asks investors to question the costs and the impact of costs on risk and return and to relate this to the overall value of the service. Market transparency over service and suitability processes, and performance benchmarking would help in this respect. Organisations such as SIPA have recommended that a companion guide be produced to support POS disclosure.

The following are excerpts form the FSA's November 2000 report, "*Informed decisions? How consumers use Key Features: a synthesis of research on the use of product information at the point of sale*":

> *Few consumers understood the effect of charges and most thought they would have little or no impact. Only two respondents in the PI research (saville rossiter-base, 2000), both 'Sophisticates', thought that charges could have a significant impact. A common finding in this research was that* ***not knowing about the degree of something led to it being dismissed as a danger****. Conversely, two consumers believed that a higher charge would improve the investment as it would reflect more active fund management:*

Part of the brief of an informed decision is to be able to consider substitutes for the allocation and risk/return management provided by a product: the POS disclosure regime keeps the investor within the product line, something which does not enhance price disclosure and market competition. This is something we see throughout the current regulatory framework within Canada: intentional asymmetry of information from products, to services to regulation.

What if I change my mind?

Just what exactly are we regulating here? The consumer, the transaction, the advisor, the advice, or is it the product? It would appear we are regulating the consumer and the consumer initiated transaction, not the advice, the advisor or the product: "what if I change my mind".

If a client is initiating a transaction, and the advisor is selecting a product off their shelf and basing the selection on the KYC parameters, the point at which the initiation and recommendation are made are likely to be simultaneous: in which case the POS documentation will be handed to the client at the point of sale, or very shortly before.

If the recommendation is based on advice that has considered the client's overall assets and financial position, to varying degree, the two (client request for advice and advisor recommendation) will a) not be simultaneous, and b) the POS document will not be the first or the most substantive communication about the advice, the product or the strategy.

The 48 hours to cancel a transaction is most likely relevant to an individual who has made an informed decision, hence the “what if I change my mind”, as opposed to “what if I do not understand what I have bought”.

But, if the POS document and the supporting disclosure framework is insufficient for an investor to make an informed investment decision, then the 48 hours available to cancel the transaction may be insufficient to protect and investor’s rights; this is especially the case if the investor is relying on the advisor to make a suitable investment recommendation.

What if I change my mind is therefore only really applicable to investors aware of the nature of the contract and its regulation.

Summary: A leap of faith

The information provided in the proposed POS disclosure document is insufficient to support an informed decision by an investor where the basis of the decision is a constrained parameter (KYC) to parameter (POS) framework. That the POS disclosure is meant to represent the parameters needed to make an informed decision represents an unwaranted leap of faith on behalf of regulators.

The information provided is also insufficient to help a sophisticated individual investor make an informed decision as to the asset allocation and risk and return profiles for inclusion within a portfolio of different assets.

As a short summary of basic information it may provide access to information that is currently in a less accessible format (prospectus) but, as discussed does not represent information that an investor can use to make either an informed decision on a transaction or an informed decision about a transaction in the context of a whole portfolio.

The information provided could be improved by providing asset allocation benchmarks (as discussed) and performance benchmarks; for less sophisticated investors the provision of such information may make the disclosure less understandable.

Much of the UK research suggests that investors will rely on what their advisors says about the fund and the strategy and the reasons for the inclusion of the investment within their overall portfolio. But a formal communication of this (including a recorded communication) is not required in Canada under current minimum suitability standards and this will continue to be the case as long as the focus remains on the transaction.

The POS disclosure needs to be supported by a service and suitability disclosure framework for those services where the transaction is not the central element, which will shift the main reasons for the recommendation to the suitability assessment with the POS disclosure relegated to informing clients of what they are buying.

Point of Sale disclosure is important, nevertheless, and all investors should be presented with information which will inform of the investments that have been recommended by their advisors.

6. Selection of Industry and other stakeholder comments on POS document

- Ladner Gervais stakeholder comments 2007 – "we believe the Proposals do not sufficiently recognize the role of an advisor in the sales process and appear to reinforce the popular, but unfounded, belief that investors actively review and make decisions on their own based solely on the written disclosure they receive about a fund. Borden Ladner Gervaise[39]".

- Brandes Investment Partners and Co: "The thought that a simple fund facts sheet could serve as the document necessary to make a truly informed decision does a disservice to the financial advisor community…..we believe that the advisor is best equipped to truly advise the client and although the Fund Facts Sheet is a big improvement…it can never tell the entire story…

- Canaccord: The Proposed Framework states that delivery of Fund Facts must occur prior to the sale and may be by hand, fax, mail or electronically. Since a great many of our transactions take place over the phone, the above described options are limited.

- Canadian Bankers: our specific concerns with the proposed framework are those that have already been pointed out by many industry participants -- that the limited methods by which delivery of the Fund Facts is required to be made would in many cases, and particularly in non face-to-face situations, interrupt a continuous sales interaction and would frustrate investors' desire to complete a transaction quickly, efficiently and contemporaneously…. the prescriptive framework that has been proposed constitutes a.substantial new regulatory initiative that has a significant and negative impact on the manner in which investors can execute their transactions. This regulatory framework, ostensibly designed to protect consumers, presents additional costs and risks to consumers. Given the potential for these negative consequences for investors, we believe that further review of the proposed measures is needed. We are not aware, for example, that there is an industrywide problem concerning the adequacy of investor decisions about investment funds. Are investors making consistently bad decisions due to inadequate information that warrants prescribing industry-wide, the delivery of a specific document in a specified format?

- Canfin:. The major challenge with the proposal arises from the inflexibility of the requirement to deliver the Fund Facts at or before the point of sale ("POS") for all transaction types and all clients without exception, and the disruption and inefficiencies this implies for certain transactions. We believe that the Proposed Framework will limit the investment choice available to clients serviced by in-home sales The very prescriptive approach to the delivery of the Fund Facts to the consumer at or immediately before point of sale does not accommodate the many ways that consumers prefer to inform themselves about the investments they buy, and will disadvantage the sales processes by which the vast majority of mutual fund sales are done.

- CI Investments: the Joint forum should…comment on how the proposed framework is expected to support the goal of encouraging investors to seek professional investment advice…conduct analysis into whether the Fund Facts would result in investors making better investment decisions, or simply encourage investors to make decisions based on past performance, name recognition of top 10 holdings and sector affinities… the proposed framework is over simplifying the investment process…this will lead to greater misunderstandings by investors…

- CICB - We do not support the inclusion of the following disclosure in that section "Don't buy this fund if you need a steady source of income from your investment". This statement imposes a heavy burden on fund managers to make assumptions as to investor circumstances (i.e., potential tax implications, knowing each investor's particular situation, etc.) and could lead to potential liabilities. Dealer

[39] http://www.jointforum.ca/en/init/point_of_sale/2007%20POS%20Stakeholder%20Comments%20-%20A%20through%20I.pdf

representatives have the responsibility of advising their clients if an investment is not appropriate for them. As such, fund managers should not be required to take on that responsibility by virtue of adding a statement determining suitability in the Fund Facts. This section should be aligned with the prospectus disclosure under "Who should invest in this Fund?"

- Elliott & Page: We would, nevertheless, like to take this opportunity to reiterate our fundamental concerns with the proposed framework, particularly the pre-delivery requirements..

- Fidelity: most investors…will not want the sales process to stop while they wait to receive the Fund Facts…many investors will want to waive this requirement, particularly when they have a relationship with a financial advisor….people will be unable to trade or manage their investment portfolios….

- Franklin Templeton: ..to deliver the Fund Facts before or at the point of sale would place a considerable burden on dealers and could significantly prejudice investors…

- IFIC: A large proportion of mutual fund sales are conducted over the telephone. The inflexibility of the delivery requirements under the Proposed Framework will cause significant disruption to these sales. According to a sample of IFIC Members surveyed this summer, 43% of total 2006 sales were conducted over the phone. For some Member firms, telephone transactions for both subsequent and initial sales occupy a much higher percentage of their total business – some as high as 100%. IDA firms have indicated that as much as 90% of their mutual fund sales are conducted over the phone. These business models, and more importantly, the clients they serve, would be severely impacted by the delivery obligation for pre-sale delivery limited only to paper-based, faxed or e-mailed disclosure documents. A large proportion of mutual fund transactions conducted by our dealer Members, an estimated 26% in the IFIC channel survey, occur in person at the client's residence or place of business. We believe that the Proposed Framework will limit the investment choice available to clients serviced by in-home sales

  A quantitative national study of 2,508 clients conducted in May and June, for example, showed that 83% of mutual fund clients continue to rely on advisors and 65% believe that reading detailed printed information about a mutual fund should not be a requirement for purchase. In qualitative testing of clients and advisors held in Toronto, Montreal and Vancouver in August, we found that while clients generally reacted positively to the contents of Fund Facts, their reactions varied widely as to mandated delivery, and the possible consequences for the interruption of trades. Their reactions to the latter varied by their level of investment knowledge and sophistication. Sophisticated clients showed less tolerance than less knowledgeable clients of trade interruptions, and some viewed mandatory delivery of Fund Facts as an approach as too patronizing or bureaucratic.

Summary

Mutual fund providers and sellers were most concerned about delays in the sales process that would result from POS disclosure. A number expressed concern that the POS disclosure did not sufficiently recognise the role of the advisor in the sales process and that the advisor was best equipped to truly advise the client. One of the above comments was derisive about the ability of an investor to make an informed decision based on the key facts while another suggested that the imposition of such disclosure would have negative consequences for investors.

In a sense comments from the industry support the need for creating different levels of regulation for different types of investor needs: those who initiated transactions and knew what they were doing, or were at least willing to assume the responsibility and consequences of doing so, should be allowed to continue to operate within a process that allowed them to transact instantaneously. On the other hand, most clients, it was stated, rely on their advisors, and the insinuation was that the POS disclosure would get in the way of an advice/sales process which was already working quite well thank you. It would appear that POS disclosure was superfluous to the client advisor relationship, meaning that the advice and suitability processes used were operating at a higher level than the POS disclosure document; a level in fact that may well be outside the boundaries of the KYC and current regulation. Yet, the industry, it would appear, wanted to maintain the limited control of transactions arising out of unregulated service models.

7. Disclosure

Disclosure should relate to any material fact or detail that relates to a representation made with respect to a service, recommendation, strategy or investment that would or could affect an individual's decision or assessment of the value of such.

Which areas need to be disclosed?

a) If you have one you disclose it: portfolio construction, planning and management methodology (education)

b) If you have one, you disclose it: risk assessment rationale and process (education)

c) If you have one, disclose it: investment discipline

d) Assessment of market and economic risk if this drives asset allocation, timing and security selection

e) Should you have one: recommended asset allocation and security selection, recommended benchmark allocations and reasons for deviation.

f) Should you do so: asset and liability modelling and management risk and return assumptions

g) Performance analysis, asset allocation and risk analysis, reasons for transactions or changes in asset allocation.

h) Costs and benefits of service, portfolio management and other financial management decisions.

If all you are providing is a transaction service, then there is no (a), no (b) (merely recording the client's risk profile), no (c), no (d), no (e), no (f), no (g) because there is no a,b,c,d or e, and no (h), because you are not offering an integrated service. But if you are offering more than the transaction, then one or more of the above needs to be disclosed, otherwise, there is no informed decision and no accountability. Needless to say, none of the above is presently required to be disclosed in Canada for advisory services.

8. Consumer interests, investor protection and Investor responsibility

The CSA made the following statements in their staff notice 81-319 “Status report on the implementation of point of sales disclosure for mutual funds”.

a) “National Instrument 81-101 Mutual Fund Prospectus Disclosure…. aimed at providing investors with more meaningful and effective disclosure….

b) investors would receive key information about a mutual fund at a time that is relevant to their investment decision….

c) highlights the potential benefits, risks and the costs of investing in a mutual fund…….

d) This is a significant investor protection initiative….

e) The Instrument also keeps pace with developing global standards on point of sale disclosure and delivery.”

With regard to a): disclosure is limited to mutual fund key facts, is constrained to product lines, lacks a supporting disclosure framework and the information provided is insufficient to support an informed decision. It is nevertheless information which some investors may not normally be aware of, partly because of the complexity and length of historical fund disclosure documents.

With regard to b): this presumes a transaction based process, where the consumer initiates the transaction and the request is more or less simultaneous with the transaction recommendation. This is contrary to the representation of service that many investors receive: the more advice involved, the more the advisor considers the overall financial needs and assets, the longer time lapse between service request and transaction recommendations and reflects the regulatory gap discussed throughout this report. As such, the POS document is an attempt to regulate only one segment of the advisory retail financial services market place.

With regard to c): within the existing regulatory framework the focus remains on the transaction, and the information provided is limited and narrowly focused. There is in fact no comparative analysis of the impact of costs on mutual fund investment, which can at times invalidate the benefits of the underlying asset allocation.

With regard to d): this initiative ignores the very large regulatory gap recognized by the Fair Dealing Model concept paper, a gap that other international regulators are regulating. The current POS disclosure framework does little to allow investors to question the fundamentals of the service, while focusing them on fund facts that lack the necessary context to make an informed decision, even if they had the ability to make such an informed decision. Regulation needs to raise transparency and suitability standards for those providing more than the transaction and look to improve market competition via lower costs and clearer and wider choice in the market place.

With regard to e): Canadian regulators are some 15 to 20 years behind best international practice, and comments to the contrary are disingenuous.

If an investor is provided with a) an explanation of the service they are receiving, the limitations, the costs and the responsibilities, b) an explanation and understanding of the process in which the suitability of the asset allocation and security selection is made, c) a risk assessment process appropriate to that process, d) an explanation of the rationale for the recommendations, why they are suitable and appropriate, the risks, the costs given the process and e) basic information regarding the assets and securities provided, then an investor will be in a position to accept the generic risk profile of the strategy and securities provided. In such a situation the POS documentation will be relegated to a secondary role; the provision of key facts about the individual investments recommended.

9. Transaction model: what is so great about it?

Hector Sants, CEO UK FSA, March 2010; "A regulator must be willing to place themselves between consumers and harm. We will only achieve this by taking a proactive stance[40]."

Who knows why regulators seem happy with the status quo: perhaps it may be a belief influenced by the industry that the current modus operandi is the most efficient, that changes would create more costs and less employment, that investors are to blame for not taking responsibility, that a service predicated on the transaction and product distribution can achieve a socially and economically desirable option.

It is true, that for large swathes of the population, the costs of delivering personal financial advice and portfolio management, as per the current mechanisms for such, would be prohibitively expensive; it is also probably true that the majority of advisors do not possess the expertise, systems, time or knowledge to construct, plan and manage portfolios for their clients.

But, we should not be talking about what the industry can do as it is structured now, as its processes are currently directed: we need to look at what the industry could deliver were it to embrace changes in processes and organisation that could delivered through more effective use of technology. Transparency over services, costs, performance, responsibilities and suitability would create the conditions for more competition that would lead to lower costs and technologically advanced wealth management solutions.

The industry is currently structured to distribute products and to control the distribution of those products, not to deliver cost effective, competitive market solutions. A move away from selling as many transactions as possible towards instituting lower turnover portfolio structures, sensibly structured, planned and managed, would reduce revenue for many providers, and yes, at the start, the costs of restructuring may result in higher overall costs, but in the long run, costs and capital employed should fall: capital will be reallocated to other areas of the economy.

Many of the current raft of products have been developed in response to the inability of individual advisors to produce more sophisticated solutions, and these would lose market share as lower cost integrated wealth management platforms start to perform the same functions.

Instituting higher suitability standards and transparency would likely force the industry towards service and integrated processes and away from the transaction and transaction based solutions – even the transaction component of the market place would be forced to lower costs. Canadian regulators, for whatever reason, do not appear to have a vision for the future of the industry and appear not to be concerned about its current weaknesses. All they appear to be concerned with is regulating ad maintaining the status quo without question.

It is difficult to argue for the continued protection of the transaction based industry: the products tend to be high cost and the suitability process in which they are delivered very restricted.

We have the technology to deliver a higher quality suitability process and educational input into structures that are capable of managing overall financial needs and assets. Surely the long term objective of a retail based industry is to lower costs and to deliver the highest quality service, and regulation should be aimed at improving competition in this area. Many products will disappear and so will many jobs, costs and rents will fall, but this is the consequence of productivity growth.

But, as discussed, the direction of regulation since 2004 has been to move away from changing the transaction industry to making regulation fit the transaction industry, blaming market failure on the consumer's inability to take responsibility for the transaction. In 2004 the FDM concept paper blamed regulation of the transaction as a primary reason for market and regulatory failure, yet seven year later all we have is a piece of paper determined to reinforce that same regulation of the same outdated business model.

[40] http://www.fsa.gov.uk/pages/Library/Communication/PR/2010/044.shtml

10. Recommendations

The regulation of retail financial services in Canada is flawed because of its outdated focus on the transaction which ignores the wider representation of services being made in the market place. These services are afforded the protection of minimum standards that apply to the transaction when standards, disclosure and investor protection should be subject to much higher standards.

Under the current regulatory regime, the CSA and OSC (and other regulators) need to be transparent about just what they are regulating, what protection they afford investors and what investors are responsible for in the transaction service process. As it is, this information is being withheld, and communication about regulators roles in the market place risks misleading investors.

The provision of a point of sale disclosure document within a framework that fails to disclose the nature of regulation places investors' rights at risk, reinforcing the regulatory failure and sustaining the asymmetry of information between regulators the industry and the investor.

It is difficult in the context of the wider picture to make recommendations over the content and form of a POS document when larger and more important issues lie ignored. In order to make Point of Sale disclosure for all retail investment products relevant to the investor, regulators and government need to do the following:

- Recognize and regulate the wider range of transaction and advice based services that exist and differentiate regulation and standards according to the service processes being provided.

- Regulate and mandate greater transparency of the services being provided and the suitability of transactions and solutions recommended.

- Provide greater transparency over the standards that regulators expect from advisory financial services providers and that will be regulated.

- Dispense with the regulation of the industry based solely on product lines and promote transaction and service based solutions that look at meeting clients best interests. Advisors who are to provide overall financial and investment advice, on an advisory basis, in the best interests of their clients need to be able to recommend from a range of products, not just a product line.

- POS disclosure should be treated as an informational document about the investments recommended by an advisor, supported by a more important suitability statement over the rationale for the recommendation and service disclosure. Disclosure over service, suitability and the investment will provide much more robust information on which an investor can make a decision about the advice (not limited to products) they have received and allow them to make informed decisions for which they can take responsibility.

- In a pure transaction based service, information on asset allocation (sector, market cap etc), risk and yield relative to a comparable index should also be provided as should performance relative to a comparative benchmark. Such information should also be accessible by investors who are receiving advice based services focusing on their overall financial needs and assets.

- Ultimately, all advisors and firms providing advice based services covering the management of assets should also provide a performance analysis.

- But above all, a far reaching review of regulation and why regulation has taken the direction it has since 2004 needs to be urgently taken. Something is not quite right at the heart of regulation of Canada's retail financial services market place. Why has regulation moved in a totally different direction from that proposed in early 2004? That Canadian regulation is so clearly at odds with the vision and direction of progressive international regulators should be of concern to all.

11. Conclusion

If, and only if, investors did initiate all transactions, if optimal suitability could be determined on a transaction by transaction basis using simple parameters provided by the investor, then a Point of Sale disclosure "might", if appropriately structured, help investors make informed decisions. But the true nature of the regulated suitability process, implied by minimum standards, is not known to investors, and many advisors and firms promote services that represent higher suitability processes for which the advisor is responsible and which are not currently regulated.

A POS document under current regulation, where the client is not only responsible for the decision but effectively the suitability process itself (if you hand the parameters for the suitability decision to the advisor, the advisor is only responsible for making sure the product or security meets those parameter), is an undisclosed sign off to the entire service process. Investor advocate Ken Kivenko says, such "an unconscious sign off to the entire service process exposes the investor to unfair restitution claim rejection by firms, OBSI and the courts".

Without change to the way the market is regulated, the proposed POS document represents a risk to investors and further shifts the balance of responsibility and accountability to the investor. This is not an investor protection initiative.

In other countries where POS documentation has been introduced, there is regulation and disclosure of the service and the suitability process, with much higher standards required for determining suitability and for supporting suitability. Canadian regulator's logic in using research from these other markets is flawed when we consider that the supporting regulatory framework is much different. Canada lags best global standards and the current project is in clear breach of those best standards.

The FAIR Dealing Model concept paper of January 2004 recognised the regulatory gap that existed in the market place, yet Canadian regulators have ceased to consider this gap as an important regulatory omission. Such omission is not only regulatory failure (some would say malpractice) but it has placed the Canadian retail investor at significant risk. Not only that, but Canada's retail financial services market place remains uncompetitive, protected from competitive forces that might stimulate change, divided along product lines, unsophisticated and high cost and incapable of delivering the wealth management solutions that Canadians need and deserve.

Canada's regulators appeared at one time to get it, and this report probably says little more than the FDM concept paper in 2004; yet for all the money it costs to run organisations such as the OSC, all we have to show is a lousy two page document that fails to inform anyone; yet this document risks perpetuating regulatory omission and failure that has for years impaired investor protection and damaged the competitive fabric of retail financial serves in this country; and for what, to make sure that financial institutions and intermediaries can continue to sell as they wish, with limited accountability and responsibility?

One could be forgiven for thinking that regulation over the last seven years has been focused on protecting the transaction based industry from the type of change that the FDM would have brought into play. Effort appears to have been directed at making sure that regulation fits the model, on the presumption that it is not the process itself that is at fault, but the point at which responsibility is taken for the decision. In other words, the current regulatory vision is a reactionary one! We are at odds with best global practises: not ahead of or even neck and neck with.

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A special thanks to Ken Kivenko and Dr Pamela Reeve: Ken Kivenko who pushed me to write an initial report on the subject prior to a meeting we had with the OSC in July (and who provided comment on the report) and Dr. Pamela Reeve whose own comments on the history of securities regulation in Canada stimulated me to expand on the wider regulatory issues and who also provided input and perspective to my research. It is extremely frustrating to see what is happening with retail financial services regulation in Canada. Having worked in the UK for many years it was initially a great shock to find how far behind Canada was when I moved here; what became of greater concern though, was the denial by regulators, government and industry over the very real issues in this market and the lack of accountability with respect to the management of these issues. Having worked closely with investor issues over the last few years, it is clear to me that the truth and the needs of the average investor have little value here, though there are many who see what is wrong and have the integrity to let it be known.

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