CONTENTS

This document holds the TAMRIS Consultancy comments on the Registration Reform Projects working committee papers as of June 2005.

The structure of the document uses the content of the working committee papers with comments interspersed throughout the documents. The following is an example of comment box used.

In reality all relationships are defined by clear physical properties – an organization's asset allocation and investment style, the relationship between asset allocation and financial needs over time, an investor's risk and performance preferences and its relationship with the recommended allocation for a given liability profile and, strategy, implementation and management given current market valuations and market relationships. All these factors are capable of being automated within one integrated system.

ACCOUNT OPENING GROUP COMMENTS

The Account opening group was "expected to develop guidance on developing account opening and ancillary documentation and identify information that needs to be apparent to both the investment service provider and the client regarding the nature of the relationship they have agreed on"

The "WG recognized the challenge in clearly defining the boundaries between the traditional account classifications....The varying nature of these relationships and the fluidity that exists within them changes and evolves along with the parameters of the account documentation."

Little analysis or thought is provided in this report to support, detail or explain these comments or to consider a possible solution.

In reality all relationships are defined by clear physical properties – an organization's asset allocation and investment style, the relationship between asset allocation and financial needs over time, an investor's risk and performance preferences and its relationship with the recommended allocation for a given liability profile and, strategy, implementation and management given current market valuations and market relationships. All these factors are capable of being automated within one integrated system.

It may therefore be a question of evolution and the fact that the industry's tools and fundamentals have not yet adapted to an advice based service process.

"Investor education is an important objective but like investor obligations, what a client learns cannot be made the subject of an enforceable requirement. Simply put, an advisor cannot make a client "learn". Nor is there any practical way to determine if a client has learned anything. Furthermore, advisors have no training in the pedagogical skills necessary to actually teach. Framing "education" as a regulatory requirement creates regulatory liability for a process over which a firm or its advisors have no control. The WG agreed that investor education information should be provided, but the degree to which clients are successfully educated should not be regulated."

The fair dealing model never made what the client learned from the educational process an enforceable requirement. What it did make an enforceable requirement was that the client was given the opportunity to access necessary information that would help them not only make decisions but also manage their expectations.

Advisors who are apparently "experts" should be capable of communicating the information that a client needs to make their investment decisions. To state that there is no practical way to determine if a client has learned anything is incorrect. There are important points that every client needs to appreciate before they can accept a wealth and asset management solution. There are indeed practical ways in which to determine if a client has grasped the relevance of a point material to either their financial security or their ability to accept. This does however require expertise and well organized service, education and communication processes. The fact that these processes and imperatives do not exist within financial organizations was a reason for the Fair Dealing Model.

Educational processes reflect the structure of an organisation's wealth management service process, investment disciplines, portfolio construction, planning and management methodology as well as integrated software systems and risk profiling. Without a well thought out structure for the management of financial needs as well as assets, educational structures and standards will be poor. Poor service structures and standards are reflective of a transaction based industry.

Within a transaction driven business process there is little education process or material relevant to an advice driven business process, in which the short and long term relationships are different. No wonder the IDA members are concerned over the potential disclosure of costs and performance since this would highlight the lack of service standards and ultimately the weak educational frameworks. And, it is not just the education of the client they may be concerned over but, possibly the education of their representatives. This is a much greater cost and a much greater potential liability.

II. Response to Questions Posed

Question 1

Whether the current account classifications for retail accounts – self managed, advisory managed, discretionary - describe accurately and clearly the level of reliance and the nature of the client relationship?

Conclusions

Given the continuum of relationships prevalent within the investment community, the crafting of "bright line" demarcations between different relationship classifications may prove unproductive and impractical. A better descriptor than "account classification" and "relationship classification" is needed to clearly define the level of reliance and the nature of the client relationship.

The problem is partly communication. Clear and formal communication of roles and responsibilities and clear and formal explanation of the content, structure, objectives and methods of the service being provided would clearly solve the issue of responsibility and ultimately accountability. The other factor is the lack of clear service process for the management of assets and financial needs. No descriptor will ever solve these problems. The fact that no attempt has been made to enunciate this problem within this report is a critical weakness of all the RRP reports in general.

The current account classifications, while convenient for firms and regulators, do not provide clients with all the information they need to best understand the specific nature of their relationship. Relationships which change over time cannot be easily compartmentalized in this manner.

No, this information needs to be clearly and formally communicated to the client. But the foundation for such communication as discussed is a robust service framework for the management of both assets and financial needs and an advice as opposed to a transaction led service objective. Good frameworks provide incontrovertible statements of responsibilities.

The nature and quality of the service provided under each account classification is not well defined by all market participants – the firm, the industry, the regulators. As a result, the client's understanding of the service can be highly variable, incomplete and ambiguous. In addition, it is often a point for competitive differentiation for many service suppliers.

The difficulties of the account classification increase when supervising compliance with the obligation to ensure the investment is suitable is taken into account. While this compliance supervision can be achieved for the purposes of an individual account, it becomes increasingly complex in a multi-account or multi-supplier portfolio relationship.

In a product by product and a transaction by transaction world, where there is no central structure and strategy for the management of assets and financial needs, the above two paragraphs are correct. There is a clear lack of expertise in defining and managing advice driven relationships which must relate asset allocation and security selection to financial needs. Services are promising much but delivering less for obvious reasons. Good structure and well thought out frameworks actually make compliance and service delivery and definition of service responsibilities much easier.

To move away from account classifications to a "no classification" system to describe accounts uniquely to each client is attractive but probably impractical at this time. Furthermore, to substantially change the current account classifications would only have a marginal return for the quantum of time and energy, which would need to be invested by all.

When the American auto industry was faced by Asian competition it had to reorganize or die. The costs of a competitive and dynamic market place are a fact of life. It is not the current account classifications that need to change but the form, content, structure and delivery of the underlying services. It is sad to see so many representatives of the industry incapable of or unwilling to deal with the problems and issues facing them.

It is better to build upon the current account classifications that are now known and used within the industry to achieve some of the objectives articulated under the Fair Dealing Model.

In other words, keep things as they are, we do not want to change! There is no real argument and no justification for the stance taken in this report. Something more cerebral and thoughtful would have been welcome. All we appear to have is a nodding of many heads agreeing that yes there is a problem, but for want of a better solution, better the devil you think you know.

Client Relationships

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. With respect to this point, the WG agreed that the focus on the entire portfolio of the client as opposed to individual accounts would be desirable but not required. The practical implications of implementing such a structure would be significant, especially due to the range of client types and portfolio sizes which vary from firm to firm and client to client. The WG acknowledged the costs to support such a regime could have a significant impact, particularly on smaller firms. The impact on larger firms would also be significant due to the volume issues that they would face.

It is not the regulatory regime that is the reason why "a portfolio view of the relationship and suitability etc" has occurred. It has occurred because the industry is transaction driven and its earnings objectives conflict in general with the needs of the client. Practical implications of implementing a structure would be significant for an industry with no clear methodology for changing from a sale's driven to a service driven process. But the lack of a methodology for integrating the management of all assets and all financial needs is not an argument not to do so. In fact, providing an integrated wealth and asset management structure is attainable and the "fundamental knowledge" is available.

The above paragraph is indicative of the poor grasp of this committee as to the real fundamental problems in providing advice driven total wealth management solutions and relationships. They talk about a structure, but do not explain it, they talk about practical implications but give no examples, they talk about costs but are unaware of the real true costs that outweigh those they are probably aware of; new wealth management systems, better quality control, different relationships between reps and brokerages, better education for both client and advisor and a complete change in the way business is conducted. Advice driven industries represent indeed a new world.

It has been observed that a growing best practice within the dealer community is to develop a comprehensive understanding with the client across the full spectrum of existing and potential services and existing and potential staff supporting the client's account. At the time the relationship is opened, some form of "control" document is created with the client and updated by material change with the client or at the dealer.

Often dealers see this as a best practice and as a source of competitive advantage. Since current account classifications do not accurately, completely and clearly describe the nature of the client relationship, the best practice described above, should become a requirement. This requirement should take the form of additional information provided primarily by the firm to the client. Some of this information would be mandatory and some would be optional. The information could be provided in a variety of ways. This new information requirement will be referred to as the Fair Dealing Requirements.

A real example of this would have been useful, but without this example and statements such as "some form of "control" document" is not sufficient on which to base a Fair Dealing Requirement. The content of the FDR provided later is not sufficient, nor is the study of its use and application. Not enough work, 2 out of 10. Detailed structural analysis of current best practices would have been a very valuable project.

Question 2

What information should the advisor and the firm provide to a retail client with an advisory account? When and how should the information be provided?

Conclusions

1. Current account classifications do NOT accurately, completely and clearly describe the nature of the client relationship. In addition to existing KYC and suitability requirements, it **should be a requirement that all client relationships being entered into prompt the creation of the Fair Dealing Requirements ("FDR"), which describe the essential relationship information and responsibilities on both parties according to clear guidelines as to minimum core content expectations.** This new process will have prescriptive and optional elements, which are necessary to recognize the fluid and dynamic nature of the relationship. This new process will not however necessarily require the creation of any new or additional documents or forms. **At its core, the FDR is a process of providing information about the firm to the client**.

No new documents no new forms and an FDR which has not been detailed or explained. Additionally there is an attempt to limit the educational commitment of organisations by treating the FDR as the information about the firm. It would have been useful to have had some substance on which to base a more comprehensive assessment of what is actually happening here, whatever is happening here.

2. The FDR clearly establishes and documents the role and responsibilities of the advisor and the firm primarily, and perhaps of the client as well. It would set out the level and type of services provided, account reporting and monitoring obligations, fees and other costs. The totality of this new information will serve to more accurately describe the level of reliance the client places on the advisor and the firm. **It is understood that a perfect description of the degree of reliance given the numerous variables involved in an advisory relationship is probably impossible. A draft content outline for the proposed FDR is included below**.

Where communication is limited and the focus of the service is on product sales, the ability of the organization to fully describe the relationship is indeed impossible to dictate or manage. But within a centralised asset and liability management framework, a well communicated, well structured and disciplined service delivery process, it is not impossible. In fact, it is far easier. But, even the limited functionality described as "clearly establishes and documents" cannot be vouchsafed given the nebulous explanation of the structure and function of the FDR provided.

3. The additional information relating to roles and responsibilities will create a compliance supervision challenge. However, compliance staff will have a better record of what an advisor has agreed to do. The quality and precision of client complaints should also improve as a result of the increased information provided to the client concerning products, services and improved reporting concerning conflicts, compensation and account activities.

It is apparent that virtually nothing is set to change. Quite how the precision and quality of client complaints will improve is difficult to discern without the substantive and detailed analysis and explanation that is required to pair off content (of FDR) with functionality (relationship with services) and effect (ability of content to clarify and formalize relationships with respect to the many variables).

This is too glib an explanation. Again, there has been no comment about the transparency of the client complaint procedure, which is necessary before the handling of client complaints can improve.

4. The development of the FDR would result in meaningful and understandable transparency for the client, communicated at the time that the account is opened and therefore at the point that it would be most useful to the client.

Words are cheap; this is just too glib a statement on which to place confidence.

5. The FDR may create a basis for improved discussion to address client complaints as it would clearly and meaningfully communicate the role and responsibilities of the advisor/firm and the goals and expectations of the client. These changes would, in turn, result in a stronger client-advisor relationship.

Again, there is insufficient analysis, thought and examples as to why the FDR would meaningfully communicate the role and responsibilities of the advisor/firm and the goals and expectations of the client. This is especially so given the earlier qualifications as to the ability to deliver certain aspects of the FDM.

Discussion

The FDR should convey essential information about the advisor and the firm. It should be in addition to KYC and suitability requirements information, which are primarily account centered.

Part of the problem was the old KYC forms and the suitability requirements were limited and a root cause of the problems facing investors. In one sentence the FDR is information about the firm, a paragraph before it communicates the goals and expectations of the client. Again, we need to see a pro forma document. The detail below does not provide this!

a) Form of the Fair Dealing Requirements

As stated above, the process for providing the FDR should not be prescribed. **The core information content must, however be defined**. For example, in the case of a mutual fund investment, the FDR might be virtually a pre-printed form with minor customization.

Alternatively, a complex multi-account portfolio would demand a higher level of customization. The FDR information about the firm should not be lengthy, technical or complex. In fact, the FDR information noted below is complex. **It will be a challenge to summarize these complex issues in simple language that will be meaningful to a client, who does not have the advisor's professional training**.

If provided as a stand-alone document it should not exceed a page or two. It could be provided as part of other account documentation processes. **An important objective of the FDR is to improve the overall quality and reduce the overall quantity of disclosure**.

It is unclear as to whether the role, function and place of the FDR in either the transaction or advice led service process is fully understood by the committee. On the one hand it is being addressed as a point of sale piece of information (note in case of mutual fund investment) and another as one element of the information package sent to a client with a complex multi-account portfolio.

What precisely are the complex issues? A complex issue is only a challenge if you do not know how to manage the integration of the components. As such, you will find it difficult explaining how you manage all the components.

Is it going to be a stand alone or part of other document processes?

The committee members are really struggling to find focus here. There has been no analysis of the client service process and the hence the service communication process. This partly because a transaction led service process does not have disciplined communication of service structure, of portfolio structure, of portfolio planning and of portfolio management.

A good client communication process also necessarily includes an ongoing commitment to education at every stage of the client service process – initial meeting, reporting, management/transaction, and review stages.

So in fact, the FDR is actually a continuing requirement as part of an advice led service process as opposed to a transaction led service process. With the transaction, the commitment is assuaged at the sale, hence the confusion over the FDR as a simple initial piece of documentation.

What the committee really needs, although it probably would not want it, is an analysis of the basic minimum service and education standards for both process (sales and advice) which also involves an analysis of the current service and education standards for sales and advice processes.

Unfortunately, the information the company needs to provide to explain how they work, how their service works, what they will do for the client and when, the information that the client needs to understand what they are doing and the information that needs to pass between the two to ensure full accountability is more than a 1 or 2 page document. In fact, as discussed it is part of continuum of explanation, education and justification. Anathema to a transaction based organization.

On the other hand, if all you are doing is providing a series of one off transactions that over time add up to a combination of investments which are not managed as a whole, then the FDR would be a simple 1 or 2 page document sent at the time of purchase.

To ensure **that it is concise in nature, it could incorporate by reference other documents and/or client brochures that provide more details and explanations**. The FDR could be part of the firm's "welcome kit", a separate letter afterwards or any other means the firm determines appropriate. The focus of the FDR is to ensure that disclosure is meaningful and prominent.

One of the problems with existing documentation is that they are not transparent or educational. To send the FDR afterwards defeats the object of the process. It is also unclear just why the minimal disclosure of the FDR will be meaningful. Again lack of awareness of what constitutes communication within a service led process where financial needs have a significant impact on structure planning and management of assets and an inability to understand or manage the complex relationships thereof.

One reason why firms may wish to keep it "simple", is that they may want to keep their own operations simple.

While the method of delivery may not be prescribed, the **firm must have in place a reliable process to confirm that the firm has delivered the required information.** The firm must be able to demonstrate an audit trail regarding compliance with all regulatory disclosure requirements.

Unfortunately current regulatory disclosure requirements are the problem and, as the working group's recommendations have significantly toned down the fair dealing model recommendations, it is unlikely that the resulting regulations based on the working group's deliberations are going to be much different.

The WG agreed that a **client signature was not necessary on the FDR.** The question was asked: will a signature increase investor protection or reduce firm liability? It was concluded that the presence of a signature would do neither, but would be gathered at significant expense.

In reality, neither of these documents (FDR, KYC) should require a client signature, because neither of them actually provide recommendations. The FDR may not ultimately be worth the paper it is written on and the KYC is at its heart a fact find. The problem with the KYC is that it often sets an asset allocation and a risk profile and this should really be taken out of the KYC. The KYC should also really be set up as a larger and more comprehensive fact find.

Rather than the client signing the KYC or the FDR, it would make more sense to have a detailed investment policy statement sent to each client detailing the recommendations, reasons and rationale. It is this report the client will need to sign to agree to a client relationship and the commencement of the relationship whether it would be advisory or managed for you. It is this report which will need to be backed up by the additional information required by the earlier FDM. This report will need to confirm the client's present position, objectives and risk preferences as discussed in the initial meeting and should provide reference for the client to review their risk preferences. This report also needs to provide information about the company's investment discipline and style and information and the methodology of their portfolio construction, planning and management and how it manages the risks that will affect the client's preferences and financial security over time.

It should also be a regulatory requirement that no client should be able to agree to transactions in the first meeting. It should also be a regulatory requirement that all recommendations are communicated in writing at the initial stage and at all stages for advisory clients and confirmed in writing at reviews for discretionary clients.

Therefore, it is the communication and education process that needs to be assessed for each advice or transaction led service before a communication medium can be developed.

Since the FDR relates to information that is provided to clients from the firm and does not involve the capture of information provided by clients, the WG is of the view that the relevant standard to meet is that of **establishing the delivery** of the information to the client. Simply put, the client is no position to determine whether the information provided by the firm in the FDR is correct. The WG recommends that the SRO Drafting Group consider introducing a requirement that delivery must be evidenced by a signature or other reliable means. If a signature is used, the SRO Drafting Group should consider whether that also means that the client agrees to the *terms*? What is the effect of a signature? Does it mean the client not only acknowledges receipt but also acknowledges understanding and/or agreement?

A working group is meant to have the expertise and application to define the problem and go some way to defining either the solution or the framework in which a solution can be modeled. After 3 years this regulatory review process is still asking the most basic of questions.

But please note, that if a report needs to go out to the client with the recommendations with all the information needed to assess the report and recommendations, and if this report requires a signature by the client, then many of the issues discussed above become irrelevant.

Note the client is going to be in a better position to assess the recommendations after an initial meeting and with the time to go over both the supporting information and the written rationale and explanation of the recommendations. The client's signature in this case would not only note agreement with the report, the information that the advisor has, but would also note receipt of the documents that need to be sent along with the written report.

The core principles to be satisfied by such the FDR are:

- clarity as to the nature of the services and execution being provided

- completeness in terms of the responsibilities each party has to the other (although it would primarily be what the firm is responsible for)

- comprehensiveness in terms of where and how to source detailed information and where and how to resolve questions or concerns at any time

Supervising compliance supervision of the FDR will result in significant process and resource costs for the industry. The WG recognizes that this needs to be addressed.

Supervision should actually be made easier. But the real issue is that lack of compliance is costing the client and benefiting the industry. The original Fair Dealing Model core principles included the management of such conflicts, yet the only concerns we see expressed in these documents are the costs to the industry.

Note that the FDR does not include justification for any decisions, nor accountability for any decisions. It is also a moot point, that without a clear example of this document, whether it is capable of delivering the watered down core FDR principles.

b) Content of the Fair Dealing Requirements

The focus of this document is the information that the firm is responsible to provide to the client about the firm. The **core principle behind this information is that the disclosure must be meaningful**.

The information in the FDR will change over time when there is a material change at the firm or in the client's circumstances.

Where appropriate, plain language should be used. Terms used should be defined. For example, the firm should describe what is meant by the various risk categorizations, performance criteria and the investment objectives stated in the FDR and give examples of each.

Quite how the FDR that is talked about here is able to be updated to deal with changes in client circumstances is unclear. Additionally, if the document primarily delivers information about the firm just how specific can it be regarding risks and objectives and performance criteria.

The WG recognized that some of the suggested items covered in the proposed FDR are account specific, while others are client or portfolio specific. As mentioned before, it would be useful for a single FDR to cover the client and whatever accounts the client may have however, this may not be practical for all firms and it **should be left open to the firm and client to determine whether they wish the document to be focused on the entire portfolio or on a specific account**. (The firm/client would be able to make this choice only when the firm has the systems capabilities to offer it to the client).

If the client has an entire portfolio, then it should be the whole portfolio if this is managed by the advisor. Additionally, even if the manager only deals with one account, the one account has a relationship with the client's overall financial position irrespective.

The following is the minimum core content:

Statement of the types of investment risks that are relevant to the client.

The firm must disclose relevant risk factors and the types of risk that should be considered by the client when making investment decisions.

The standard industry risk assessment has significant weaknesses and fails to address key liability risks and investment style performance risks. It also provides inadequate assessment of volatility risks as well as incomplete explanation of the nature of risk and return over time. But if the FDR is to be a 1 to 2 page document there is no place for such disclosure and education.

Disclosure of any potential conflicts of interest. To be addressed by the Costs and Conflicts WG.

It would have been nice for the working group to have referenced the cost and conflicts working group on this matter and come up with some detail on this content. But since the CCW have also managed to fudge the issue this probably would not have been of use. All conflicts of interest need to be disclosed as well as their the potential consequences of conflicts of interest. Likewise, once disclosed, the firm needs to state what conflicts of interest they will take advantage of and those which they will not.

Disclosure of the firm's obligation to recommend investments that are suitable.

The firm may wish to outline general information and examples regarding the assessment of investment suitability and the role of the firm in providing advice and determining the suitability of the investments. The firm should state whether or not their services also include an ongoing suitability obligation.

The firm's standards regarding suitability should be addressed in the FDR. Actual suitability should be stated in the written recommendations if, advisory and, confirmation, if discretionary. Suitability is first and foremost the relationship with the size and timing of the client's financial needs, secondly the relationship to the investment strategy selected for the client profile and, thirdly valuation, risk and asset allocation imperatives for the change.

The spectrum of investment options available to the client.

What products does the firm sell and what services does the firm provide and what information does the firm have about these product and services? Examples of products: stocks, bonds, income trusts.

Examples of services: advice, research, RRSPs, RESPs, ongoing monitoring of account performance. The information about the products and services should be provided to the clients interested.

It is not just the spectrum of options available, but how they determine which options are best for a given client liability and risk profile. Every asset within a portfolio has a role and a relationship to all three components of suitability discussed. In an advice based process where portfolios are constructed to meet financial needs given a client's risk preferences, an organisation's investment approach and market and economic conditions, it is inappropriate to build a portfolio up product by product and transaction by transaction. The FDM was intended to be specific to the client. The FDR appears to be another rehash of what services the company offers. On the one hand the committee talks about keeping things simple and non technical and on another they are trying to cram it full of self serving adverts. Please note the OSC comment below.

[Dissenting view: Rather than simply providing this information to clients, OSC staff believe that the FDR should identify what products and services the client is interested in. The WG believed that this level of customization would be too costly to provide to each and every client.]

Agreed. The firm must communicate to the client the areas it is to advise on and the parameters of their relationship. One of the reasons for the FDM was the compliance issues surrounding vague service agreements. The FRD is just another useless of paper bereft of communication, qualification and education. Hence, more important than the FDR is the written recommendation and justification for recommendations in all three areas – suitability to financial needs, suitability to portfolio option, suitability to valuation, risk and asset allocation.

The WG suggested that services should focus on significant items, especially requiring disclosure when the firm no longer offers a significant service. What constitutes a "significant" service is a matter for the SRO Drafting Group to consider. Alternatively, the FDR could provide for a defined agreement between the firm and the client as to what significant products and services are.

What this means is debatable, but it is symptomatic of a general lack of focus, understanding and clarification of the form and content of the relevant issues. Much of this document could have been put together over a weekend.

Explain the "fit" between the client's objectives provided in the KYC information and the firm's services.

Underlying this requirement are three assumptions: (1) financial advice and money management are services not products and (2) these services are a means to an end, not an end in themselves and (3) no future investment outcome can be guaranteed.

Financial advice is not a product only if it exists within a well defined formal relationship with clear communication of both the advice and the structure in which the advice will be delivered, monitored and judged. Financial advice without a formal framework is part of a sales driven as opposed to a service driven process. The only way in which a service can be assessed as a means to an end is within a proper service structure with full disclosure, transparency and accountability. No future investment outcome can be guaranteed even if most Investment Policy Statements provide a specific client return objective and this return objective drives the portfolio composition. The assumptions noted have no fundamental grounding or justification within this report. It is worth noting that a service implies a relationship and a relationship provides an ongoing responsibility for education, disclosure and transparency. Product sales on the other hand do not. The viability of product sales is questionable within the construct originally recommended by the FDM and the concerns and confusion noted in this document are understandable if the authors and contributors were mentally operating within the intellectual and analytical confines of a product distribution framework.

This information will **explain to the client what the firm will do for them and how it will do it**. It could include a reference to the firm's investment policies, ranges of typical asset allocations for various types of clients, or particular expertise in the firm to manage various investments that will "fit" the needs of the client. The investment risks, limitations, other opportunities given up, and what the firm won't do for this client should also be provided. This explanation will of course be tailored to the nature of the firm and the needs of the client. More information will likely be provided where the client's investment objectives are measured in decades.

The above paragraph does not reflect or relate to the general content of the report, nor does it relate to an actual FDR format or assessable content. If this document had preceded the FDM as an exploratory assessment of the issues it would have been acceptable, but it is not. A clear structure and functionality of the FDR has not been delivered by this document. **What the firm will do and how it will do it is best left to a personal written report with recommendations and justification as to suitability**. This report will be the standard on which the advice and relationship will be judged in the event of a complaint.

Reference specific account documents currently required to be provided to the client with respect to each account. See Schedule A for the disclosures that are required under current SRO rules and securities legislation.

The WG agreed that these legal disclosure documents should be reviewed to determine if they are still necessary and useful. This would be consistent with one of the core principles of the project to have meaningful and understandable disclosure and also to eliminate unnecessary regulatory requirements.

This should have been conducted by the working group.

Reporting process for each account in terms of content and frequency.

To be addressed by the Performance Reporting WG. Frequency of reporting with the advisor should also be disclosed.

Reporting process for the portfolio of the account(s) in terms of content and frequency.

To be addressed by the Performance Reporting WG. Frequency of reporting with the advisor should also be disclosed.

The nature of changes in the relationship, **which represent material changes and which require the firm to update the information in the FDR.**

Issues raised with this item include what is considered "material" and how are the material changes actually documented. This issue is an important one that requires resolution in order to improve the account opening process and maintenance of the account documentation going forward. How is an appropriate audit trail created?

These issues may best be addressed by the SRO Drafting Group.

Again, these issues should have been given much more thought. The drafting stage is too late a stage for the analytical process which should have been fully fleshed out by now. Were these working groups not allowed to communicate with each other?

The options the client has available to pose questions or concerns (web, e-mail, call center, advisor's telephone number, as appropriate).

This item simply outlines the various communication channels available to the client.

The WG suggested that the current mandated disclosure regarding services available to address client concerns should be referenced in the FDR. If such disclosure is included, we raised the issue of how detailed/prescriptive the required language should be.

Again this should have been addressed by the working group. But the complaints procedure has been largely if not completely ignored by the FDM and the RRP.

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Any additional material obligations identified by the SROs in the rule-making process, which need to be satisfied within the client relationship by the advisor over time.

This is a “basket clause”. It may be needed due to the fluid and evolving nature of the advisory relationship. It supports the principles of clarity and completeness and assists client understanding of the relationship.

The following is an optional item:

Account(s) created under the auspices of (name of advisor responsible).

Not only must the name of the advisor be disclosed but also what type of relationship exists between the firm and the advisor (i.e. employer/employee or principal/agent). The main focus however, is contact information.

[Dissenting view: OSC staff believe that the name of the advisor providing the services shouldbe mandatory. However, the MFDA note that many MFDA dealers do not assignspecific advisors to accounts. In addition, some IDA dealers refer clients to a cal center for accounts below a certain dollar amount.]

c) Implications of the Fair Dealing Requirements

The WG acknowledged that the supervision of compliance surrounding such a document may be complex. If the FDR is at the portfolio level, supervisory and compliance issues further increase.

One would assume that the supervision would fit neatly into the existing supervision of representatives. An insight into the member’s knowledge of compliance and supervision would have been interesting.

Importantly, it is not supervision of the FDR that is important, but supervision of the actual advice and the actual structure in which suitability is determined, managed and justified. If the FDR is a general information as appears to be the case from this document (although not totally clear) then the supervision will be minimal.

All documents need to have a direct relationship with the structure and framework in which advice is delivered within the company. Supervision of compliance is not just the FDR but compliance with the integrated and related advice given to clients. This is indeed a complex issue, made easier by well structured service processes. If these service processes were well structured and disciplined we would not have had the FDM initiation.

Another issue in relation to supervision is the **responsibility for supervision surrounding the preparation of the FDR itself.** Should there be some sort of supervision mechanism to ensure that a designated person reviews the FDR? This issue will be considered by the SRO Drafting Group.

If the FDR relates to service structure and is an integral part of the advice delivery mechanism, it will be an inviolate part of an organisation’s service delivery process and will automatically be updated. If it is not a living breathing document then it is nothing. *“Oh by the way Mr and Mrs Client, we have to hand you this information, it is a regulatory thing”.*

The inclusion of requirements and guidelines in the FDR will have implications. It will lead to more complete discussions between a client and advisor and will assist in clarifying the relationship. Additional information may change the scope of liability for that additional information, however, the essential nature of the liability of the advisor and firm to the client to deal with the client honestly and in good faith will not change.

What requirements and what guidelines and, why does the proposed (totally unclear FDR structure and function) lead to more complete discussions and, why would it clarify the relationship if the document does not actually need to state which services are being provided and, there is no mandated document which states which services the client has agreed to and, if there is no mandated education or risk assessment process and if advisors are not capable of educating clients and if information is to be kept to a minimum?

It can only aide the process if the underlying quality of the process itself improves. Changing the cover doth not change the book!

The WG recognized that another implication that will face firms is increased costs with the implementation of the FDR. **However, the group did not complete a cost-benefit analysis**. The WG recognized that while costs may be calculated, the benefits arising from a regulatory provision are much more difficult to assess. However, while it may be challenging to quantify benefits, a measurement of the benefits should be endeavoured.

Part IV of the Direction Document below, provides some suggestions to measure benefits. With respect to the costs, an effort to assess the costs to the industry of implementation of the FDR should be attempted. Without a reasonable effort to estimate the costs, the FDR cannot be realistically recommended.

We have industry representatives who know so little about their own processes that they cannot reasonably determine whether or not the FDR, which is hardly a rod to their backs, can be implemented cost effectively.

The whole reason for the process was to protect investors and irrespective of the costs disclosure, transparency and accountability are a must.

The industry must treat this as the cost of doing business. But, it is doubtful after reading this document that the industry has the necessary expertise, knowledge and intelligence to meaningfully police itself let alone develop a service structure capable of managing investors' assets and financial needs. If this document is beyond them one can but wonder what precisely is within their grasp!

Consider this. If an organization has a well organized service process, good organization and established lines of control and management of quality of advice, a well structured wealth and asset management process and good client communication and education standards, it has already satisfied the requirements of the FDR. This is only a cost for this organisations who do not possess such.

With respect to implementation issues, the WG raised the question of the retroactive or prospective effect of the FDR. The ultimate determination of this matter is one for the SRO Drafting Group to consider. However, the WG wanted to stress that a retroactive application of the FDR would entail significant cost.

Just in case you have not understood the cost argument.

Question 3

What information should the client with the advisory account provide to the firm? When and how should the information be provided?

Conclusions

1. The CLS Form No. 2 Sub-Committee has created a set of minimum standards that clearly and comprehensively obtains the necessary information from the client. **Much of the necessary information is also captured in the MFDA Sample New Client Account Form, which was drafted jointly by the industry and regulators at the time of the creation of the MFDA rules.** The existing requirements of both the IDA and MFDA should be reviewed by the SRO Working Group to ensure that these reflect the minimum standards that are applicable to their Members.

The MFDA sample new account form is insufficient to be able to structure plan and manage a portfolio that reflects the client's financial needs over time and the disposition of their existing investments. It is sufficient to sell a portfolio solution for a given amount of capital, for a restrictive objective based on a simple and restrictive risk assessment. Much of the problems in terms of risk, education, suitability, communication and the management of expectations are caused by the minimum service standards which underpin the minimum information requirements. Falling back on past documentation and current problematic standards should not have been the objective of the working group.

Likewise the IDA minimum account opening information can hardly be construed as "clearly and comprehensively obtains the necessary information from the client". For one, the document does not state the need to know the client's current and future income and capital liabilities, the size and timing of which has the most important impact on suitability. The account information is also focused on traditional transaction based business and lacks a proper service process focus.

It relies on the client's investment knowledge, their wealth and wealth generating ability and simple investment objectives and risk tolerance information (similar to those noted in the MFDA form) to assess suitability.

2. These minimum standards assist in articulating the role and responsibilities of the client. These responsibilities include providing information on financial status, personal circumstances and investment goals.

Quite how these minimum standards articulate the role and the responsibilities of the client is difficult to discern. The information that is given is limited. Again no justification has been provided within these reports to justify the comments made.

3. The minimum standards would achieve increased transparency through a clearer, more comprehensive KYC form that is more understandable and meaningful to clients. A client that understands the information that they must provide to the firm will also assist in better managing client expectations and thereby reduce the number of disputes.

These minimum standards (the MFDA KYC and the IDA minimum standards document) would not achieve increased transparency.

It is doubtful whether the KYC form would actually be more meaningful to clients because it does not explain why the data provided relates to a specific portfolio outcome, how the portfolio will be managed, the rational for the relationship between their needs and portfolio structure. Additionally it does not provide transparency of costs nor does it provide a set of minimum services standard the client can expect form the provider.

Why it will assist better management of expectations is not explained but expectations are managed by education and communication and the assessment of risk aversion given a certain level of education and communication.

There is still no clarity as to how disputes will be better managed since it should have been obvious to the compliance departments what the problem is and was even under the old rules, which are apparently clear and comprehensive about the information needed from the client.

4. Confirmation by the client with a signature on the KYC document should not be required. However, a firm should verify the client's agreement with the information recorded. Similarly, firms should have policies and procedures for verifying material changes to client information. Client verification should be the standard.

Signatures are needed if the KYC is recommending an asset allocation and no further correspondence or communication or acceptance of actions is to be undertaken by the advisor. Without signatures how can one start to validate suitability and know your client?

Clients need to sign an agreement that dictates the parameters of the relationship, the rationale and structure for the planning and management of assets, the costs and the justification of investments and investment strategy.

5. Clients should notify the firm of material changes to their KYC documentation. What events constitute a material change should be discussed. It is unclear what the consequences would be if the client fails to inform the firm of material changes to his or her circumstances.

Really, this should not even be a question. What is material is anything which affects the structure planning and management of assets to meet financial needs. This means a change in risk aversion, a change in financial needs or a change in the timing of financial needs or a change in financial objectives or a change in wealth and earnings that would directly affect the structure of the portfolio.

However, a proper service review process and client communication standards would resolve these issues. What is material should not even be up for discussion, but should be easily stated as a point of fact.

Discussion

While Questions 1 and 2 discussed what information should flow *from* the *firm* to the client with an advisory account, Question 3 addresses the information that should flow *from* the *client* to the firm. It examines the information that the firm requires from the client to manage the relationship effectively in order to achieve the client's desired results.

The Compliance and Legal Section of the Investment Dealers Association had previously struck a sub-committee to examine the IDA's current KYC form, known as Form No. 2

"New Client Application Form".

The sub-committee revised the New Client Application Form in order to come up with more flexible guidelines for the various types of accounts. A set of minimum standards was created for retail, institutional and discount accounts.

The WG reviewed the Minimum Standards documents of the IDA and MFDA (see Attachments II and III). The WG agreed that the SRO Drafting Group analyze these documents to determine if they adequately address the requirements for information to be obtained and maintained with respect to retail "advisory" clients.

The WG also examined the question of whether a client signature should be required on the KYC document. The WG agreed with the original recommendations of the Form No.2 Sub-Committee as contained in section 5(a) and (c) of Attachment II. These recommendations refer to client verification of the critical KYC information.

Section 5(a) states that Members should be required to verify the client's agreement with the information recorded. The verification may be by way of a client signature, or by other means acceptable such as a verification letter sent to the client providing negative consent.

Section 5(c) states that Members should be required to have policies and procedures for verifying material changes to client information, including address changes and material changes in financial information, investment objectives or risk tolerance. Such policies and procedures may include the receipt of a signed client acknowledgement of the changed information, some other form of client acknowledgement such as through a password protected Web access system, or failure by the client to respond to a notification of the change.

However, what is considered a "material change" in the Minimum Standards is not clearly defined, nor is it clearly articulated how and when this change is made. These are matters that should be addressed by the SRO Drafting Group. The issue is an important one that requires resolution in order to improve the account opening process and maintenance of the account documentation going forward. Knowing when material changes should be communicated and what these changes are is directly related to the fair dealing principle of clear allocation of responsibilities.

See the above comments.

Question 4

What informational elements have to be compatible with a practical compliance and supervision process?

All information relevant to the firm's supervisory responsibilities must take a form that is usable in the member's supervision process.

Question 5

Whether and to what extent the recommendations of the CLS Form No. 2 Sub-Committeethe existing MFDA Rules and Policies address the issues identified in questions 1 to 4 above.

As discussed above, Question 2 would, in addition to the new FDR, also require certain agreements and disclosure statements to be provided to the client from the firm. These are based on existing regulatory and SRO requirements and are set out in Schedule A entitled "Existing CSA and SRO Disclosure Requirements for Dealers".

No analysis is provided regarding the integration of these agreements within an FDR regime, or whether many of the original FDM considerations would be better housed as additional agreements to those noted.

Question 3 is fully addressed via the IDA's Minimum Standards for New Client Account Opening Documentation and the MFDA's Sample New Client Account Form.

Not really, see prior comments.

Question 4 is not addressed by the IDA and MFDA Minimum Standards documents, which only requires information relative to supervision suitability, not supervision in general.

Comments throughout this document cover the fundamental concerns underlying this context.

Question 6

Are the information requirements for self-managed and managed accounts different fromthe information requirements for an advisory account?

While the WG's primary focus was on the challenges surrounding advisory accounts, service and/or confusion issues may be raised by clients with respect to their selfmanaged or managed accounts. Consequently, FDRs for these types of accounts may help eliminate these problems. The WG recommends that the SRO Group draft FDRs for self-managed and managed accounts, which would outline the different information requirements for these accounts.

This, or at least a good portion of this work should have been conducted by this working group!

In addition, the CLS Form No. 2 Sub-Committee has drafted Minimum Standards for New Client Account Opening Documentation for both self-managed and managed accounts, which is another useful tools for setting out some guidance for the advisor/client relationship.

Again, not as usefull as they think. See prior comments.

III. Bill of Rights that Outlines the Responsibilities as an Investor

The Securities Industry Association's "Commitment to Clarity" initiative contains a statement of the rights and obligations for clients that firms should provide to each client.

The WG recommends a similar approach. It would set out the rights conferred on the client under SRO rules and securities legislation. The document would also set out the client's responsibilities and obligations as an investor. However, to the extent that clients' rights are already articulated in the FDR, the Bill of Rights may be primarily focused on the client's obligations.

The trouble is that current regulation does not effectively manage these rights. In fact, the reason for the FDM in the first place was that regulation was inadequate when it came to protecting individuals from poor self serving advice. Regulation deals primarily with specific securities and market issues as well as fraud and does not deal specifically with standards of financial advice.

The SIA investor's rights document is a fair document. At the firm level it needs to be backed up with clear service standards, better communication and comprehensive education. On their own these rights mean nothing unless there is point of reference to determine when a company has veered from acting in accordance with those rights.

The WG believes that the use of such a Bill of Rights and Responsibilities should be flexible in regards to whether it is part of the FDR information. We recommend that the SRO Group consider whether the provision of the statement of rights and obligations should be mandatory.

Statements of rights should encompass the right to full disclosure and transparency, accountability and justification of decisions. These rights should not just be a set of bland statements unenforceable in a court of law but a set of rights that bind the service provider to meeting certain standards. It is up to the company to determine the level of rights and the accountability it wishes to burden itself with. However a company's service standards and costs should be capable of being compared to any other company in the market place. Investors should not be forced to contact an advisor to find out the limited information they are currently given.

IV. How to Measure Progress of the Working Group's Proposals

All three WGs were asked to consider developing benchmarks to measure the success of their recommendations. With respect to the proposal for the Minimum Standards for New Client Account Opening Documentation, the WG considered asking advisors and retail clients alike to complete the new document to determine if it is easier to understand and more straightforward.

But there is no new document and there are no new procedures and there is no detailed analysis and there is no solution or framework for the development of a solution.

We suggest that a focus group format be used to receive client input on the FDR. The focus groups would offer input not just on the general document but what is missing from it and whether the FDR clarifies the advisor/client relationship. The WG agreed that the SRO Drafting Group draft a prototype FDR to be used for the focus groups. The exercise of drafting one by the SRO group would also assist in revealing any issues/difficulties in the creation of such a document.

Industry experts, academics, asset management consultancies and consumer bodies should have been brought into these working groups to enhance their accountability and objectivity. Likewise so should the focus groups. But, this type of involvement would open up issues that brokerages would prefer to avoid. For instance, concerns over basic administrative and compliance costs over documentation discussed here could derail the implementation of the FDR.

The WG also considered a customer satisfaction survey to compare satisfaction currently and then after the Minimum Standards and FDR are implemented. We also considered looking at the number of complaints before the new Minimum Standards and FDR are implemented and after they are in place, but the **WG concluded that the number of complaints may not be a useful indicator as there are a**

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variety of factors that affect the number of complaints. For example, complaints often rise and fall depending on whether it is a bear or bull market. It would be difficult to attribute complaints to factors (such as the lack of the FDR). A better measure may be an analysis of the complaint handling process and whether complaints are resolved more efficiently after the implementation of the FDR compared to previous complaint resolution benchmarks.

On the contrary, irrespective of whether the market is rising or falling, it is easy to determine whether a complaint is due to a lack of an effective structure and process for the construction, planning and management of assets to meet financial needs over time.

What is important is that you have a structure that relates needs to assets. What the group is saying, is that in an unstructured industry all complaints are effectively both valid and invalid because there is no way of determining what is or is not an appropriate structure, planning and management of assets.

An analysis of the complaint handling process in detail would be a good starting point but not, as suggested, an alternative.

The WG strongly recommends that the amount and complexity of mandated disclosure be consolidated and reduced. Currently, Schedule A contains a list of such mandated disclosure. A reduction of the amount and the use of plain language to further reduce the length of these documents would be a measurable and achievable benchmark.

It is hard to take this last recommendation seriously. Obviously the main consideration is that education, transparency and disclosure slows down the sales driven business process of the IDA and MFDA member firms. The representatives of the firms and the firm's systems and portfolio construction, planning and management processes and methodologies cannot cope with the higher standards needed to provide meaningful wealth and asset management advice, at this present time.

There is nothing fundamental or rigorous in this document to substantiate any of their claims, recommendations or objectives. But this should not be a surprise. The members of the group are a product of the practises that have been embodied in the institutions and handed down generation after generation. Pharmaceutical companies do not, on their own, determine whether a drug is suitable for sale to the public and tobacco companies do not determine tax or tobacco legislation.

Processes, systems and methodologies reflect the values and objectives of a given company or industry. The institutions represented on the working group do not have the expertise to understand the operational requirements of delivering asset management services to within a liability management framework, which is what relating asset allocation and security selection to financial needs is principally about.

Current services have grown up around a product and transaction driven industry and the rules, regulations and service and business processes reflect that association. The industry lacks the frameworks needed to directly relate financial needs to portfolio construction, planning and management, thereby providing a fundamental basis for client relationships and its effective management.

A fundamental change is therefore required to take the original FDM concept to its logical and ultimate conclusion; rules and regulations for an advice based industry. This change far exceeds the simple renaming of account documentation, simple disclosure and token transparency offered by the RRP documents.

Specific comments

The client advisor relationship depends on the level and form of communication. Client communication involves the giving of all the necessary information that will allow a portfolio to be structured, planned and managed to meet the stated objective as well as feedback to risk assessment, education, written/oral proposals and recommendations.

Advisor communication involves education about investment, their style of investment, their assessment of the client's attitudes to the various investment risks and degree of aversion to their investment style.

Effective communication involves reporting in writing the reasons and rationale for the management of assets and financial needs at outset of the relationship and over time. The level and quality of advisor communication is a direct reflection of their expertise, ability, organisation and service objectives; the narrower the service and asset management objective the lower the reporting requirement.

Only effective communication will result in a portfolio appropriate to client needs, market conditions and to the numerous risk preferences that influence an investor's decision. Risk assessment is a key area of weakness within the financial services industry. Most risk assessment is ill suited to managing client expectations or in relating the client's investment preferences to those of the advisor. In fact, much of the industry's risk assessment is based on a minimum standard designed to cover basic compliance requirements required to satisfy security regulations.

As to the client's investment knowledge, many firms simply identify the client's existing investment knowledge and the client's attitude to risks based on that knowledge. This is insufficient to develop the necessary communication required to provide effective long term asset management. Education is not a regulatory requirement and should be.

The education many advisors give their clients is either limited or is comprised of "naïve" simple messages designed to assuage client concerns over risk and return and to deliver a product or portfolio solution.

Transaction driven service processes lack an internal structure around which to manage financial needs and assets. Education, communication and justification of recommendations require such a structure. The fact that what a client is getting is not clear and open to interpretation is therefore no surprise. Unless the underlying process changes, merely mandating better communication is not going to change what the client gets, nor will it manage the conflicts of interest inherent in the process.

But, you cannot force an industry to deliver a certain service. What you can mandate is complete disclosure of all factors that an investor will need to know to make a decision. Additionally, a complete and detailed statement of services and service standards and significant factors affecting investment and portfolio construction disciplines, the level of personalization provided, the risks managed and how they are managed needs to be openly provided by firms. The trouble is trying to get firms to disclose this information and when and if this information is disclosed to have independent assessment of this disclosure.

PERFORMANCE REPORTING GROUP COMMENTS

The Working Group did not establish its own mandate but rather adopted relevant aspects of the mandate that was to apply collectively to the Core Principles Working Groups (as set out in the November 10, 2004 memo sent to all Core Principles Working Group participants) as indicated below

- the three core principles; clear allocation of responsibilities among the client, the services provider and the firm, transparency (i.e. disclosure that is understandable and meaningful to the client communicated at the time and in the form most likely to be useful) conflicts managed to avoid self-serving outcomes, existing regulatory and SRO requirements that successfully address the core principles the gaps that exist between current regulatory requirements and the core principles possible solutions to fill the gaps (e.g. revised or new rules … or less prescriptive enunciation of
- existing regulatory requirements that may no longer be necessary
- specific methods for the measurement of the success of the new regulatory and SRO
- requirements and benchmarks, if applicable
- recommendations for the Drafting Group

The primary focus of the Working Group was therefore the development of recommendations for **understandable and meaningful disclosure of performance, performance benchmarks, service costs and risks.**

As with the other working group documents, the recommendations made lacked the necessary analysis of the problem and the detail that would help the drafting group. Recommendations may have been understandable but were far from meaningful. An opportunity to make a comprehensive analysis of the problem which would have led to better and clearer regulation and/or voluntary rules of conduct was not made.

Of all the areas (account opening, costs and conflicts of interest and performance analysis), performance analysis is probably the most complex and the most subtle. Performance analysis of portfolios constructed to meet financial needs is actually more complex than traditional performance analysis.

In reality, the ability to conduct performance analysis is related to and determined by the order and structure of the wealth and asset management service process. This requires discipline at the valuation, security selection, asset allocation, portfolio construction (adjusted for size and timing of financial needs, risk and performance preferences), portfolio planning and management levels.

Of all the areas considered by the FDM, performance analysis has the greatest potential to be a catalyst for change within the industry. It is also a development to be feared the most by a decentralized, disorganized transaction driven service industry. If there is a can of worms, meaningful (to the client) performance analysis will open it.

To understand "it", to develop "it" and to apply "it" to value added analysis of private client portfolios requires a high level of expertise. As every organization will have a different defined methodology, the decision rules for determining performance analysis and benchmarks will be different for each organisation.

Work Plan

The Working Group approached its task by first performing a review of the regulatory requirements. A summary of the current requirements mandated by the OSC, the IDA and the MFDA is included as part of the document entitled "Matrix of Performance Reporting Working Group Issues, Current Requirements and Working Group Recommendations" (enclosed as Attachment #1). As the title indicates, this document lists the issues reviewed, the current regulatory requirements and summary recommendations of the Working Group on each issue. The remainder of this direction document discusses the recommendations of the Working Group in greater detail.

Current rules and regulations are weak to non existent. The minimum standards relate to regular valuations and communication of account statements in the event of transactions.

Perhaps the regulators should have a set of voluntary rules regarding higher levels of performance and risk analysis. Those companies complying with the various levels would be displayed on the IDA website. Investors would therefore know which companies provided the highest levels of accountability.

Working Group discussions and recommendations

Account statements

The Working Group discussed both the content of the current client account statement and the operational implications to the dealers of making changes to the content of the client account statement. It was agreed that disclosures that would provide meaningful information, in addition to those contained in the current client account statement, **in the areas of performance, services costs and risk,** could be provided to the customer.

We need a rigorous definition in this document of the word meaningful and its application to performance analysis. A salesman's attitude to what a client really wants is not considered the type of statement that should be driving this working group's focus.

In order to make practical recommendations as to how these additional disclosures should be provided to the client, the current approach used by IDA Member firms in providing performance information to their clients was reviewed. **This review determined that performance information was being provided to clients through the use of a system that was separate from the books and records system that is used to prepare the client's statement of account**. Based on this review, the Working Group concluded that any requirement to mandate that additional disclosures be incorporated into the client account statement would be too costly in relation to the minimal benefit of incorporating all client account related disclosures into one document.

On this basis, the Working Group did not believe it was appropriate to mandate that any additional disclosures be incorporated into the client account statement. *The Working Group was informed that there are vendors that offer "all in one" solutions that could incorporate additional performance, service cost and risk disclosures into the current client account statement format. If a dealer were to adopt one of these solutions, costs would be incurred in abandoning existing performance systems that might be in excess of the costs of modifying their existing performance reporting system.*

This is not really clear, or if it is clear, it is not adequately explained.

It appears that the portfolio administration systems do not have a performance analysis or statement of performance capability. It states that performance analysis is conducted by systems that are separate from the books and records system. If this is the case, then those providing performance analysis must be inputting client holding and transaction data twice.

If they are not inputting data twice and if performance systems are separate then the performance analysis is not the performance of their investments or their investments versus a comparable benchmark.

No explanation has been given as to why providing performance analysis capability into account statement is too difficult and costly within existing systems and, or, why it is a problem in the first place, if other systems provide the same reporting requirements.

It also does not explain why those firms who do not provide performance analysis should not upgrade their books and record systems. Part of the consideration paid by investors over the years could even be considered an implicit payment towards this type of information.

Additionally, providing performance analysis is appended to the account statement, it does not matter where the performance data comes from. It could therefore be sent along with the statement of account.

The above does not explain why costs and risk could not be mandated into the account statements, only why performance data could not.

The text does not fully explain the role of this so called "performance analysis system". It could very well be an internal quality control instrument monitoring performance, hence the fact that it is separate. Most software nowadays has an eye towards integration. As such, designing an interface in the books and records systems to access data from the performance system should be simple and, thereafter designing a report would be relatively easy. All run of the mill software development issues!

The Working Group did identify that the collection and maintenance of security / account cost information was a critical ingredient to the calculation of performance information. Since market value information is already being reported in the client account statement on both a security specific and total for account basis, the Working Group recommended that the same disclosures of cost information be required to be provided in the client account statement.

Security/account cost information is critical to performance analysis, what a revelation. It would be a surprise if the books and records systems do not hold this cost information, but the performance analysis systems do. In order to provide a performance analysis, you need cost and transaction data, which, means the performance analysis systems may actually have all the information needed to perform a valuation of investments, provide a book cost as well as a performance analysis.

The above does not actually state whether the general books and records systems possess the cost information and, if they do, that they do or do not report it.

The Working Group did not make recommendations on client account statement frequency as a result of recommending that the additional disclosures being recommended need not be incorporated into the client account statement.

Actually they only recommend that the performance data not be incorporated, they did recommend that cost data was included, but made no mention of risk data to this point.

The Working Group concluded that the dealer should have the flexibility to adopt the most cost effective approach to providing these additional disclosures.

As long as the solution meets minimum standards of communication, which are not fully disclosed or comprehensively discussed.

Account statement recommendations

Recommended that any additional performance, service cost and risk disclosures that are mandated need not be incorporated into account statements and that the frequency of these disclosures need not be tied to minimum account statement requirements

No explanation as to why risk disclosure should not be provided, did actually recommend that cost be disclosed in account statement as noted below (the latter may just be confusion over poor drafting).

There is also no analysis of the responsibility of disclosure of this information with regard to frequency. For example, during volatile markets it makes sense to communicate to the client how investment strategy and portfolio structure is managing the risks and returns of the environment. Leaving this to a yearly frequency implies that these communications are not an important part of the client relationship. Yet, as far as the client is concerned, risk and return are two of the most important ways in which they can assess whether the manager is doing their job and whether the portfolio is doing what it is supposed to do.

In what is supposed to be an advice based industry, the trappings and influence of the transaction led service process seem hard to shake off. Many services sell themselves on their ability to personalize and manage risk and return. This statement needs to be backed up with communication and commitment. The technological age we are in provides us with the tools to do this at a much lower cost.

Recommended that the disclosure of cost information (both security specific and total for account) be required in account statements No recommendations were developed for statement frequency as the Working Group did not recommend that the incorporation of additional disclosures into the client account statements be mandated.

Performance reporting

(i) Target client audience

The Working Group discussed the client audience to which performance reporting should be targeted. The Working Group concluded that the greatest concern is with retail clients with limited investment knowledge that are highly reliant on an advisor for investment advice. The performance disclosure provided would therefore need to take into consideration what matters most to these clients.

Presumably this does not mean that those with greater knowledge do not need performance reporting?

It is not just a question of reporting what matters most to a client. Many investors are ignorant of just what it is they need and or are entitled to. To say that what clients really want to know, is whether they have made or lost money, is an abnegation of a responsibility to the investor.

The investor hands their money to be managed by professionals, individuals and companies with the expertise to do their best, within reason. The investor therefore needs to be able to measure the value that the advisor has added relative to costs and to what he or she could have achieved either elsewhere or by being invested in a passive alternative. Value added can be measured, justified and communicated in a number of ways. What is important is that the advisor regards this duty of care as an imperative not an involuntary enforced action.

A discussion of this responsibility would have been most helpful and an opportunity was lost to define the rights of investors and the responsibilities of advisors in this key area.

(ii) Form of disclosure and calculation method

The Working Group looked at various forms of performance reporting that would address the specific needs of retail clients. Most retail clients want to know first and foremost whether they are making money or losing money. To address this, the Working Group has recommended that a summary of account activity report be provided.

The needs of the retail client should be translated as the rights of the retail client and the responsibilities and duties of the advisor/firm.

The Working Group has also recommended disclosure of percentage return performance information to the retail client. AIMR standards would be followed to calculate portfolio performance information. Where multiple AIMR standards are permissible, the SROs will need to determine whether to prescribe the use of certain standards to ensure there is comparable disclosure.

(iii) Aggregation approach

The Working Group discussed a number of questions relating to the client account positions upon which performance information should be provided as follows:

Should performance be reported on an account or a portfolio level?

Should non-advised positions be excluded?

Should positions not in the custody of the dealer be excluded?

Account versus portfolio

The books and records system at most dealers has been set up to report on an account by account basis and not on an individual portfolio or household portfolio basis. The Working Group therefore expects that the default form of performance reporting will be account reporting, but considers either account or multiple account (either individual portfolio or household portfolio) performance reporting to be acceptable. Further, if the dealer makes multiple account reporting available, the retail client should be allowed to choose between receiving account or multiple account reporting.

Asset allocation and security selection should be effected within a portfolio structure. It is only through the portfolio that we can effectively assess the contribution of all portfolio components to risk and return and hence the effectiveness and cohesiveness of the advice given. Default performance analysis should be at the portfolio level since this is the level at which the client will benefit most from disclosure and transparency.

Definition of the service to be provided at outcome is very important. An advisor looking to manage all an individual's assets and needs and is responsible for the allocation, planning and management of all assets has a responsibility to assess the risk return structure of the entire allocation.

An advisor who is just managing the individual's RRSP only needs to report the performance on the RRSP and an advisor who has been asked only for a recommendation for a security or mutual fund would only need a performance analysis of the security.

An analysis of the service and service responsibilities relative to performance reporting requirements would have been useful. As with the other reports you wonder how much time was spent on the detail and whether the reports provided represent the sum total of thought and synthesis of the problems and issues at hand.

Inclusion or exclusion of non-advised positions

For similar systems limitations reasons, the Working Group did not feel it would be appropriate to mandate that performance reporting also detail the performance of advised versus non-advised securities positions. However, if the dealer makes it available, the retail client should be allowed to receive performance reporting with advised/non-advised detail.

What exactly is a non advised position?

Is it a position which the advisor would not recommend but the client wanted it, or retained it from a previous portfolio?

Is it an asset recommended by a previous manager and which although not recommended by the advisor has been retained because it fits the asset allocation strategy?

For example, a client holds a large cap index fund but, the advisor recommends a different large cap index fund. Both funds have the same cost and risk/return profile. It would not make sense selling the existing holding which would be incorporated in the advisor portfolio. This could be technically called a non advised position. Additionally, a holding in a large cap stock recommended by a previous manager is retained by the current.

Additionally, if the advisor is being paid for overall asset allocation, risk/return and liquidity management on a fee basis, he or she could be earning a return on non advised positions. In this case, performance analysis is necessary.

Likewise if you are charged with managing the entire financial position and you are receiving a fee on this management, there is a duty to communicate the risk and return profiles of non advised positions. As long as they can be easily entered within a portfolio administration system, they can be incorporated into performance, risk and asset allocation analysis.

Systems limitation reasons are not historical imperatives nor are they arguments which fit well within the duty of care that an advisor has. If you do not mandate now, systems may never change while organisations will continue to earn a return from their omissions.

There should have been an assessment of the rationale for the legacy systems the industry has and whether or not they represent the type of systems needed within an advice based service process. Indeed, if the industry is still transaction led then performance analysis of non advised investments, investments not in the custody of the advisor etc would not need to be an objective of the industry.

Inclusion or exclusion of positions held in custody outside of the dealer

The Working Group discussed in great detail the various means by which securities positions are held for a customer. Security positions may be:

In nominee name

In client name in physical form and held by the dealer in custody for the client

In client name in physical form and held by an outside custodian

In client name in book based form and held by the security's issuer or the issuer's custodian

The Working Group was quick to agree that performance reporting should be provided for client account security positions held in nominee and client name that are held in custody by the dealer for the client.

The Working Group had lengthy discussions about whether or not to extend the performance reporting requirement to include client name security positions that are either held in physical form by an outside custodian or in book based form. The factors considered by the Working Group were impact on operations and accountability.

Dealers that exclusively execute trades in security positions held in client name in book based form have no current means of providing detailed performance information, since their existing books and records systems do not track client named book based security positions at a client account level. In the case of client named security positions held in physical form by an outside custodian, **there is also the practical consideration that the dealer would have no way of knowing when the position is sold**. On the issue of accountability, the Working Group agreed that dealers should be held accountable for the performance of all securities positions on which they continue to earn commissions, trailer fees or any other form of revenue.

The Working Group has recommended that, in the near term, performance reporting should be limited to client account security positions held in nominee and client name that are held in custody by the dealer for the client. While the Working Group agrees that dealers should be held accountable for the performance of all securities positions on which they continue to earn revenue, the significant operational impacts involved make providing performance information on client named securities positions that are either held in physical form by an outside custodian or in book based form a longer term objective.

That accountability should be limited by weaknesses in the portfolio administration systems of IDA and MFDA members is not a reason for not mandating performance analysis on all investments on which a commission or fee is earned, either directly or indirectly. As stated, excluding assets recommended for their contribution to the portfolio would severely limit the benefits of performance analysis and would restrict the ability to communicate and justify performance.

Advisors and the services they provide need to be accountable. If "you" cannot deliver then you should not be allowed to operate within the industry.

Again, the scope of the service and the responsibility taken on by the advisor and the service the client thinks the advisor is providing will also have a bearing on whether all investments are taken into consideration within performance analysis.

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[Dissenting view: OSC staff do not agree with this limitation, as this would result in no near term disclosure by dealers to their clients in respect of client named securities not held by the dealer. OSC staff believe that performance reporting should be provided by the dealer for all securities for which the dealer continues to receive compensation. However, OSC staff recognize that dealers should be able to outsource this function to take advantage of some of the current sources of information.]

Other security exclusions

As a practical matter, there are a number of classes of illiquid securities that are hard to value and in some instances regulatory requirements mandate that certain security positions be given no market value. As a result, it may be appropriate to exclude certain securities where market value is difficult to determine.

(iv) Timeframe

The Working Group has recommended that performance be disclosed for the current year and since account inception, at a minimum. As practical implementation matter, performance from rule implementation date could be provided in place of performance from account inception. The dealer may make available additional timeframes that are consistent with the client's investment timeframe.

Advice based services should provide performance and risk analysis of portfolios every six months. Importantly it is not just the figures that need to be provided but also a justification of strategy and rationale and an explanation of what has been happening to markets in general and portfolio components in particular.

All portfolios should be capable of being related back to a central valuation, allocation and management discipline. All that is happening in the portfolio at the client level is that central asset allocation and security selection is adjusted for financial needs and risk preferences. You should not have to write 100s of individual reports.

It is important to note that an efficient portfolio administration system should be capable of generating performance analysis on all portfolios at the click of a button providing all entries are up to date. Such a system should be capable of being accessed real time at all times without being a cost burden.

(v) Frequency

The Working Group discussed at length the appropriate performance reporting frequency.

Concerns were expressed that if performance was reported too often, clients might be inappropriately influenced by short-term market value movements. It was also noted that there would be retail clients engaged in short term trading that may wish to receive performance information on a more frequent basis than other retail clients. The Working Group has recommended that performance reporting should be provided on an annual basis, at a minimum. More frequent reporting can be provided depending on the level of service being provided by the dealer and the client's willingness to pay for such service.

Six monthly as a minimum would be best for advice based services since it is important that a manager justifies their strategy and transactions to the investor within a time frame relevant to current events. Organisations that place an emphasis on education and communication would naturally report at least six monthly to clients. Transaction led firms would find annual performance analysis an onerous commitment.

It is within unstructured and undisciplined service structures that having to report and justify performance will quite possible cripple the ability to deliver the service. If this means the development of a leaner, fitter industry delivering higher quality services at a lower overall cost, then so be it.

Inefficient firms should not be protected from market forces.

Disclosure and transparency will force companies to compete, benefiting the individual investor and having a positive impact on the public interest.

(vi) Target returns

The Working Group did not address the provision of target returns for purposes other than providing a range of possible returns for risk disclosure purposes. This issue of providing a range of possible returns for risk disclosure purposes is discussed as part of the "Risk disclosure" section of this document.

Target returns are often provided to investors because they are part of the basis on which the recommended portfolio is selected. They are also the basis on which mean variance optimizers construct portfolios.

Where returns have been provided as part of the investment policy statement, the target return and the actual return do need to be explained. Otherwise you have misrepresentation if the target return provided is not fully explained.

Most retail risk assessment provides a range of portfolios with upper and lower limits of either return or percentage change in values. The problem here is that if the ranges are derived from average monthly historical risk/return data, they are likely to deviate at times significantly from actual performance. For example investors buying in 2000 are still unlikely to see average annual returns in the ranges provided in this document.

Additionally, if the ranges are provided from the maximum and minimum rises and falls experienced from a portfolio of that type, it does not adequately allow for current market valuations and risks. Explanation will still be needed if performance differs from these ranges or lies at the extremes of these ranges and, if the performance ranges are given as a guide as to what performance to expect form the risk profile of the portfolio. Performance analysis should explain and justify strategy in the event of extreme or prolonged adverse market movements. Additionally, performance analysis and justification represents the continuing commitment to client education.

One of the problems with performance analysis that is not obvious is that the justification for performance and adverse market movements requires an explanation of valuation and current events. Most retail portfolio construction and management is only conducted within a mean variance construct. There is no relationship between point in time valuation and economic risks and mean variance optimization.

Additionally, greater explanations of the realities of Monte Carlo distributions, where used, need to be provided as well as the limitations of mean variance optimizers, where used. Where representation of risk and return is different from that actually experienced and where consequences and realities have not been explained at outset, the advisor's statements to the client regarding the service could be a misrepresentation.

The use of target returns within portfolios need to be regulated and standards for their use and the explanation of the weaknesses and limitations of these return estimates or variation of return/risk estimates needs to be explained.

Performance reporting recommendations

Recommended that the focus of the disclosures should be on retail clients only Recommended that cost information be used to provide a summary account activity report. The definition of the term "market value of securities" as set out in the General Notes and Definitions to Form 1 of the IDA Rule Book specifies that where a security position is "not readily marketable, no market value shall be assigned".

Recommended that AIMR standards should be used to calculate portfolio performance information

Where multiple AIMR standards are permissible, the SROs will need to determine whether to prescribe the use of certain standards to ensure comparable disclosure.

It is expected that the default form of performance reporting would be account level reporting, but either account level or portfolio level performance reporting would be acceptable.

Portfolio level should be the default and, only if there is no portfolio level should the account level be the default. **Otherwise, this is not meaningful disclosure.**

If the dealer makes it available, the retail client should be allowed to choose between receiving account level and multiple account level (either individual portfolio or household portfolio) reporting.

There are software solutions that can deliver all of the above. Again, if you provide a service you have to communicate performance and risks relevant to the service you are providing. Otherwise, where is the consideration. Consideration in any other contract needs to be clearly stated.

If the dealer makes it available, the retail client should be allowed to receive performance reporting with advised/non-advised detail.

See points discussed re advised and non-advised.

Recommended that, in the near term, performance reporting should only be provided for nominee and client name securities that are held in custody by the dealer for the client.

While the Working Group agrees that dealers should be held accountable for the performance of all securities positions on which they continue to earn revenue, the significant operational impacts involved make providing performance information on client named securities positions that are either held in physical form by an outside custodian or in book based form a longer term objective *[Dissenting view: OSC staff do not agree with this limitation, as this would result in no disclosure by dealers to their clients in respect of client named securities not held by the dealer. OSC staff believe that performance reporting should be provided by the dealer for all securities for which the dealer continues to receive compensation. However, OSC staff recognize that dealers should be able to outsource this function to take advantage of someof the current sources of information.]*

Performance analysis is effectively useless without the inclusion of all assets on which a commission or fee return is earned. **This is not meaningful disclosure and this considerably weakens accountability**.

Investors should not be placing their money with advisors who cannot justify their performance on all the investments they recommend and manage.

It may also be appropriate to exclude certain securities where market value is difficult to determine

Recommended that performance be disclosed for the current year and since account inception at a minimum.

Last six months, last year, last three years, last 5 years and last 10 years and/or since inception. Accounts that have been in existence for a long period of time, need to be able differentiate between short and long term performance.

It is also important that where model portfolios are provided, the historical track record of these model portfolios relative to a comparative benchmark (s) are provided and an explanation of the performance is provided. This should be mandatory.

As practical implementation matter, performance from rule implementation date could be provided in place of performance from account inception The dealer may make available additional timeframes that are consistent with the client's investment timeframe

Recommended that performance reporting should be provided on an annual basis, at a minimum.

More frequent reporting can be provided depending on the level of service being provided by the dealer and the client's willingness to pay for such service The provision of target returns for purposes other than providing a range of possible returns for risk disclosure purposes has not been recommended by the Working Group

The FDM document did not recommended target returns, they did recommend that where provided deviations from the target returns were explained and justified. This should be mandatory since it represents a requirement to justify performance where target returns are provided. But does the working group recommended that target returns should no longer be provided.

Performance benchmarks

The Working Group agrees in concept that appropriate performance benchmarks should be provided for those accounts for which performance information is provided to enable the retail client to compare with account/portfolio performance information.

However, the Working Group does not believe that appropriate benchmarks are always available. As a result, the Working Group has recommended that an appropriate benchmark should be provided but if there is no appropriate benchmark, no benchmark information need be disclosed. Situations where benchmarks may not be available/appropriate include: complex portfolios, where no relevant reference benchmark is available and simple portfolios involving relatively few securities, where the use of a benchmark may provide no meaningful information. Guidance on determining when it is appropriate to provide a benchmark should be developed by the SRO drafting group.

There should always be a reference point and as discussed, irrespective of complexity there should always be a rationale benchmark for a rationale portfolio construct. All asset allocation has a relationship with a comparable benchmark. Simple portfolios with only a few securities should also have a benchmark comparison to show the risks of the portfolio.

However what is not sufficiently disclosed is that an appropriate benchmark for the private client objective is different from what is an appropriate benchmark for say a smaller company fund manager, or, a large cap or an emerging market fund manager.

Again, the benchmark decision is also affected by what service or investment objective the client has selected. If the client is looking for a manager to manage the smaller company component of a portfolio, then standard industry benchmarking analysis can be used.

If however, the client is looking for the management of all assets to meet financial needs and is invested in smaller company investments on the advice of the advisor, the benchmark decision is different. In this case an asset allocation towards smaller stocks away from the market has been taken and therefore one of the benchmarks needs to be the main market index, representing as it does the universe of investment options available to the portfolio within that market.

Within the realm of the private investor where the advisor makes the asset allocation decisions relative to the financial needs and risk and performance preferences of the individual, benchmarks needs to include domestic and international market indexes as well as a style specific and risk specific benchmark. When an advisor is investing a client, he or she is making a definitive value statement when deciding both the asset allocation and security selection. They are saying that they can add value, reduce risk, manage economic risks, enhance long term returns, facilitate better management of inflows and outflows to the portfolio than a straightforward allocation to the domestic market benchmark.

The client needs to know if these value statements are being met and the advisor needs to know why and, explain why, if they are not. Performance analysis and benchmarking will raise standards in the industry because their mandatory inclusion will enforce higher quality service and better decisions.

It will also likely force centralization of security selection and asset allocation decisions to those with the expertise to make and manage them. The transition will be a difficult one because the industry is not ready, en masse, to deliver these higher standards. A restructuring of the way portfolios are constructed planned and managed may need to be effected as the only way that the higher standards that benchmarks demand can be delivered, is through much more sophisticated systems.

Performance benchmarks recommendations

Recommended that an appropriate benchmark should be provided but if there is no appropriate benchmark, no benchmark information need be disclosed

There is always a benchmark, because there is always a relative valuation position within any portfolio. What this means is that each security has a valuation and a risk relationship with the market or the global market index. Otherwise how do you justify the inclusion of an investment within a portfolio?

Situations where benchmarks may not be available/appropriate include: complex portfolios, where no relevant reference benchmark is available and simple portfolios involving relatively few securities, where the use of a benchmark may provide no meaningful information

Service costs

The Working Group reviewed the disclosure of service costs on both a transactional and aggregated basis.

(i) Transactional disclosure requirements

While the Working Group was aware that the disclosure of service costs on a transactional basis was within the mandate of the Costs and Conflicts Working Group, there were discussions on whether costs should be disclosed on a "gross to the dealer" or "net to the advisor" basis and on the specific transactional disclosures that should be provided for mutual fund and bond transactions. The Working Group expressed concern that, if the intent of service cost disclosure is to provide the retail client with a true comparison of account/portfolio earnings versus costs, the basis of service cost disclosure should allow for a proper "apples to apples" comparison. The Working Group deferred making any final recommendations of transactional service costs until the recommendations of the Costs and Conflicts Working Group are known.

All transaction costs should be clear and transparent. Information on these discussions would have been useful. As it is all the time that may have been expended on this item has not made its way to the reporting stage, which would have been useful. For example the bid/offer spread the dealer makes, the commission the broker receives, the administration costs the client pays, represent information that the client ultimately needs to have access to.

(ii) Aggregated disclosure requirements

The Working Group felt it was important that service cost information, covering the same timeframe and provided on the same frequency as performance information, be provided to the retail client. Having such information will allow the retail client to make an assessment of the value of the advice being provided in relation to the service costs being paid. The Working Group has recommended that aggregated service cost information should be made available on an annual basis, at a minimum and at the same time that performance information is made available (and preferably as part of the same report).

Every time a transaction is made, the client should presumably receive information on the remuneration impact of that transaction at the time it happens. Every time a service charge is made, this should be communicated to the client. Aggregated service cost information should not only be provided at the time of the performance analysis, but should also be charged against performance if these charges have not otherwise been discounted in the figures.

Service cost recommendations

Recommended that aggregated service cost information should be made available on an annual basis, at a minimum and at the same time that performance information is made available (and preferably as part of the same report)

Portfolio risks

The Working Group found it very difficult to come up with precise recommendations on risk disclosure. The Working Group acknowledged the importance of risk disclosure but felt it would be difficult to develop disclosure requirements that were comparable from dealer to dealer and that resulted in understandable and meaningful disclosure. Further, it was felt that it would be very difficult to mandate a specific approach to measuring risk, particularly if there is to be no mandated approach to determine a client's risk tolerance (included in Attachment #2 is a sample approach for assessing a client's willingness/ability to assume risk). Specifically, mandating a risk disclosure regime that would require the disclosure of the expected return range on an account/portfolio, if a similar range of performance was not being used to determine a client's risk tolerance.

Requiring that standard deviations for each security and portfolio be provided on the one hand as longer term technical average risk measures would be appropriate.

Secondly, to accompagny technical measures of risk it would be appropriate to provide valuation and relative valuation measures such as yield and yield relatives (yield and yield relative to market), P/E and P/E relatives (absolute and relative to market) and other valuation measures key to the investment style of the manager.

These risk measures, both statistical and valuation would force the manager to justify their strategy relative to the client's risk profiles and current market conditions. It would also provide greater accountability.

Standard deviations (and/or the shorter term risk metric measures) and fundamental valuation criteria need to be provided as a matter of fact. Explanations of what these statistics mean should be provided at the initial recommendation stage, at the performance analysis stage and at the transaction stage.

Standard deviation gives an historical analysis risk and fundamental valuation measures a current assessment of value and risk as well as price relatives.

It is a concern that the working group have focused too much on the "**target return" red herring**. Target returns as discussed have primarily arisen because of the way mean variance optimizers construct portfolios and the way in which these risks and returns can be used to explain the relative attractions of each portfolio. These target returns are nonsensical because the calculations on which they were derived bear no relationship to current market and economic conditions.

The fair dealing concept document only stated that where provided, target returns need to be justified. It did not say the target returns and target risks be provided!

The Working Group was also uncomfortable with assuming that everyone's definition of risk was the same and that the disclosure of the same expected return range to different holders of the same or similar portfolio would have the same meaning. The Working Group concluded that there was a need to define portfolio risk as, on account by account basis, risk could be measured in different ways taking into account the client's investment timeline and the trading strategy being employed (i.e., short-term trading versus buy and hold).

Retail risk assessment lacks an ability to relate an investor's financial needs over time to the structure of the portfolio. To a large extent it is the size and timing of financial needs that determines risk aversion. Additionally, because it is the nature of the short and long term risk of different asset classes that affects the ability of a portfolio to meet short and long term needs, portfolio structure and asset allocation should be primarily and directly related to financial needs first, then and only then aversion to point in time risk or volatility.

However, it is not the risk assessment that is at fault. It is rather the portfolio construction, planning and management methodology that cannot incorporate size and timing of liabilities into the structure of the portfolio. Hence the cut and paste retail solutions that we see and the over reliance on volatility as the primary determinant of risk aversion. Mean variance optimizers use correlation, standard deviation and historical return (or return data consistent with the correlation and standard deviation), but no size and timing of financial needs.

Again, we are also subject yet again to the target return red herring.

What the working group are actually hinting at is the ability to illustrate risk in terms of the size and timing of financial needs over time. This is fairly simple, but needs to combine both a liquidity analysis of the portfolio and an analysis of the portfolio's ability to meet financial needs irrespective of significant and prolonged short term risk events. In this sense the structure of the portfolio relative to financial needs and the ability to meet financial needs irrespective of risk events such as bear markets, crashes and economic recessions needs to be provided.

But, the information that is needed to perform this analysis far exceeds the minimum information standards of the KYC or the minimum account standards set by the IDA. It will also conflict with the industry standard model portfolio solution and the primary portfolio construction methodology.

While everyone's attitude to risk is different, everyone lives in the same risk universe, which means risk aversion is relative, which means it is possible to agree on the fundamentals of risk assessment but allow each investor and each advisor the freedom to determine where in the universe each resides relative to the other. In this instance systems need to be able to adjust portfolio allocations for the deviations in the client's relative position. Unfortunately the industry is not advanced enough to provide this yet. This topic is well beyond the remit of the working group and well beyond its knowledge base.

While the Working Group concluded that defining risk and performing a risk assessment is not an exact science, they reaffirmed the need for the advisor to perform and provide to their clients a periodic portfolio risk assessment. For a risk assessment to be meaningful, the underlying logic for assessing the portfolio risk at a certain level should be provided to the client at the same time as the risk assessment itself.

This means greater education at the start of the client relationship than is actually occurring, this means greater ongoing education and communication than is currently occurring and greater content and a higher minimum standard than that recommended by any of the working groups.

The Working Group was unwilling to prescribe a precise numeric risk disclosure approach, such as providing an expected portfolio return range. Rather, to provide some context/framework for the advisor's risk assessment, the Working Group suggested that the client could be given a dealer risk information document (included in Attachment #2 is a sample approach for disclosing risk information) outlining the key risk factors that are considered in assessing portfolio risk including asset mix risk, interest rate term risk, industry sector risk and geographic risk, along with details of the client's actual asset mix, interest rate term, industry sector and geographic portfolio weightings.

Again, the target portfolio return creeps back into the text.

Attachment 2 tries to relate size and timing of financial needs to portfolio structure. This is the correct approach but cannot be achieved with the data required in the minimum standards of the IDA and MFDA and, cannot be implemented within the portfolio construction, planning and management systems currently used in the industry.

It is not only the size and timing of the need, but its relationship with the overall asset position over time that is key. A need starting in 5 years time does not impact the portfolio all at once. Financial demands, especially in retirement can last for 25 to 30 years and sometimes longer. Additionally, every client's relationship between assets and liabilities over time differs. So we do not need a rule of thumb, we need to ensure that systems and processes can directly relate portfolio structure to financial needs. This will provide more effective risk assessment and provide a reference point against which each individual client can assess their own aversion to risk. Because we can relate the need for financial security to portfolio structure, we have a perfect platform to illustrate the risk of any given portfolio at any given time relative to the client's financial needs.

As such, three risk components of a portfolio need to be reported to the investor at the start and throughout the management of the portfolio.

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- The relationship of portfolio structure with financial needs and, the security the portfolio offers against significant and prolonged short term market and economic risk.
- Technical and longer term statistical measures of risk such portfolio and security standard deviation.
- Fundamental market and economic valuation factors pertinent to style and current valuation risks.

Portfolio risk recommendations

The Working Group acknowledged the importance of risk disclosure but felt it would be difficult to develop disclosure requirements that were comparable from dealer to dealer and that resulted in understandable and meaningful disclosure.

The minimum standards discussed in the comments (statistical and fundamental indicators) should be easily accommodated by any dealer and any advisor who is managing money.

It was felt that it would be very difficult to mandate a specific approach to measuring risk, particularly if there is to be no mandated approach to determine a client's risk tolerance

Risk is a given and can be measured irrespective of the risk assessment process. The fact that risk should be disclosed at the time recommendations are made and at the time of the portfolio reviews will force companies to deliver higher standards. This is a cop out.

There is also a need to define portfolio risk as, on account by account basis, risk could be measured in different ways taking into account the client's investment timeline and the trading strategy being employed (i.e., short-term trading versus buy and hold).

As discussed, the three measures proposed would taken into account timeline and liabilities as well as statistical and fundamental portfolio risk characteristics.

The Working Group reaffirmed the need for the advisor to perform and provide to their clients a periodic portfolio risk assessment. For a risk assessment to be meaningful, the underlying logic for assessing the portfolio risk at a certain level should be provided to the client at the same time as the risk assessment itself.

This will be difficult seeing as many advisors do not appreciate or understand the logic. The fact that mean variance optimization bears no relationship to actual financial needs and, that the portfolio in most instances bears little relationship to the actual size and timing of financial needs will be a difficult one to explain away. The reason the financial services boat has kept afloat for so long is precisely because few have actually tried to understand and explain the logic. The more you try to explain and understand the less sense it all makes.

The Working Group was unwilling to prescribe a precise numeric risk disclosure approach, such as providing an expected portfolio return range. Rather, to provide some context/framework for the advisor's risk assessment, the Working Group suggested that the client could be given a dealer risk information document outlining the key risk factors that are considered in assessing portfolio risk including asset mix risk, interest rate term risk, industry sector risk and geographic risk, along with details of the client's actual asset mix, interest rate term, industry sector and geographic portfolio weightings.

These risks are all really the b list of risks in a properly constructed portfolio. Liability risks, current valuation risks and statistical risks provide the most central and important and easily digestible risks for the investor. They are also the better risks for assessing and justifying strategy, structure and performance.

Use of information for marketing purposes

At the request of one of the Working Group members, the use of performance information for marketing purposes was discussed. The concern raised related to the use of performance information by mutual fund issuers; specifically, providing performance information which may mislead the retail client as to the future performance prospects of the mutual fund. The Working Group did not disagree with the concern but felt that this was an issuer reporting matter that was outside the mandate of the Working Group. The Working Group did review the regulatory requirements relating to marketing materials and found them to be adequate.

No disagreement here, although one would have thought (hoped rather) the advisor selecting fund would have dealt with this problem. The only issue is that risk and valuation data justifying the selection is the same as the risk and valuation data needed to communicate risk to the client.

Use of information for marketing purposes recommendations

The Working Group considers the current regulatory requirements to be adequate.

Benchmarks to measure the success of the Working Group's Recommendations

All three Working Groups have been asked to consider developing benchmarks to measure the success of their recommendations. All of the Working Group's recommendations relate to improving disclosure of performance, performance benchmarks, service costs and risks and these disclosures are intended to be more understandable and meaningful. As a result, the most direct way of measuring the success of the Working Group's recommendations is to survey retail clients.

The most effective way of measuring success is to set minimum standards and a set of voluntary higher standards. The next step is to monitor the reporting provided by advisors and to assess the explanation of risk, strategy, structure and performance as dictated by minimum standards as well as higher standards.

A survey of retail clients need to comprise an analysis of what they received before, what they receive after, whether they understand, what is communicated and also to provide them with examples of different reporting standards and assess their attitudes toward these.

Most of all, the survey needs to include assessment by independent bodies. An IDA member is unlikely to be as objective in their analysis and as constructive in their assessment of weakness.

Specific comments

In the absence of performance analysis a portfolio can hide a multitude of sins. Risk and return at any given point in time have a direct relationship to a firm's valuation, allocation and management disciplines as well as portfolio construction, planning and management disciplines.

If you cannot justify, explain and account for what is happening, it is likely that you do not have the expertise to manage or provide a personalized portfolio solution in the first place.

Disclosure of costs and the risk/return profile of the portfolio solution relative to a comparative performance benchmark and relative to the client's financial needs are what the investor wants and needs.

This document apparently states that the industry is ill prepared to provide the necessary disclosure of risk, costs, performance and the necessary relatives needed to identify value for money.

It is also clear from the document that much of the industry is still trapped in a transaction led service process mindset, even though most providers portray themselves as advisors.

The industry is clearly at a crossroads. If it decides to implement better and complete disclosure it will also disclose the failings and weaknesses of its current practices, practices which have evolved from a transaction led service process.

It is also a concern that the working groups have operated in isolation when education and service (account opening) disclosure are all key points of performance analysis.

The service you are getting will determine the performance analysis parameters as well as the performance benchmarks. The performance analysis and benchmarks used will also impact on the education the client receives as will the frequency and detail of reporting provided.

Much more thought is needed with regard to the alignment between service and service standards and, whether in addition to minimum standards a voluntary code of higher standards should also be mandated. Each firm would need to note what standards of service and service disclosure they provide. Investors can then work out themselves the level of consideration they want to pay and the level of service they want to receive.

Much of the quibbling in the document relates to a lack of expertise in the key areas of risk assessment and the valuation, allocation and management disciplines that underpin asset allocation. Importantly there is also a considerable lack of expertise and knowledge of asset and liability management frameworks key to managing risks to the ability of assets to meet financial needs. A cause of this is the preponderance of mean variance optimizers within the financial services industry. These optimizers do not have the ability to relate asset allocation to size and timing of financial needs arising both at a point in time and over time. They are very effective at delivering products and portfolio distribution services while covering numerous compliance risks.

Additionally, performance benchmarking techniques are slightly different for determining value added within personalized portfolios as opposed to portfolios with specific risk return objectives such as small cap, value or growth mutual funds/portfolios. Every portfolio, no matter how complex has a benchmark relative because all asset allocation decisions are either about relative value or relative risk.

Importantly, there is a general lack of what performance and risk analysis actually means to the investor and the member firms. To the IDA member it really means very close scrutiny of what they are doing, charging and achieving. Performance analysis is not a friend, but those who do a well structured well disciplined job should not fear the scrutiny. Consider performance analysis and audit of everything the wealth manager does. It is far more than just letting the investor know how much they have earned or lost.

COSTS, CONFLICTS AND COMPENSATION TRANSPARENCY WORKING GROUP COMMENTS

The Registration Project Steering Committee has constituted the Costs, Conflicts and Compensation Transparency Working Group (Working Group) to examine the costs of trading and advisory services and compensation provided to registrants in the provision of those services. The Working Group is also charged with determining how conflicts should be handled in connection with costs and compensation.

It does not actually address any of the two structural causes of conflicts of interest addressed in the Fair Dealing Model, nor does it address issues relating to how these conflicts affect advice given to individuals or how to manage the conflicts. Throughout this and the other two documents, the purpose of the FDM to push towards an advice driven financial services framework is broadly and silently repealed.

It does not specifically examine the costs of trading and advisory services and compensation provided to registrants in the provision of those services. This would have involved an analysis of the relationship between the output (services) and the costs (compensation etc) attributed to each type of service, which would have helped assess how conflicts affect advice and the cost of advice.

The goal of the Working Group is to consider whether the regulatory requirements governing costs and compensation were in keeping with the governing principles enunciated in the Fair Dealing Model Concept Paper. In particular, the requirements governing costs, compensation and conflict transparency should ensure that clients receive adequate disclosure in an accessible, understandable form and that any conflicts inherent in the client/registrant relationship are managed in way that avoids self-serving outcomes. If they do not, the Working Group is charged with providing recommendations to the Registration Project Steering Committee to ensure that the requirements uphold the governing principles.

This document fails to adequately address self serving outcomes. It addresses disclosure but does not demand it outright and it fails to address regulations dealing with self serving outcomes where it impacts on wealth and asset management advice for the individual investor, for which there are none currently in existence.

As such it fails to address each individual investor's fundamental rights with respect to their own capital. For example, taking a trailer fee without informing the client and without disclosing the exact amount (or an approximate exact amount) is a breach of a basic human right. Such an action is probably contrary to contract law and in this context could even be considered a fraudulent misrepresentation. Trailer fees are an example of an extreme conflict of interest and decisions resulting in trailer fees are without a doubt self serving.

The Working Group's mandate is restricted to making recommendations with respect to the rules and by-laws of Investment Dealers Association and the Mutual Fund Dealers Association (the selfregulatory organizations, or SROs).

If the objective is to assess whether regulatory requirements governing costs and compensation are in keeping with governing principles of the FDM, it must not restrict itself to rules that exist but rules that do not and should exist. As such there is no restriction, only a restriction as to whom these recommendations apply.

We recognize that the relationships between clients and registrants are commercial in nature, and that clients should expect to pay for the products and services they receive. We also recognize that the costs of implementing recommendations should be commensurate with the benefits that clients will receive from the additional information provided.

Should there actually be a cost/benefit justification with regard to the need for disclosure? We are dealing with a failure to disclose which represents an omission of a duty to act honestly and in good faith.

Disclosure and transparency are innate investor rights, not probabilities of a cost/benefit analysis. Investors should be seeking redress as these rights have been taken without permission. To ask investors to wait for the outcome of a cost benefit analysis is a travesty.

It is worthwhile noting that eliminating trailer fees and moving to a fee basis for advisory portfolios would reduce costs and simplify the administrative and compliance issues. So this is not about costs, it is about interests, conflicts of interests, self serving outcomes and a wholesale and complicity ommission to disclose interests honestly and in good faith.

One of the most important principles of modern capitalism is competition. Practices which are anti competitive are ruled against and are considered bad for the public interest. Yet, we have a clear failure to disclose material facts that investors need to make decisions about the competitive nature of services available in the market place. Investors should know what they are paying in any commercial transaction.

If it is because of the trust that investors place in their advisors that the industry has been able to get away with what they are doing, then such practices involve a breach of trust and therefore a breach of a fiduciary duty.

Recommendations accepted by the Registration Project Steering Committee will be communicated to a working group involving the SROs and used as guidance in assessing existing requirements and creating or amending SRO rules, by-laws, or policies, as required. After the SRO rule, by-law and policy changes have been determined, the Registration Project Steering Committee will consider whether corresponding changes to securities laws or regulations are needed.

It may be that the investor is going to need a statutory declaration of human investment rights. The IDA and MFDA have their noses too deep in their own pie to deal investor rights.

We have described some recommendations as “long term”. We recognize that certain recommendations will require changes to dealers’ back office systems, including the ability for dealers and fund managers to share information that they do not share at present, and that dealers and their service providers will require time to make the necessary system changes. We expect that the SRO rules, by-laws, or policies can be adopted in the same time frame as the other recommendations, but that the effective date will take into account the time needed for system changes. We believe this will provide dealers and their service providers with the necessary certainty about the system requirements with sufficient time to make changes. We also recognize that some dealers may encounter more difficulty than others in making system changes to accommodate the requirements.

Many of the changes needed represent a redress of violations of basic human rights and need to be amended immediately. The only time constraint should be the time it takes to physically alter the systems to record and detail the necessary communication of information. Consumers are paying without knowing, are possibly paying too much, do not have the information to make important decisions, financial security may be impaired by excessive costs and decisions of self interest and investors are generally unaware of the value for money they are receiving.

What of their costs? It is wrong that investors should wait and pay while the industry waits and earns.

The SROs and the OSC have already had three years notice to deal with the issues stated in early FDM communication. The industry has also been aware of these issues, that they have not pre-empted them is as good an indication as any of their own self serving interests and as good a reason as any to take the decision out of their hands.

Information-gathering process

We met in person in Toronto on three occasions and by conference call on two occasions to examine issues related to costs and compensation, and conflicts arising with respect to costs and compensation. At these meetings we decided to use a gap analysis approach.

We examined current requirements governing costs charged and compensation earned with respect to specific investment products and services. We then determined where regulatory gaps exist in the current system. The recommendations provided in this paper are the culmination of that process.

Existing Requirements

Securities legislation and SRO requirements already address conflicts of interest, and potential conflicts of interest, in a number of ways. For example:

• a dealer may not act as principal in a transaction unless it has disclosed to its client that it is acting as principal;

• an advisor must disclose in any printed or published material any interest that the advisor or any partner, officer or director of the advisor has in the securities referred to in the printed or published material;

• in any printed material in which a dealer makes a recommendation to buy, sell or hold securities, the dealer must disclose whether: it will receive a fee as a result of the recommended action; it has assumed an underwriting liability with respect to the securities in the past 12 months; or it has been paid for providing financial advice to the issuer of the securities in the past 12 months;

• a registrant may only vote securities that it beneficially owns; that is, it cannot vote securities registered in the name of the registrant that are beneficially owned by a client;

• a registrant may not act as an underwriter with respect to securities of a related or connected issuer unless it meets specified conditions;

• a registrant must disclose to its clients a list of related issuers of the registrant that are reporting issuers;

• a registrant may not trade in or purchase securities of the registrant or of a related issuer of the registrant on behalf of a client unless the registrant has advised the client of the relationship between the issuer of the securities and the registrant;

• confirmations of sales or purchases of securities of the registrant or a related issuer of the registrant must state that the securities are securities of the registrant or a related issuer of the registrant;

• a registrant may not act as an advisor with respect to securities of the registrant or a related issuer of the registrant unless the client has granted specific consent for the registrant to do so

• tied selling in relation to investing in securities is prohibited;

• a registrant may not trade, or permit others to trade, based on knowledge of trades made or to be made for a discretionary or managed account;

• a branch manager of a registrant must review trading activity to detect conflicts of interest between registered individual and client trading activities.

We attempted not to duplicate any of the existing conflicts of interest provisions. We also noted that the above list is not exhaustive.

Disclosing an interest is not the same thing as being affected by an interest. Managing these interests was part of the objective of the fair dealing model. Most of the above relate to disclosing interests, which may conflict but do not bar advisors from operating with conflicts as long as they are disclosed and does not therefore prevent decisions resulting in self serving outcomes.

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Whether the above rules are sufficient to prevent a conflict of interest from acting against the best interests of the investor can only be ajudged on a case by case basis. But, because there are no rules regarding the quality and cost of advice in self serving outcomes, there is no effective protection against self serving outcomes in the current regime.

The only way to assess self serving outcomes is to have clear statements of standards of service and limitations of standards of service, of costs and of performance and that these standards are used as service benchmarks.

It is a moot point as to whether someone responsible for objective and impartial management should be allowed to have interests that conflict. But this is the overriding structure of the current wealth management industry in Canada.

It is also a moot point as to whether a client can claim restitution for a conflict of interest if this conflict was disclosed, irrespective of its consequences. The FDM raised these issues when discussing structural conflicts of interest. "Firms must insulate their retail investment business…firms cannot offer incentives, pressure or quotas". Where are the IDA and MFDA rules regarding this? Where are the comments regarding the lack of such rules? Why are these not being discussed in this document when they were clearly discussed in the FDM concept paper?

Recommendations need to be put to assess the structure and operation of firms in this area and possible regulatory oversight. This is an OSC regulatory responsibility. Is the OSC protecting the investor from unfair and improper practises? No. Are trailer fees fraudulent practises? Possibly!

Another area of concern regarding potential conflicts of interest in the FDM concept paper was the main method of remuneration and that the rules and regulations noted did not touch on how to manage these conflicts. Additionally, the concept paper discussed the fact that the rules and regulations largely ignored the impact advice can have on the client.

Because there are no service standards, there are no rules to ensure that advice is in keeping with those service standards.

If we are truly in an advice led market place then we can no longer play by the rules of a transaction based system. The only way you can force companies to act in the best interests of the investor is to force them to disclose not only their costs and their conflicts of interests (not just in front of the client but in an open and accessible form to investors looking for advisors) but their service standards, service processes, investment approach, portfolio construction, planning and management methodologies, client education materials, risk assessment processes and rationale, and their portfolio performance. Significant deviation from these standards within the service process is a breach of the duty of care. The client needs to know what to expect at every stage and where outcomes deviate from expectations these needs to be justified explained and related to service standards issued by the service provider.

As such, costs, conflicts and compensation cannot be viewed separately from the whole.

Costs, conflicts and compensation associated with specific investment products

Different costs and compensation structures exist with respect to different investment products. Different requirements govern the treatment of costs, conflicts and compensation with respect to different investment products. We have attached a table setting out the various costs and compensation associated with specific investment products and the current self-regulatory organization requirements that govern costs and compensation.

We discussed equities, fixed income securities, investment funds, managed accounts, fee-based accounts, registered plans and other accounts, and foreign exchange. The more problematic areas are those where clients may not be able to see the fees charged for the transaction or service. In that regard, we determined that investment funds and fixed income securities were the most complicated products with respect to costs and compensation. Foreign exchange instruments generated little discussion.

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Recommendations

We determined that there were several gaps in the current regulatory requirements with respect to costs and compensation. We provide some recommendations in relation to the following specific investment products and services.

1. Equities

Most retail equity trades are conducted through an exchange or quotation system. These are typically transparent markets in which participants can see the available offers to buy or sell securities, and which provide near-real time data feeds of trading activities to the public. We believe that current regulatory requirements regarding these equity trades are sufficient.

The transparency of the equity market is an interesting point. If the market for the provision of advice for the private individual was as regulated as that of the capital market there would have been no need for the fair dealing model in the first place.

Importantly, what is not understood is that the capital markets and the market for the management of personal financial capital are two separate markets, with two separate objectives and a true competitive system for personal financial management would divorce the two markets entirely. Securities regulation and IDA rules and bylaws only deal with the first market.

We were amenable to the notion of including disclosure on the trade confirmation of fees payable to the dealer with respect to a distribution.

Some members of the Working Group also suggested that there should be a requirement to provide additional disclosure where a distribution has unusual compensation terms. For example, assume a dealer or salesperson is able to earn the IDA Policy 2 Minimum Standards for Retail Account Supervision. For the purpose of this discussion investment funds include open-end mutual funds, closed-end funds, and other structured products such as hedge funds.

A distribution for the purposes of this paper may be considered a trade from the issuer's treasury or from the holdings of a control person. A distribution is typically effected pursuant to a prospectus or as a private placement.

"normal" commission for selling securities of one issuer but twice the "normal" commission for selling securities of another issuer. A reasonable observer would expect the reason for the difference is to provide an incentive to sell the securities of the first issuer irrespective of whether it was the more appropriate investment for the client. Most clients will not know what is a "normal" commission, so even disclosure of the amount of the commission would not provide adequate transparency in these circumstances. However, disclosure that the commission is in excess of the "normal" should alert the client about the possible conflict. We recognized that there could be some difficulty defining the "normal" commissions for distributions.

Again there is ignorance of the importance of the relationship between costs and added value and the ability to compare costs and performance across the board. If clients had mandatory benchmarks then they could compare the costs and the performance of their assets over time. In the end, it is not just a question of what you pay but also what you get. After all, unless you have been put in an index ETF you are paying for active management.

An investor is not a securities point of distribution for a brokerage firm and their return matters.

A conflict may arise when a dealer is acting as an underwriter with respect to a distribution of securities of a related issuer or connected issuer of the dealer. We note that National Instrument 33-105 imposes certain restrictions and mandates disclosure in an offering document in these circumstances. We also note that securities legislation also requires additional disclosure on trade confirmations for trades in securities of the registrant, of a related issuer of the registrant, or of a connected issuer of the registrant.

Recommendations:

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We recommend that trade confirmations should contain disclosure of fees payable to the dealer with respect to a distribution.

We recommend that the SROs determine the feasibility of defining a range of “normal” commissions for distributions of different types of securities, and whether commissions higher than the range could be disclosed as such on trade confirmations.

The SROs can consider whether “normal” commissions should be determined with respect to the particular dealer’s practices or whether it should be determined on an industry-wide basis.

If you are going to allow conflicts of interest as long as they are disclosed and extra incentives as long as they are justified, then there has to be a quid pro quo. The advisor has to justify their return in the form of added value to the client. One method is mandatory performance benchmarking.

The other issue that keeps recurring relates to the fact that the above relates primarily to rules for the regulation of the securities market and not as such the market for the management of personal financial needs. The only way we have issues with commissions from distributions is that the two markets are not defined and the relationship between the two markets not sufficiently separated. It would be best that the advisor receives no special commission for such distributions, only receiving a normal commission.

Additionally another point that is ignored; advisors select securities, salesman sell securities, traders buy and sell securities. An advisor should receive a selection return and not a selling return.

2. Fixed income securities

The main problem identified is that the markets in fixed income securities are not as transparent as listed equity markets. As noted above, equities generally trade based on open offers of prices at which a party will buy or sell a security. The fixed income market is generally a principal market. This means that the dealer sells to the client out of the dealer’s own inventory or buys from the client for the dealer’s own inventory, as opposed to acting as an agent to facilitate a trade between two clients.

Quotes or indications of interest may be available on the dealer’s website or the client may have to contact the dealer to obtain them. Clients may have to have an account at each dealer to get a meaningful price quote. The result is that clients cannot easily determine if they are receiving reasonable prices on a fixed income security.

However, there are some alternative trading systems that provide retail clients with access to quotes on fixed income securities, both government and corporate debt.

They provide their quotes for free on the Internet and summary information is provided to newspapers. As well, National Instrument 21-101 has imposed transparency requirements on dealers trading corporate bonds in a marketplace, as defined in that instrument. CanPX, the information processor for corporate debt securities disseminates information on corporate debt trades within one hour of execution.

When dealers act as principal on a trade in a fixed income security, the prices include a mark-up, or internal transfer price, that serves the same function as the commission charged when trading equities. National Instrument 23-101 requires dealers to record the price at which a trade occurred, including the mark-up or mark-down. As a result, to comply with National Instrument 23-101 dealers must already have policies, procedures and systems to track and record the mark-up and mark-down on fixed income securities.

We discussed whether a dealer should be required to disclose the mark-up to the client. We recognize that a number of factors that can affect the mark-up. For example, the size of the dealer’s holdings of a particular fixed income security compared to its desired holdings will affect the price quoted. Also, the mark-up may increase when the fixed income security has been in the dealer’s inventory for a long period of time and the dealer has borne market risk on the security. We also noted NASD Rule 244016 respecting an upper limit on mark-ups when the dealer acts as principal.

A conflict may arise when a dealer is acting as an underwriter with respect to a distribution of securities of a related issuer or connected issuer of the dealer. We note that National Instrument 33-105 imposes certain restrictions and mandates disclosure in an offering document in these circumstances.

Clients need to be able to compare prices. We expect that increased transparency, combined with a rule limiting the percentage mark-up or mark-down that a dealer can charge, will lead to increased confidence in the fixed-income securities market. 16 NASD Rule 2440. Fair Prices and Commissions

In "over-the-counter" transactions, whether in "listed" or "unlisted" securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefore

Recommendations:

The best solution would be to have a fully transparent fixed income market but that is outside the scope of this project. We recommend the continuation of current regulatory initiatives to improve transparency.

We recommend that dealers disclose the mark-up or mark-down on trade confirmations with respect to transactions in fixed income securities. We also recommend that this information be provided to clients on request before executing a trade in a fixed income security.

We recommend that the SROs consider a rule similar to NASD Rule 2440 limiting the percentage mark-up or mark-down that a dealer is permitted to charge when it is acting as principal, and a policy similar to the companion policy to NASD Rule 2440.

All compensation earned needs to be justified, whether this is a transaction commission or a return earned as a result of being the principal in the trade or the return earned from underwriting a new issue. Importantly, bid offer spreads also need to be shown for each security purchased and sold.

3. Investment Funds

Addressing the issues related to compensation paid and costs charged with respect to investment funds is complex. The major part of the problem is that most investment funds have embedded compensation that is paid from the fund manager to the dealer. This includes sales commissions paid at the time of the sale, on-going trailer commissions, or both. Many funds are sold on a deferred sales charge basis, under which the client is not charged a commission at the time of the sale but is required to pay a fee if the client sells the fund within a certain number of years of purchase.

They fail to point out that a commission does not have to be taken and that deferred sales charges only exist because much of the industry is still transaction as opposed to advice led.

A commission is a fee received in consideration of the effort expended in selling something, while a fee is consideration of the effort expended in selecting something. It is not a complex issue.

You are either advice led in which case you charge a fee or, you are sales led and receive a commission

The commission structure on mutual funds is another example of a conflict of interest leading to wholesale self serving outcomes?

A complicating factor is the over-abundance of disclosure that is required with respect to investment funds. However, cost and compensation disclosure with respect to the client's transaction is not provided in a concise, readily accessible fashion, particularly with respect to deferred sales charges and

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trailer commissions. We discussed possible changes to the prospectus disclosure requirements, but such changes are outside the scope of this project.

The Joint Forum of Financial Regulators is working on the issue of point of sale disclosure and intends to design a two to three page disclosure document that contains the most pertinent information about an investment fund. This document would contain information about costs and compensation. Unfortunately, the point of sale project is likely a few years from completion.

Let us pray they are not waiting for this working group too. But this document is about the disclosure required of the primary advisor and waiting for the point of sale disclosure documentation required by mutual funds should not even be a consideration.

Working Group members have differing views about what type of information should be provided and by whom. Some Working Group members would like clients to be provided with information about the total costs of their funds in a comprehensive, understandable form. These costs would include the management fees earned by the fund manager with respect to the specific client's assets, as well as the sales and trailer commissions paid to the dealer and to the salesperson on an annual basis.

Other Working Group members believe that clients receive as much information as they want under current requirements, and those clients who wish to determine costs in detail can determine this from information in a fund's prospectus. However, it was acknowledged that this calculation might be difficult for many clients.

Again, members need to be reminded that it is not their money they are talking about. It is a concern that those charged with determining the necessary changes to protect the rights of investors hold these self serving attitudes.

A further view held that account and fund performance, after fees, is all that clients really want since that is the standard by which they judge the benefits of any costs they pay: a low-cost fund that loses money still is not a bargain, and a high-cost fund with a high return may be worth the expense. However, performance reporting is outside the scope of the Working Group's mandate and is being dealt with by the Performance Reporting Working Group.

Performance and value for money is the consideration for costs and compensation. To ignore consideration is to ignore one of the most important legal principles of all, the law of contract. Again, the members appear to forget what self serving outcomes are and whose money it is. You buy an appliance and you know what you are getting for the additional cost relative to the cheaper model. Performance after fees is not all that clients really want. It may be all that the industry want the investor to see, because then they would truly see the impact of costs, compensation and advice on the value added by the services in question.

There was considerable discussion about who should be providing information to the client about investment fund costs and compensation. Some Working Group members believe that the information should be provided by the investment fund itself. Other members believe that the dealer should provide the information, as it is the dealer that has the direct relationship with the client and that only the dealer would be able to provide information with respect to all of the client's investment funds.

Responsibility should lie with the person who receives and decides the method of compensation. In an advisory relationship where the advisor is charged with security selection and not sale, it is without doubt the responsibility of the advisor to ensure that all costs and compensation are communicated to the client. At the same time, all transaction statements form the fund company should include all current and future compensation resulting from the trade. The advisor needs to let the client know before the trade and the fund company needs to report it after the trade. Additionally the advisor needs to let the client know total compensation and or fees paid in respect of the management of the account or portfolio depending on the terminology used.

However, we recognize that dealers may not have the necessary data. For example, a dealer's back office system would not typically include the detailed information about a fund's management and trailer commission percentages or the deferred sales charge schedule that would be needed to calculate the fees attributable to specific clients.

Dealers need to be able to provide this information, irrespective. If the client is not told about the trailer, is not told that it comes from his or her money, is not given a choice and does not give explicit authorisation for the advisor to take these fees, then there is misrepresentation.

The fund manager has this information, and would have to provide it to dealers on a client-by-client basis.

We noted that, at present, the disclosure of trailer commissions in investment fund prospectuses is typically given as a range for all the funds distributed under the prospectus, such as that it may be from 0% to 100% of the management fee. This does not give a client sufficient information to determine how much the dealer actually receives with respect to the client's investment.

We noted that some fund managers pay a higher trailer commission based on the length of time that the client maintained an investment in a particular investment fund or in investment funds managed by the manager. This payment is clearly intended as an incentive for dealers and salespeople to recommend that clients not switch to other investments and, as such, is a clear conflict of interest for the dealer and the salesperson.

Yet another interest, which, conflicts with the interests of the client, potentially leading to a self serving outcome.

We noted that salespeople may have a financial incentive to switch clients' investments between similar investment funds in order to receive further sales commissions. This has been observed when a client has held a fund subject to a deferred sales charge long enough that there is no longer a redemption fee, and the salesperson recommends switching to another fund with similar investment objectives and performance history. We believe that clearer, on-going information about cost structures will help clients protect themselves in these circumstances. In addition, dealers' compliance systems should be designed to detect and prevent such practices.

Again, clearer information about cost structures is not the only thing needed here. Clear regulation to prevent practices contrary to the public interest is also needed.

Recommendations:

We recommend that clients should be provided with general cost information about their investment funds on an annual basis. Dealers should disclose annually whether they receive a trailer commission and should inform clients that they can find more detailed information about the trailer commission in the prospectus.

Dealers should also disclose annually whether a client's fund holding is subject to deferred sales charges and how such charges work. The disclosure could, for example, be a notation beside each investment fund on the statement of account to indicate whether the fund pays the dealer a trailer commission and whether the client's holding is subject to deferred sales charges. We expect that this kind of general information could be provided in relatively short order once a requirement is in place.

We also suggest that the Account Opening Working Group consider recommending that dealers provide information about how trailer commissions and deferred sales charges work at the time of account opening.

We recommend that trade confirmations use clear prose to describe the kinds of charges that are made with respect to an investment fund. For example, rather than using the acronym "DSC" the trade confirmation should contain the words "deferred sales charge" and refer the client to the prospectus for further details.

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We recommend that trade confirmations alert clients when the dealer will be receiving on-going compensation with respect to the investment fund, such as a statement that the dealer will receive a quarterly trailer commission based on the amount of the client's investment.

This is a clear abnegation of the responsibility within an advisory relationship and furthers self serving interests which conflicts with those of the client.

Again, we need a clear description of the difference between an advisory and a transaction relationship and have clear rules regarding remuneration for the services performed. General information is not explicit enough.

Advisor relationships should not be based on deferred sales charges or trailer commissions. There should be clear disclosure and transparency between all companies as to their treatment of such.

We are not looking at the public interest here.

Explicit information with respect to actual dollar costs or approximate dollar costs need to be provided. Otherwise conflicts of interest cannot be effectively managed and value for money determined. Alerting clients is not enough. Let us pray that the Joint Forum is not relying on this working group for its own recommendations.

As noted in the discussion section above, there is a project of the Joint Forum of Financial Regulators concerning point of sale disclosure issues. We suggest that at the time the SROs are considering the recommendations above, they take into account the anticipated timing of the completion of the work of the Joint Forum project.

Additional Recommendations:

We identified additional information that we believe clients should receive with respect to investment funds. The recommendations below are not entirely within the scope of this project because they will require systems and procedural changes by fund managers, who are not subject to SRO rules. Because fund managers maintain information about trailer commissions for individual client holdings but dealers' systems typically do not include that information, fund managers' systems would have to be changed to provide the information to dealers, and dealers' systems would have to be changed to receive the information from the fund managers. In addition, implementation of these recommendations will require consultation, and exploration of alternatives, with dealers and fund managers. They may also require changes to the rules of the Canadian Securities Administrators.

Concerns over costs did not enter into the minds of the industry when trailer fees and other hidden forms of compensation were being introduced. These issues need to be addressed now. Costs should not stand in the way of the public interest. The fees already earned from trailer commissions are probably sufficient to retool the entire industry many times over.

• We believe that statements of account should clearly mark or flag any investment funds on which the dealer receives an escalating trailer commission. For example, there could be a statement, in print no smaller than the body of the account statement, that the dealer is being paid an incentive for the client to retain the investment.

Comments made fully cover this point. Flagging should hopefully shame enough advisors into submission.

• We believe that clients should receive annual disclosure of the total sales commissions and trailer commissions, in dollars, received by the dealer with respect to each client account. We understand that this would be a longer-term fix. In the shorter term, clients may receive this information separately from each fund manager with respect to investment funds managed by the fund manager.

A long term fix!

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• We recommend that Part B of a simplified prospectus disclose the actual trailer commission that the fund manager will be paying with respect to each investment fund.

We recommend that the public be given the freedom to purchase investments themselves without commission and without the trailer costs. This would force advisors to compete on service and the quality of their advice. At the moment there is no true competition for advice in the market place.

Ask yourself this one question. Being paid a trailer fee from a fund manager means that an advisor is being charged for a service he or she is not performing. This type of remuneration unless it is offset against valid and measurable services provided by the advisor only serves to increase the costs of the wealth management process at the expense of the investor. Such is not in the public interest.

4. Other third party compensation

Dealers may receive a fee for soliciting clients to exercise rights under a rights offering, to tender securities to a take-over or issuer bid, to exercise conversion or exchange options on securities, and in other similar circumstances. Clients may not be aware of the payments, and therefore may not be aware of any financial motivations for the recommendations.

Recommendations:

We recommend that when a dealer makes any recommendation to a client for which the dealer receives compensation from a third party, the dealer should disclose to the client at the time of making the recommendation that the dealer will be receiving compensation from the third party if the client follows the dealer's recommendation.

Amount of compensation at the very least needs to be provided to the client. More importantly the above underlines the need for a clear differentiation of the line between the capital markets and the market for the provision of personal financial wealth.

5. Managed accounts

We examined two primary issues with respect to managed accounts: what costs does the client pay and what is the dealer's compensation. With respect to the first issue, we looked at the potential costs a client might be charged on a managed account. We understand that it may be difficult with current back office systems for a dealer to compile all fees and trading costs for a client's account.

With respect to the second issue, we considered whether it would be useful for dealers to have to disclose to clients any compensation that is provided to the dealer by third parties. This would include any type of embedded compensation as discussed under Investment funds above. Generally, we believe that this information should be provided to the client. In particular, the client should know how the dealer treats third party compensation. For example, if the dealer invests the account in a mutual fund and receives a trailer commission, the dealer may treat that fee as additional revenue or it may reduce its management fee by the amount of the trailer commission.

Some Working Group members suggested that the most important information to clients who hold a managed account is the account's performance. We expect that the Performance Reporting Working Group will deal with this.

We note that the SROs currently require dealers to disclose fees for a managed account before the fee is charged, and fees charged to a client's account will be disclosed on the statement of account.

Recommendations:

Clients should be advised whether the managed account is permitted to hold products that pay third-party compensation and, if so, whether the compensation received by the dealer is in addition to the fee it receives from the client or if the compensation is netted against the client fee.

See other comments.

In the long term, the SROs may consider requiring dealers to determine and disclose the total compensation received by the dealer with respect to a managed account on at least an annual basis. We expect that disclosure would be introduced at the same time as similar disclosure for non-managed purchases of the same products.

See other comments.

6. Fee-based accounts

Fee-based accounts are non-discretionary accounts in which the fees are primarily charged to clients as a percentage of the assets in the account rather than on a transaction basis. The main differences between a fee-based account and a managed account is that often only a certain number or amount of transaction costs are subsumed in the fee (e.g. a client may not have to pay for the first ten equity trades but is responsible for transaction costs thereafter) and a fee-based account is not a discretionary account. In other words, the client makes the decisions for the account. A primary concern with fee-based accounts is a client may pay more than the client would have paid on a transaction basis. For example, an inactive account is likely to pay more in fees that in commissions, particularly if the account is large enough to avoid any minimum commission charge.

Recommendations:

We recommend the same disclosures for a fee-based account about the treatment of third party compensation and of total compensation received by a dealer as for a managed account.

These type of fee based accounts are different from portfolios run on a percentage fee basis. They are effectively accounts run by the private investor and would be similar to the self managed options discussed in the FDM. It goes without saying that full and total disclosure should be mandatory for these accounts. Although, if there is no full disclosure of costs how is the client going to work out the difference between a commission based and a fee based account.

We recommend that clients be given disclosure about the likely difference in overall costs between selecting a fee-based account and a commission-based account before opening a fee-based account or switching from a commission-based account to a fee based account.

We suggest the SROs consider whether it would be feasible for dealers to give clients an annual estimate of the fees that would have been paid in a fee-based account over the previous year if the account had been commission-based.

7. Registered plan and other account fees

Industry members on the Working Group commented that clients often are unaware of the costs and account-closing terms related to registered plans and other accounts.

Recommendations:

We recommend that the dealer provide its dealer fee schedule to clients each year coupled with information about the costs of closing registered plans and other accounts.

8. Foreign exchange

Industry members on the Working Group commented that clients might not know how the dealer determines the rates used for foreign exchange transactions.

Recommendations:

We recommend that the dealer disclose how it determines the rates for foreign exchange transactions. In particular, the disclosure should specify whether the dealer charges the client the dealer's cost or whether the dealer adds a mark-up. This may be done at the time of account opening so we recommend that the Account Opening Working Group consider the issue.

Conclusion

We believe that the recommendations would improve cost and compensation transparency, having taken into account the system costs and other burdens the recommendations would impose on dealers. Clients would be able to use the additional information to assess the effect of conflicts of interest in their transactions with dealers.

Specific comments

Reading these documents one thing that is obvious is that the industry has little rationale or framework for determining what is and what is not advice and is unaware of the significance of the difference between the transaction and, the construction, planning and management of assets to meet financial needs over time.

In this context, the premise of the FDM was premature; that the industry had become an advice as opposed to a transaction based industry and that regulation needed to change to keep up with the times.

That the regulators had woken up to the need to protect the consumer against the conflicts of interest of a transaction based industry would have been closer to the point. In this sense, it is not as much that rules need to be changed but that a whole new set of rules need to be set up to deal with what is effectively a different market place and a different set of responsibilities.

OSC and IDA regulations deal essentially with the securities markets and are not intended to manage the market for the management of private client wealth. Likewise MFDA regulations have risen out of this same framework.

One can draw the conclusion that the life of the Fair Dealing Model has been carefully expunged by the three working groups, protecting as they are their own mutual interests. Additionally, because the OSC 's framework is directed towards protecting the integrity of the securities markets, it is itself at conflict in trying to resolve interests in what is effectively a market place over which it has no authority.

It is time that the market for the provision of financial advice was fully regulated and the interests of the securities markets and the firms that service those markets effectively separated from the interests of the individual and the markets that serve that individual. This not going to be initiated by the current regulatory framework; there are too many conflicts of interests. It is not in the commercial interests of the firms the members of the working group represent to initiate such or applaud the development of such.

Investors need to know how much they are paying for a service. Failure to inform an investor of what their advisor is receiving could well be tantamount to misrepresentation in some circumstances. Advice means selection of investments not the sale of investments and as such no advisor should really be paid by the commission or by the transaction. That most advisors are still remunerated by commission can mean only one thing. They are salespeople and their main service is not advice but the implementation of a transaction. This is reinforced by the recalcitrance on the behalf of IDA and MFDA members to fully institute full and proper disclosure of performance and costs and, a greater commitment to education. It also reflects the nature and structure of the industry at large; financial institutions that earn a return from the sale of products, services and transactions and advisors that are the distributors not the selectors of these products, transactions and services.

As such, better qualification of service, costs and accountability of value added will truly reveal what the client is actually getting.