

# INVESTMENT INDUSTRY SRO FORUM SUBMISSION

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## INTRODUCTION

The Investment Industry SRO Forum (Forum) is pleased to submit recommendations for your consideration as you finalize the CSA SRO Framework Consultation.

The Forum is comprised of members of the Boards of Directors of the Investment Funds Institute of Canada, the Investment Industry Association of Canada and the Federation of Mutual Fund Dealers. While each of our organizations made submissions to the CSA consultation, we felt it was important for the investment industry to continue the discussions and provide a broad industry view on how to improve self-regulation through consolidation.

The recommendations we have developed are high-level, strategic and practical. They focus on investor access to advice and financial products and services, stronger investor protection, better governance, improved operating efficiencies through streamlined regulation and reduced regulatory barriers, and more effective rule-making and compliance oversight.

The recommendations are premised on the following principles:

- Self-regulation is critical to the Canadian capital markets;
- There should be one national SRO in Canada, providing services in both English and French;
- The SRO should have an operating model flexible enough to accommodate all categories of dealer and advisor registrants;
- SRO consolidation should be done in two phases. Phase 1 would consolidate the operations of IIROC and MFDA. Phase 2 could consider other categories of dealer and advisor registrants not currently within the SRO framework, but only after consultation with those other categories of registrants to ensure willing partners.

Consolidating the SROs will be a very worthwhile undertaking. It is clearly important to take the necessary time to achieve all of the opportunities to improve self-regulation through this consolidation. However, it is also imperative that this process proceed as quickly as possible to safeguard the ongoing stability of the Canadian capital markets.

The considerable assets of both the MFDA and IIROC should be leveraged to the fullest extent to this end, including potential use of existing national incorporations and recognition orders. The successful consolidation will require the full commitment and engagement of both the IIROC and MFDA boards, as well as their expert staff members. It will be critical to involve the most knowledgeable people in the consolidation planning and execution to ensure that it occurs as smoothly and effectively as possible.

# RECOMMENDATIONS

## GOVERNANCE RECOMMENDATIONS

*The SRO Board of Directors needs to represent both industry and non-industry perspectives. This is necessary to ensure the appropriate balance between investor protection and efficient and competitive markets is achieved in all board deliberations. As the SRO Board members have a fiduciary responsibility to balance investor protection and efficient and competitive capital markets, the Board should include members with knowledge and experience of consumer issues, as well as have available advice from an Investor Advisory Panel. Finally, the board composition and nomination process must ensure the Board can manage the inherent conflicts in self-regulation. The Forum supports Recommendation #10 of the Capital Markets Modernization Taskforce [Report](#) as it relates to the criteria for an independent SRO director.*

### **Recommendation 1**

The SRO Board of Directors should be representative of all regions of Canada and member business models. The Board should incorporate best practices with respect to board size, term limits, diversity and inclusion. Allowance for a larger transitional board during the consolidation process will have to be considered.

### **Recommendation 2**

There should be a majority of independent directors on the SRO Board. All directors should have experience with consumer and retail investor issues. The Chair of the Board should be an independent director. Other members of the Board would include the SRO CEO and industry members.

### **Recommendation 3**

The Nominating Committee should be comprised of only independent directors. Board nominees should be referred to the CSA for non-disapproval within 10 days.

### **Recommendation 4**

The SRO Chair and CEO candidates should be referred to the CSA for non-disapproval within 10 days.

### **Recommendation 5**

The SRO should create an Investor Advisory Panel with a mandate similar to the OSC Investor Advisory Panel. The SRO IAP would report annually to the Board.

*Transparency is key to maintaining regulator and public confidence in the SRO. A framework of public accountability and regular dialogue with the CSA and the SRO Board and management should be implemented to facilitate this outcome.*

### **Recommendation 6**

The SRO should report to the CSA quarterly and annually, and publish its annual strategic plan for comment. The contents of quarterly and annual reports should be defined in the Recognition Order and be made public.

### **Recommendation 7**

There should be a formal escalation process to the CSA for any urgent issues and an annual meeting of the independent directors and the CSA.

*One of the important benefits of self-regulation is the ability of an SRO to move quickly to respond to fast-moving market developments to protect investors. Also, many SRO rule changes are housekeeping in nature and do not require extensive CSA review.*

### **Recommendation 8**

Develop a new rule approval process that ensures continued oversight, but also allows a swift response to emerging risks. Less review of non-material rule changes should be considered.

*SRO rules, compliance examinations and enforcement comprise the three elements of the SRO's regulatory supervision of its dealer members. SRO enforcement must be, and be seen to be, timely, effective and fair. As SROs evolved, more and more of the regulatory activity was delegated to full time professional staff. District Councils would, however, continue to raise issues of regional interest and add perspective to policy efforts and national issues.*

### **Recommendation 9**

The SRO disciplinary panels in all regions should be composed of five members: the chair would be a retired judge or experienced lawyer with two public members and two industry members. District Councils would continue to recommend candidates for the disciplinary panels, as well as provide input on policy. Panel members would be selected by rotation by the Hearing Panel Coordinator. All panel members would be vetted by CSA annually.

*Investor confidence in the SRO is critical to the success of self-regulation. The initial branding and messaging of the SRO will be important elements in fostering public confidence and support. Further, most investors have little knowledge of the regulatory framework; they rely on effective CSA oversight of the SRO to ensure their confidence is not misplaced. Equally important is the confidence of the SRO members in their SRO.*

### **Recommendation 10**

Choose a name for the SRO that is straightforward and reflects the advice-driven culture of the investment industry instead of a product-driven orientation.

### **Recommendation 11**

The SRO should survey its members regularly to ensure the SRO Board and management continue to enjoy the support and confidence of the members. The results of the surveys should be public.

## **POLICY RECOMMENDATIONS**

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*A disciplined approach to rule making will help control the future cost of regulation. A clear problem statement at an early stage will align stakeholders and the industry around the need to implement a solution and reduce the cost of rule development and implementation. Pre- and post-implementation analysis will identify what works and what doesn't. Plain language rules can be both principles based and prescriptive as appropriate. For example, business conduct rules lend themselves to a more flexible approach due to the variety of different business models, however, a more direct approach is appropriate for financial compliance standards. The key for any rule is to ensure that it describes the regulatory outcome it must achieve.*

### **Recommendation 12**

The SRO should publish for comment a clear statement of the problem that requires regulatory intervention in order to decide on the best regulatory response.

### **Recommendation 13**

Use pre- and post-implementation cost/benefit and impact analysis for significant rule proposals.

### **Recommendation 14**

Publish plain language rules that articulate a clear regulatory outcome.

*The way the rules are interpreted and applied by SRO staff is also important. A consistent approach within the SRO will improve compliance and investor protection. Proportionate application will limit the scope of regulatory intervention to only what is needed and reduce unintended consequences. A risk-based approach enables the SRO to manage scarce resources. A consistent risk-based approach would ensure similar risks are assessed in the same way. Making rules by guidance note should be discouraged because it avoids the important discipline of stakeholder consultation, as well as CSA oversight of the rule development. Member conduct should not be audited against elements of the guidance that is not contained in the rules.*

### **Recommendation 15**

The SRO should use proportionate regulatory tools according to the scale, extent and complexity of the problem.

### **Recommendation 16**

The SRO should take a consistent risk-based approach to investment activities and products that present the same risks to investors.

### **Recommendation 17**

Rulemaking by guidance notice should not be permitted.

*IIROC/MFDA rules are already highly harmonized. The MFDA borrowed heavily from the IDA rule book when drafting its rules. Nevertheless, differences in IIROC and MFDA business models justify a different approach in some cases. However, there are a number of areas where SRO rules that address the same risks are different without any principled reason why they should be different. In some cases, the anticipated implementation of new rules provides opportunities to harmonize. For example, the MFDA is planning to introduce their CE requirements later in 2021.*

### **Recommendation 18**

Harmonize SRO rules where appropriate, including Know Your Client, Outside Business Activities, Continuing Education and Suitability.

*IIROC has been delegated legislative authority to register investment dealer representatives in every province and territory and to register investment dealer firms in some jurisdictions. CSA members register all mutual fund dealer representatives and firms across Canada. Registration is an important investor protection tool. It bars unsuitable individuals from dealing with the public and places conditions on those who require enhanced oversight. Investor protection would be strengthened by legislative delegation of all registration review and approval of their members and representatives to the SRO in those provinces where the legislation permits delegation. This would give the SRO full access to all National Registration Database (NRD) data and information. In addition, to be truly effective, the CSA should also delegate the use of statutory tools to manage registration risk, such as the power to impose terms and conditions.*

### **Recommendation 19**

Delegate registration of investment dealer and mutual fund dealer firms and individuals to the SRO, as well as the power to impose terms and conditions on the registrant.

## **OPERATING EFFICIENCIES RECOMMENDATIONS**

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*Financial advice has demonstrated value. Studies show investors with a long-tenured financial advisor acquire significantly more financial assets than a similarly situated investor without an advisor. It is critical that SRO rules facilitate, or at least do not unnecessarily restrict, access to advice for investors of all financial means across Canada. Collectively, the Client Relationship Model Reforms and the Client Focused Reforms provide investors with arguably the best disclosure and business conduct standards in the world for clients of investment dealers and mutual fund dealers. It is important that the benefits of these reforms are not impeded by the regulatory barriers created by more than one SRO. For example, the value of a long term client advisor relationship can be lost by the need to transition a client account between legal entities created by multiple SROs.*

**Recommendation 20**

SRO rules should enable easier transition of clients to different registrants, or operating entities within the firm, for specialized products and services without having to create additional accounts.

**Recommendation 21**

SRO rules should enable easier transition of advisors between affiliated legal entities.

**Recommendation 22**

The SRO should provide a single consolidated proficiency pathway for all categories of registrants and harmonized CE processes, based on the standard of a fully competent professional for the activity undertaken.

*One client and their family may have many types of accounts - RRSP, RRIF, LIRA, TFSA, RESP, RDSP etc. Each account type has its own coded account number and needs its own KYC and investment strategy. The SROs currently require a separate account range for different types of client accounts because of different compliance oversight requirements for each account type. While this facilitates account supervision, it complicates the client experience. The SRO should invest in technology that will support multiple views of client account ranges: a regulatory view to support all necessary account supervision requirements and a client view that would provide the client with “one touch” access to their accounts.*

**Recommendation 23**

Support the development of a single client “master” account to consolidate client account information that would reduce client confusion and provide a seamless client experience through the client’s lifecycle with the advisor and firm.

*It is not unusual for a client to engage with several advisors for specialized products and services, in addition to their primary advisor. Moreover, clients may also be confused by the multiplicity of titles accorded to advisors.*

**Recommendation 24**

Consolidate and streamline the number and variety of business titles used by advisors in various registration categories.

**Recommendation 25**

Provide disclosure of all advisors dealing with the client, and the duties and the qualifications of each advisor.

*The pandemic has accelerated the use of technology in the client-advisor relationship. Online client onboarding, advice and trade execution have witnessed increased popularity with investors. The SRO should support continued innovation and integration of dealer systems for order management, custody of financial assets and portfolio management.*



**Recommendation 26**

The SRO should reduce regulatory barriers to the adoption of technologies that reduce costs for small client accounts and support end-to-end digital processing activities, which will improve client access and the client experience.

*SRO data requests are increasing in scope and frequency to monitor markets, manage systemic risk and populate compliance dealer risk models. Increased use of technology and standardization of data requests could significantly reduce the regulatory burden of these requests.*

**Recommendation 27**

The SRO should improve its capability to request, import, store and use industry data in whatever format is maintained by the member. Further, the SRO should provide clear guidelines for security, transfer and use of data.

*It is important that investors have complete and accurate information about an advisor's discipline history. The SRO's web site should provide investors with user-friendly access to a comprehensive advisor database to help investors search the discipline history of a registered advisor.*

**Recommendation 28**

Consolidate the SRO firm and advisor discipline databases and provide investors with user-friendly access to the data.

*SRO member firms require better access to the NRD data they file in NRD for supervision and compliance purposes. They also need better access to individual discipline history to better vet new hires. Prospective employers can see whether formal discipline action has been taken and the penalties imposed, however, details concerning detrimental information, falling short of public discipline, such as multiple warning letters, is not available.*

**Recommendation 29**

The CSA should prioritize improving the NRD as part of the SEDAR+ project. The SRO should provide access to a prospective employer of detrimental information concerning a new hire, about meritorious complaints that fall short of formal discipline.

*Specialization in client facing and back office operations reduces costs and risk and improves the client experience. SRO members today cannot introduce and carry members of the other SRO because they have separate investor protection funds.*

**Recommendation 30**

Integrate the investor protection funds in order to permit investment dealers to carry mutual fund dealers.

*IIROC member client accounts are primarily in nominee name. While many of the mutual fund dealer firms use nominee name accounts extensively, overall, the majority of mutual fund dealer accounts are in client name. Both platforms offer advantages to firms and clients, and dealers should have the flexibility to continue to offer client name accounts. However, a review of these requirements could improve their operation. For example, client account reporting requirements could be streamlined to eliminate duplication and overlap. In addition, it is important to explore eliminating the need to use fax and phone in submitting client orders to fund managers and streamlining the transfer of accounts, as well as other low-cost nominee name account options for smaller accounts.*

### **Recommendation 31**

Develop a regulatory platform for both “nominee name” and “client name” business models that would eliminate duplication of client reporting requirements.

*Arrangements between firms and their representatives directing the payment of commissions are primarily a matter of provincial corporate law and federal tax law. Unfortunately, the existing SROs have taken a different approach to this issue. A mutual fund dealer firm may direct their representative’s commissions to the representative’s private corporation. IIROC rules prohibit a similar arrangement between an investment dealer and their representatives.*

### **Recommendation 32**

The SRO should permit its member firms to direct commissions to their representatives’ personal corporations.

## **CONCLUSION**

The Forum’s overarching objective in developing these recommendations is to improve the investor experience and strengthen investor protection.

We firmly believe that investors will benefit from a single national SRO. Ultimately, the consolidated SRO will enable its members to deliver a consistent and seamless experience to investors trying to access financial advice and a diversified range of financial products, without inefficiencies and unnecessary costs.

Again, the Forum strongly urges the CSA to capitalize on the considerable assets of the two SROs to achieve a swift implementation of the consolidated SRO. We stand ready to assist with these efforts.

An SRO consolidation of some sort is unavoidable and inevitable. Even though the respective Boards and management teams of the existing SROs may have different approaches, they also share common objectives. We encourage them to begin discussion sooner rather than later. It would be far easier to achieve shared objectives and work out any differences when there is a spirit of collaboration and mutual understanding.