PMAC
PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA
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February 22, 2013

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Financial and Consumer Affairs Authority of Saskatchewan
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Ontario Securities Commission
Autorité des marchés financiers
New Brunswick Securities Commission
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Office of the Superintendent of Securities, Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

John Stevenson, The Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, Ontario M5H 3S8

and

Me Anne-Marie Beaudoin
Directrice du sécretariat
Autorité des marchés financiers
800, square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec H4Z 1G3

Dear Sir and Madam:

Re: Response to Canadian Securities Administrators Consultation Paper 33-403: *The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*

The Portfolio Management Association of Canada (PMAC), through its Industry, Regulation and Tax Committee, is pleased to have the opportunity to submit the following comments regarding the Canadian Securities Administrators Consultation Paper 33-403: *The Standard Of Conduct For Advisers And Dealers: Exploring The Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients* (the "Consultation Paper") which discusses the desirability and feasibility of introducing a statutory best interest duty (referred to in this submission as a "fiduciary duty") to address potential investor protection concerns regarding the current standard of conduct that advisers and dealers in Canada owe to their clients.

As background, PMAC represents investment management firms registered to do business in Canada as portfolio managers. We have over 170 members from across Canada that are

comprised of both large and small firms managing total assets in excess of $800 billion (excluding mutual funds assets) for institutional and private client portfolios. Our mission is to advocate the highest standards of unbiased portfolio management in the interest of the investors served by Members. For more information about PMAC and our mandate, please visit our website at www.portfoliomanagement.org.

General Comments

We agree that the fiduciary debate in Canada is an important one. PMAC fully supports the notion of implementing a statutory fiduciary duty across all jurisdictions in Canada that applies equally to advisers and dealers who are providing investment advice. Portfolio managers already owe a fiduciary duty to their clients under common law[1] and under the statutory provisions of certain provinces. Accordingly, portfolio managers conduct their businesses pursuant to this high standard. We are supportive of this high level of investor protection and believe that all persons providing investment advice about securities to clients (regardless of the level of the client's sophistication) should be subject to the same high standard of care. We believe there should be a harmonized statutory duty for advisers and dealers across Canada with legal certainty on what a fiduciary duty means. We also believe the CSA and other applicable regulators would need to implement a robust oversight program to ensure all registrants are applying the fiduciary duty consistently.

The Canadian investing public should be educated on what a fiduciary duty means and which investment professionals must meet this high standard. We believe this would address the current gap between the levels of investment services offered in Canada and the standard of care to which those services are offered. While we view this direction as being in the best interests of investors, we acknowledge the complexities that may be involved with moving in this direction and the operational impact it might have on some members of the investment industry. That said, we do not feel that these challenges should be an obstacle in moving forward with implementing a statutory best interest duty.

We note that we will not be responding to every consultation question included in the Consultation Paper. We propose to cover issues in the Consultation Paper more broadly and provide some general comments on the contents and proposals set out in the Consultation Paper.

It should also be noted that certain PMAC Members continue to have concerns with a statutory fiduciary duty being applied broadly to advisers and dealers (for example, Members who are affiliates of dealers) and in view of that, the comments included in this submission may not reflect the views of these Members, which will be expressed in their individual submissions and/or other industry association submissions.

A Statutory Fiduciary Duty on Advisers

PMAC is made up of Members who are registered as advisers in the category of portfolio manager, the majority of whom are guided by the CFA Institute's Code of Ethics and Standards of Professional Conduct (the "Code"), both at the firm and individual levels. Portfolio managers are bound by the CFA Institute's Code as charter holders and members of the CFA Institute. The CFA Institute Code and Standards of Practice[2] explicitly states in Standard III (A) *Loyalty, Prudence and Care that: "Members and Candidates have a duty of loyalty to their clients and must act with reasonable care and exercise prudent judgment. Members and Candidates must act for the benefit of their clients and place their*

[1] For example, this is the case where the client has a discretionary account.
[2] See CFA Institute's Code of Ethics and Standards of Professional Conduct at: http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx. See CFA Institute Standards of Practice Handbook, pages 83 – 113 for guidance on complying with the duty to clients standard (loyalty, prudence and care), http://www.cfapubs.org/doi/pdf/10.2469/ccb.v2010.n2.1

client's interests before their employer's or their own interest." Investment decisions therefore must be independent and place the client's interests above all other considerations. This results in a higher level of trust placed on portfolio managers. Investors trust their adviser to provide advice that benefits the client first. This trust is underpinned by a belief that their adviser has a legal responsibility to "put the client's best interest first".[3] As fiduciaries, securities regulation requires that portfolio managers have the highest level of education and experience in the investment industry.

As noted in our opening remarks, portfolio managers already operate under the framework of a fiduciary duty. As highlighted in the Consultation Paper, advisers in Alberta, Manitoba, New Brunswick and Newfoundland and Labrador already owe their clients a fiduciary duty pursuant to statutory requirements in their respective jurisdiction. For most PMAC Members, the proposed statutory fiduciary duty will be of little impact to advisers acting on behalf of a client under a discretionary managed account agreement who are already fiduciaries. However, we strongly believe that a harmonized fiduciary duty framework across Canada is in the best interest of investors. In our view, investors in each province and territory should have the same protections afforded to them when receiving investment advice and the same remedies regardless of where they reside in our country. Harmonizing the protections available to investors is of tantamount importance to the harmonization of regulations that apply to registrants.

Finally, while the current regulatory system imposes certain aspects of the proposed best interest duty standard on registrants, we still believe that the highest form of protection for investors is a uniform statutory fiduciary duty. In our view, the suitability rules and the requirement to disclose all conflicts of interest and all fees (commissions, trailers, etc.) are not sufficient to replace a statutory fiduciary duty. These rules work to bolster the fiduciary duty and support the principle that an adviser has a duty to provide advice to a client that is in their best interest and ahead of the adviser's own interests.

Recommendation: *Portfolio managers owe a fiduciary duty to their clients under common law as well as under statutory requirements in some provinces and, accordingly, already conduct their businesses pursuant to this high standard. We are therefore supportive of this being a statutory requirement for advisers across Canada.*

A Statutory Fiduciary Duty on Dealers

It is currently unclear whether dealers who provide advice to their clients have a fiduciary duty at common law (except for an IIROC registered dealer who provides advice to clients with discretionary accounts). Our members have observed that some dealers have increasingly moved toward more comprehensive investment advisory activities resulting in some confusion as to the services being provided and the investor's expectations as to the advice being given. We acknowledge that CFA charter holders who are representatives of broker/dealers may or may not provide services at the level of a fiduciary, depending on the nature of client, whether the broker/dealer is providing investment advice, and other variables or circumstances of a particular transaction. For instance, we are not suggesting that brokers who provide execution services should be subject to a statutory fiduciary duty. In our view, a statutory fiduciary requirement for dealers would be applicable where investment advice is being provided. This would ensure that investors' are owed the highest level of protection when being provided with investment advice regardless of whether that advice is being provided by a dealer or an adviser. One of the main benefits we see to investors of applying a statutory fiduciary duty to dealers who provide advice to clients is that they would be required to recommend investments that are in the best

[3] "Investor behaviour and beliefs: Advisor relationships and investor decision-making study", Written by *The Brondesbury Group*, Toronto, ON 2012 (Investor Education Fund).

interests of their clients, and would not be able to steer investors to certain investments or products that, while technically not inappropriate for the customer and that may be "suitable", are not in the investor's best interests.

Though we understand the possible business and operational impact this might have on some dealers, we don't think this should impede the implementation of a uniform statutory fiduciary duty or necessarily have a detrimental impact on certain dealer business models. We think more analysis, research and industry consultation is needed to understand the validity of this concern.

Recommendation: *We believe there should be a harmonized statutory duty for dealers who provide investment advice across Canada.*

A Review of Fiduciary Duty Reforms in Other Jurisdictions

While it is important to review the experience of other jurisdictions on the issue and application of a fiduciary duty, we believe these reforms must be evaluated in the context of each jurisdiction's individual registration regime as well as the local market in which advisers and dealers have developed and operate their businesses.

We have concerns with the approach reflected in the Australian Reforms and UK Reforms to accommodate restricted advice and scaled advice because this would not eliminate the "expectation gap"[4] among investors and could potentially cause more confusion as to the level of service and investment advice being received. Notwithstanding that in the Australian Reforms, the "scaled" advice still has to consider the client's best interest, any standard short of a full fiduciary duty applied uniformly will continue to perpetuate unequal investor protection. In the Canadian context, if there were a lower tier of duty for dealers, mutual fund dealers, or other registered dealers and the duty was not applied equally across the "continuum for providing advice"[5], the same questions highlighted at the outset of the Consultation Paper would remain unanswered. [6]

We are generally supportive of the U.S. direction that would impose a uniform fiduciary standard of conduct for all brokers, dealers and investment advisers when providing personalized advice about securities to retail clients. The SEC Study[7] recommends the SEC establish a fiduciary duty that is at least as stringent as the current fiduciary standard applicable to investment advisers under the Advisers Act. Although, we believe one of the shortcomings of the SEC's proposal is that such a uniform duty would be somewhat qualified. We are wary of any reform proposals that would water down the duty as it is applied to various registrants.

We also support the Investment Adviser Association's (IAA)[8] advocacy efforts on this issue and its position that there is a significant regulatory gap between broker-dealers and

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[4] See Consultation Paper at p.9581, Concern 3: Standard of conduct expectation gap. See also The Brondesbury Group, *Investor behaviour and beliefs: Advisor relationships and investor decision-making study* (March 2012), online: http://www.getsmarteraboutmoney.ca/en/research/Our-research/Pages/Investor-behaviour-and-beliefs.aspx

[5] See Consultation Paper at p.9565.

[6] For example, what are the current obligations of an adviser/dealer when providing advice to a client; do investors and advisers/dealers understand the nature of their relationship; do investors believe (and expect) that their advisers and dealers act in their best interest, etc.

[7] Securities and Exchange Commission (Staff), Study on Investment Advisers and Broker-Dealers - As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (January 2011).

[8] For more information on the IAA, go to https://www.investmentadviser.org/eweb/.
The IAA strongly supports extension of the Investment Advisers Act of 1940 fiduciary duty to all broker-dealers when they offer personalized investment advice about securities to retail customers.

investment advisers who provide personalized investment advice to retail investors because broker-dealers are not subject to a fiduciary duty.[9]

As it remains unclear whether the SEC will move forward with the implementation of the recommendations in the SEC Study, we recommend the CSA continue to monitor the developments in the U.S. closely.

Addressing the "Expectation Gap"

As highlighted in the Consultation Paper, investors incorrectly assume that their adviser/dealer must always give advice that is in their best interests. We believe this is in part because of the confusion caused by the various designations and titles in the investment industry and a lack of general understanding of role of professionals licensed in the investment industry. A statutory fiduciary requirement applied in all retail client investment advice interactions would eliminate all doubt in the mind of the investor of the service he or she is receiving. Moreover, any relationship with a client where an advisory role is inferred should be governed by a fiduciary level of care. Where no advice is being provided, it should be made explicitly clear that no fiduciary duty exists and that the transaction is not based on advice that is in the client's best interest.

If the CSA does not move forward with implementing a statutory fiduciary duty, we believe the CSA should streamline professional/registration titles and corresponding designations in order to clarify which investment professionals are actually operating under a fiduciary duty when providing investment advice and to ensure that these roles are properly understood by investors.[10] In this regard, the role of portfolio managers in Canada's investment industry urgently needs to be made clear to the public as part of the push for improved "financial literacy".

Compensation Practices

The statutory best interest duty, if implemented, would likely impact the current compensation practices of advisers and dealers. However, before a conclusive determination that this potential impact might impede applying a uniform standard to adviser and dealers who provide investment advice, a careful assessment of the issues should be undertaken. We understand this is a complex and technical area to tackle, and we believe more research and analysis is required in this area. Following the implementation of CRM II[11], some of these compensation structure issues may be alleviated. We also note the recent consultation paper released by the CSA on mutual fund fees and that work is already underway in this area.

Conclusion

We strongly believe that advisers and dealers who perform similar activities should be held to the same standard of conduct. PMAC supports the implementation of a statutory fiduciary duty across all jurisdictions in Canada that applies equally to advisers (as currently

[9] See various IAA submissions including:
- https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/100830cmnt_BDIA.pdf
- https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/120328cmnt.pdf
- https://www.investmentadviser.org/eweb/docs/Publications_News/Comments_and_Statements/Current_Comments_Statements/110913tstmny.pdf

[10] For example, see IIROC Notice 13-005, Use of Business Titles and Financial Designations (January 8, 2013). http://docs.iiroc.ca/DisplayDocument.aspx?Language=en&DocumentID=4E2E74177B4B43D6A47AE14A9D7CB7F8

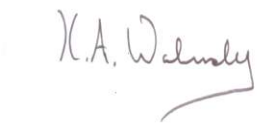
[11] The CSA and the SROs are pursuing a variety of additional CRM initiatives, such as improved cost and compensation disclosure and performance reporting. See: http://www.osc.gov.on.ca/en/SecuritiesLaw_ni_20110622_31-103_rfc-pro-amd.htm and http://www.osc.gov.on.ca/en/SecuritiesLaw_rule_20120614_31-103_proposed-amendments.htm

is the case with portfolio managers at common law) and dealers who are providing investment advice. We recognize the potential far reaching implications the issues raised in the Consultation Paper could have and for this reason, we recommend more research and analysis be completed as well as monitoring of international developments to determine the net impact this may have on all registrants in the Canadian context. Notwithstanding, introducing a fiduciary level of care and requiring registrants to adapt their businesses in a way that is conducive to upholding a fiduciary duty to clients is essential to safeguarding the interests of Canadian investors and boosting trust and confidence in Canada's investment industry.

We would be pleased to discuss the comments in this submission. If you have any questions regarding our submission, please do not hesitate to contact Katie Walmsley (kwalmsley@portfoliomanagement.org) at (416) 504-7018 or Julie Cordeiro at (416) 504-1118 ext 202.

Yours truly;

PORTFOLIO MANAGEMENT ASSOCIATION OF CANADA



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