August 16, 2002

Five Year Review Committee,
C/o Purdy Crawford, Chair,
Osler, Hoskin & Harcourt,
Box 50, 1 First Canadian Place,
Toronto ON
M5X 1B8

Dear Mr. Crawford:

We are writing you to provide the comments and suggestions of our Association on the Five Year Review Committee Draft Report.

Independent Financial Brokers of Canada ("IFB") is an association comprised of independent life insurance and mutual fund brokers - financial services professionals. As our name suggests, our members operate as 'independents' - free of ties to any one insurance or mutual fund company. As independents, providing reliable, trustworthy and accurate advice is the key to building a strong and viable business. Our members answer directly to their clients – not to insurance or mutual fund companies, and as a result, they have a deep concern for customer service and consumer protection.

We are of the view that your Committee has done an admirable job in its review of the current state of securities legislation in Ontario – a complex area. Our review of the Report indicates that there are some areas where we agree with the recommendations, some we disagree with, some we wish to suggest be considered with caution and others which we offer comment on. Those which we do not comment on are either satisfactory to us, or do not significantly impact our members.

Our concerns relate particularly to Parts 2, 3, 5 and 6 of the Report.

Part 2 – Flexible Regulation

Chapter 5: Structure of the Act

The first comment we would make is in regard to the Committee's request for input from interested parties on "other significant provisions that should be set out in the Act, rather than in a regulation or rule". (Chapter 5 – 5.1).

We are of the view that the Securities Act ("Act") should be amended to provide for protection of the civil liberties of those who the Commission (or others) accuses of transgressions, as well as prospective witnesses. The current legislation provides, perhaps, an expedient method of regulating persons and corporations, but at the same time, it detracts in many areas from many of the rights and protections in legal proceedings that individuals and corporations in a country such as Canada believe they enjoy, and should enjoy. These are compellability, disclosure of information, Rules of Evidence, and in general, natural justice. It is important that such protections be enshrined in the Act.

Also, our members, the Ontario Securities Commission ("Commission"), the MFDA and mutual fund dealers have run into difficulty with the current enshrinement in the Act of the 'employer-employee' relationship between securities dealers and their brokers. This relationship is being questioned in the securities industry at present and that will develop as an issue. However, it is currently an issue in the mutual fund area where many of those involved are dually licensed as life insurance brokers and mutual fund brokers. These people face the anomaly of being 'independent' on the insurance side of their businesses and being forced into a captive relationship with Fund Dealers on the mutual fund side. A recognition of an independent contractor type of relationship would assist with this situation.

Chapter 6: Rulemaking

This chapter relates to the rulemaking authority of the Commission. Under s. 6.2 of this chapter your Committee recommends that the Commission be given 'basket' rulemaking authority. We are of the view that this might impinge on legislative authority and are opposed to this proposal.

Section 6.3 proposes a reduction in the time for comment periods from the current 90 days for rules to 60 days, and from the current 60 days for policies to 30 days. As an association which represents independent brokers, our organization is one of limited resources when compared to the large Commission, company driven organizations, such as the IDA and larger dealers. Also, being national in scope, we are unable to focus on Ontario issues solely. We are comfortable with the current comment periods although they sometimes stretch our resources.

For similar reasons we believe that republishing shouldn't be changed from the current regulation.

We have in the past had major disagreements about what the regulator considers material and what the industry considers material. Any change to the rule must be published for full comment.

We believe that the Ministry should be able to thoroughly vet rules and proposed changes to them and do not think that reducing the time for Ministry response as proposed in 6.3 would be wise. Given current events and changes in government representatives, it would be against all principals that the government stands for to prevent the Minister from having adequate time to review matters that will impact her constituents significantly.

We do agree with the proposal to require a cost-benefit analysis to assess the effectiveness of proposed legislation and that these analyses should be made public. We are of the view, however, that these 'cost-benefit analyses' should be done in consultation with industry stakeholders representing those impacted by such costs to insure greater accuracy of the analysis.

Section 6.7 recommends a five year review of the Act. We suggest a change in the review process from what appears to have been done this time. It appears that the majority of consultation was done between the regulatory staff and the Commission. We believe that the review should be done with more outside input to provide transparency. Further, we suggest that Ministry staff should be used as resources rather than OSC staff, who cannot help but have an interest in the outcome of any such review.

Part 3 – Regulation of Market Participants

Chapter 8 – Registration

In section 8.3 the role of the 'Financial Planner' is discussed briefly and it is noted that 'securities regulators have been struggling to find an effective model for regulating financial planners'. Our Association has been engaged in the process with other members of the Joint Industry Group ("JIG"), which has offered an industry solution.

This report suggests that the reason for the regulators involvement in this issue is that "the range of matters on which they advise exceeds the ambit of the Act..". However, it should be noted that many of the items of advice enumerated are regulated by other agencies – an example is life insurance. In our view such regulation is well handled and quite appropriate. Many of our members are involved in the sale of life insurance in combination with mutual funds and are referred to as 'dual licensed' and termed 'financial advisors'. Some are also designated as financial planners through pursuing that designation through education. The public is well protected by this dual regulatory situation.

Further in 8.3 it is stated that MI 33 - 107 has been enacted by the CSA. Our understanding is that it has not and that a draft of a new Commission version is expected to be released soon. We suggest that the Committee make no recommendation to the Minister without hearing the industry position as proposed by the JIG. This Group shares the proposition that registrants who wish to be in business to trade in securities and offer ancillary advice in connection with that business must be proficient and qualified to do so". A major difference between what the Commission is proposing and what the JIG

wants is the Commission's determination to extend the brand "financial planner" beyond industry use and customer expectations.

Chapter 9 – Self-Regulation

IFB agrees that there is a potential conflict of interest between a SRO's role as a trade association and its responsibilities as a SRO and suggests that before any new SRO be approved, that it divest itself of its role as a trade association. We also agree that at least 50% of the directors of a SRO should be independent of its members, but we further believe that a percentage of these 'independent' directors represent those who distribute the financial product directly to the public – such as independent mutual fund brokers in the case of Mutual Fund Dealers' Association ("MFDA").

Part 5 – Enhancing Fundamental Shareholder Rights

Chapter 17 – Mutual Fund Governance

IFB is not supportive of the Commission's proposals to introduce a requirement for all publicly offered mutual funds to establish and maintain impendent governance bodies. We believe that the potential expense of such an initiative to the mutual fund customer far exceeds the potential benefit to the customer. From what we can see there would be no cap on what this might cost the mutual fund holder.

The recommendation that governance body could terminate the manager concerns us. We think it is dangerous and counter to the benefit of the customer, who after all has bought the fund through choice. A decision to terminate the manager could override the unit holder's decision to buy that fund based on management's record. The unit holder already has a remedy - which is to exit the fund through the market. Such a sale would not have the economic consequences on the fund that a termination of the manager would have – the latter could be devastating to the value of the unit holders remaining in the fund. At present competitive forces determine the recognition of a manager by performance measurement, higher MERs or otherwise.

The criteria to terminate a manager for poor performance would be difficult and probably unacceptable in many instances. After all, in a statistical universe the majority of managers do not beat the benchmark indexes, which ultimately qualifies them for firing. This is the law of averages, which means that most managers will continually be fired and probably rehired elsewhere. Any suggestion that members of such Boards would be better equipped to make financial investment decisions for someone else's money, in our opinion, is incorrect. Also, the ability to expropriate a manager from his position of financial interest for something other than fraud or misleading conduct, in our opinion is inappropriate.

The cost for smaller start up fund companies to establish a governance board would reduce entry to competition, and create more consolidation and less choice for investors.

If such Boards were to be mandated, then members of such Boards should shoulder some responsibility for their actions to the unit holder which could result in liabilities of millions of dollars.

The larger and publicly traded corporations who either solely or as a part of their business manage mutual funds have Boards of Directors in place whose responsibilities include oversight of operations of the corporation. Many of these Boards include have Compliance Committees already.

If such governance bodies are to be mandated, they should be governed by those whose economic interests would be most impacted – unit holders. Independent advisors might also be included for their expertise and market and customer awareness. In our view, creating and relying on a professional 'independent director' class would be dangerous as they are often removed in day-to-day experience from those they are chosen to protect.

Our members are of the view that management expense ratios ("MERs") are important considerations to those choosing to invest in the mutual funds industry. Costs to be attributable to MERs should be carefully considered before implementation, especially in the current market conditions.

Where we believe mandatory governance boards could be useful is where affiliated companies have multiple platforms in the financial services business or otherwise. Such potential conflicts of interest and inappropriate practices could compromise the interest of the unit holder. Cross ownership of affiliated companies within mutual fund portfolios shouldn't be allowed.

Inappropriate practices could also arise from lack of independence whereby proprietary and non-portable products are sold. We believe that the lack of portability is a greater problem in the industry then proprietary products. Furthermore, we are concerned about preferential compensation in Employer/Employee relationships with proprietary non-portable products which create conflicts of interest for the advisor.

Being opposed to the Committee's proposed governance boards, we naturally oppose the extension of Commission rule making to such governance system.

Part 6 – Enforcement

Chapter 19: What New Powers of Enforcement Should the Commission Have

We note the recommendations as to new powers including Administrative Fine, Disgorgement of Profits, etc. While these powers may be of assistance in a few cases, they must be considered in context with the absence of protections ordinarily available to Canadians outside of the securities industry. Chapter 22, section 1 considers the issue of Confidentiality under Section 16 of the Securities Act. We believe that this is problem should be addressed before any further powers are provided to the Commission.

As our organization stated in its submission to the Ministry of Finance relative to the proposed merger between the Commission and the Financial Services Commission of Ontario ("FSCO") about the proposed enforcement powers which were included in the proposed draft Act:

> "During the course of an investigation, exceptionally broad powers have been granted to the Commission, including the power to summon, the right to enter and inspect, the power to issue a warrant, and powers of search and seizure, among others, and these exceptional powers concern us."

We further advised that we were concerned, in light of the current trend in criminal and civil proceedings to more and more disclosure of information and documentation, with the parts of the Act which did not conform with this trend. One example was the power given to Commission to permit evidence to be given by Affidavit in a proceeding before the Commission without the accused having the power to openly cross-examine on this Affidavit.

Other concerns which need to be dealt with include the rights and protections in legal proceedings that individuals and corporations normally enjoy including compellability, disclosure of information, Rules of Evidence, and in general, natural justice.

In light of the new regulatory areas being recommended by the Committee, we would like to see the above issues considered and resolved in the interests of justice, fairness and credibility of the Commission.

INDEPENDENCE MATTERS:

Historically, the securities industry has operated in an employee/employer environment which has enabled the Commission to look to an employer for supervision and compliance. The life insurance business has evolved in a different way whereby most companies now sell their products to the public through independent agents and/or brokers. FSCO then is looked to as the regulator for enforcement and compliance.

We believe that the public is better served through the status of independent brokers being preserved, which should be enshrined in the Securities Act. After all, the independent broker is the only one in the marketplace who can and does recommend the best product for the customer, not the best product for a particular company. Comparison of products of a variety of companies is the norm among our members. As mentioned, our members come from both the life insurance and mutual funds areas.

Our members and other independents in the life insurance and mutual fund industries are fiercely independent business people who are not employees and do not wish to be employees. The current MFDA regulations impose a principal/agent relationship upon mutual fund dealers and their brokers which is too restrictive and unequal in the dealers' favour – enabling dealers to exploit the broker with impunity – giving the broker little or no recourse. IFB suggests that there be provision made for an 'Ombudsman' who would

have the power to provide redress to a broker from unscrupulous and exploitive behaviour by dealers. The Commission and MFDA have been powerless to date to correct the abuse of power by such dealers.

The system is one which encourages the broker to invest time, effort and money to build up a clientele for the broker, and through him/her the dealer, and then purports to take away any right to the broker to maintain this clientele, and further restricts his/her ability to realize a return of capital – let alone a profit from a sale of his/her business. The regulators need to acknowledge that the independent practices are self-contained businesses. Some of the MFDA rules (primarily the elimination of bulk transfers, reduction of business name, and the potential limitation of incorporation) have effectively expropriated the value and potential sale of these businesses. These concerns can be remedied and client service improved through changes in the MFDA rules. Bulk transfers are important to the industry so that a broker is free to leave a dealer and the broker's clients can follow him/her without interference by the original dealer. The contractual relationship should be left to the business entities – the dealer and the licensed advisor and not imposed on the entities by the MFDA.

Another particular concern of our members about the rules and regulations of the MFDA is the non-recognition of their stature as independent distributors of mutual fund products and the long-term recognition of their right to a "personal service corporation". In discussions with the Commission, this was acknowledged and an undertaking was given to amend the Securities Act to acknowledge this important concept. This would be a propitious time to make such an amendment as part of the changes to the act prompted by the Committee Report.

Please feel free to contact John Whaley at the address shown on the letterhead, by phone at (905) 279-2727, fax (905) 276-7295 or by Email at jaw@ifbc.ca.

We appreciate the opportunity to have submitted our comments to you, and will be pleased to discuss them with you.

Sincerely,

David Barber
President

Roy Maiero
Vice President – Mutual Funds

John Whaley
Executive Director