

2015 Annual Report of the Ontario Securities Commission Investor Advisory Panel

April 2016



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INTRODUCTION

We are pleased to present our 2015 Annual Report outlining our activities, submissions, consultations, and meetings during the calendar year.

In 2015, the Panel had many opportunities to bring the investor perspective to several key regulatory initiatives, including a review of financial product regulation and consumer protection in Ontario, the ongoing development of the new Capital Markets Regulatory Authority, and calls on the part of the OSC and the Investment Industry Regulatory Organization of Canada (IIROC) for input on strategic priorities and planning imperatives.

In 2015, we were also pleased to see evidence-based research on the regulatory agenda. The OSC issued two studies showing serious deficiencies in how investment products are sold: the Mystery Shop Results and a paper by Douglas Cumming, Sofia Johan, and Yelin Zhang: "A Dissection of Mutual Fund Fees, Flows, and Performance."

For its part, the Panel also added to the body of research meant to guide policymakers. We funded a study on risk profiling called "Current Practices for Risk Profiling in Canada and Review of Global Best Practices" which was undertaken by PlanPlus Inc. on our behalf.

A positive development in 2015 was the Commission's ongoing request for the Panel's input as it identified priorities and conducted its business planning process. We have seen positive changes at the OSC over the last year and these are most evident in the collaborative relationship that has evolved between the Commission and the Panel. We also appreciate the support we received during the year from the newly refocused OSC Investor Office.

However, the Panel believes it is time to move from consultation to action – regulators are now well aware of the changes that must be made to protect investors and foster an industry that puts investors' needs first and foremost. This means introducing a best interest standard, eliminating conflicted compensation and making access to restitution and dispute resolution a reality for Ontario investors.

PANEL PRIORITIES AND RECOMMENDATIONS

In past years, the Panel has expressed frustration with the slow pace of progress at the Commission in improving investor protection. 2015 marked a much better year from the perspective of investors, who

will benefit from a welcome focus on investor protection as outlined in the OSC's 2016 Statement of Priorities. The Panel was pleased to see listed among the priorities a best interest standard, compensation arrangements in mutual funds, regulatory compliance and enforcement and the needs of seniors.

These are solid steps forward. However, we continue to push the OSC and other regulators to address the fundamental misalignment between the needs and interests of investors and the industry that serves them.

As such, several key themes have driven our submissions, comments, and focus this year:

THE NEED FOR A BEST INTEREST STANDARD

During 2015, the Panel repeatedly urged the Commission to create a best interest standard which would require advisors to be the true agent of their clients and put their clients' interest first. It's a basic first step in investor protection - and it's long overdue. This was a key recommendation made both during face-to-face meetings and in written submissions, including our response to the OSC's Statement of Priorities and our preliminary recommendations to the Expert Advisory Panel reviewing the mandates of the Financial Services Commission of Ontario (FSCO), the Financial Services Tribunal (FST), and the Deposit Insurance Corporation of Ontario (DICO), in which we urged the Panel to "Foster a system that puts financial consumers first."

The Panel has repeatedly encouraged the Ontario Securities Commission to advance regulatory reforms that put the interests of investors first. The best way to do this is through a best interest standard whereby the interests of financial consumers come before those of the industry that services them.

CONFLICTED COMPENSATION IN THE ADVISOR-CLIENT RELATIONSHIP

During the year, the Panel continued to urge the OSC to act to prohibit the payment of embedded trailer commissions. Other jurisdictions have already done so - the OSC must follow suit by eliminating all third-party embedded commissions and remuneration.

As part of this issue, we expressed concern about the proliferation of new products designed to skirt around the Canadian Securities Administrators' rules regarding cost and performance reporting (CRM2). These rules do not apply to insurance products because insurance companies do not fall under the purview of securities regulators. As we noted in our submission to the Expert Committee to Consider Financial Advisory and Financial Planning Policy Alternatives,

It is time to break down the regulatory silos and harmonize regulation - the goal must be to have the same rules for comparable services and products. And to ensure consistent compliance and enforcement of the rules, a single independent regulatory organization is required.

We also wrote in our response to the OSC's Mystery Shop Results, that, in many cases the KYC process is not being followed. KYC information was gathered in just 32% of shops - worse, in shops leading to a recommendation, 29% did not gather KYC information at all and 14% of recommendations were found to be unsuitable. As we wrote at the time,

"a best interest standard is a necessary part of a system where the interests of investors come before those of the industry that serves them. Individuals who provide investment advice should be professionals, bound by professional standards, including in-depth and ongoing educational requirements."

The Panel also expressed dismay at the findings of Douglas Cumming, Sofia Johan, and Yelin Zhang in a research paper funded by the Commission: "A Dissection of Mutual Fund Fees, Flows, and Performance." The research found that mutual funds with trailer commissions perform worse than other funds and, at the same time, attract higher inflows of cash from investors even when they perform badly.

To that end, we again urged the Commission to prohibit the payment of embedded trailer commissions and to eliminate all third-party embedded commissions, noting that other jurisdictions have already moved to eliminate conflicted remuneration and the OSC needs to follow suit.

CONFLICT RESOLUTION AND RESTITUTION

The G20 High-Level Principles on Financial Consumer Protection, which the Panel points to as a set of foundational principles for the FSRA, states as one of its principles complaints handling and redress: "Jurisdictions should ensure that consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient."

We took several opportunities during 2015 to assert that restitution is essential to the complaint and redress process and should be of paramount importance to regulators. In our comment on the OSC's Statement of Priorities we noted that regulators must provide Ontario investors with access to timely, independent and binding restitution and urged the OSC to put the issue of restitution back on its list of priorities.

We also addressed restitution in our response to Preliminary Position Paper: Review of the Mandates of FSCO, FST and the DICO where we urged the Expert Panel to strengthen its recommendation around restitution for wronged financial consumers. Specifically, we recommended a compensation fund that would not only compensate victims of fraud but offer restitution for consumers who are harmed by poor or negligent behaviour on the part of their service providers or registrants.

Restitution was also part of our recommendations in our Response to IIROC's Request for Comments on Strategic Issues. As we wrote,

IIROC-regulated firms are required to fully cooperate with the Ombudsman for Banking Services and Investments (OBSI) in its consideration of client complaints received from IIROC-regulated firms. Recently, some IIROC firms have rejected OBSI client compensation recommendations and OBSI has also reported increasing numbers of low-ball offers.

IIROC cannot continue to sit silent and inactive as some member firms defy OBSI, leaving clients with no recourse except to go to the courts for compensation. IIROC must make fixing the current OBSI impasse a top priority.

We urged IIROC to conduct a review of its Enforcement procedures to identify how its Enforcement Counsel can more often include disgorgement in its penalty recommendations to Disciplinary panels.

THE KNOW-YOUR-CLIENT PROCESS

The KYC process is a key concern for the Panel. In addition to our comments on the OSC's Mystery Shop Results (noted above) we funded a study on risk profiling called "Current Practices for Risk Profiling in Canada and Review of Global Best Practices" which was undertaken by PlanPlus Inc. It revealed that regulators offer little guidance on how firms and advisors should determine a risk profile, which is an essential part of the suitability process.

They also found that 83% of the risk profile questionnaires they reviewed to be "not fit for purpose," creating a fundamental and dangerous gap in communication between the investment industry and the individuals it serves.

Clearly there is work for regulators and the industry to do in improving the know your client process.

THE INTRODUCTION OF A COMMON REGULATOR

The Panel has repeatedly urged the Commission to ensure that the new Capital Markets Regulatory Authority acts in the interests of Ontario investors. Among several recommendations, we have asked that the revised Capital Markets Act include an investor advisory panel to ensure that the investor perspective is represented at all levels of policymaking. We also urge the Commission to keep its focus and efforts on protecting Ontario investors and not to become distracted by capacity constraints and additional work involved in creating the common regulator.

LOOKING AHEAD: PRIORITIES AND FOCUS

The Panel has worked hard this year responding to a very ambitious agenda of investor related proposals and initiatives. Areas of focus included:

- The introduction of a best interest standard, title and proficiency reforms
- The debt market
- Conflicted compensation
- Compliance, enforcement
- Complaint handling and restitution
- Building on risk profiling research and our successful seniors outreach initiative
- Regulatory arbitrage
- The future of OBSI

We also look forward to monitoring the impact of CRM2 on investors.

The Panel is pleased to submit this Annual Report to the Ontario Securities Commission and looks forward to continuing its efforts to support and enhance investor protection in Ontario.

LIST OF CONSULTATIONS AND MEETINGS

CONSULTATION - EXTERNAL ORGANIZATIONS

During the year, we had the opportunity to meet with key OSC staff members as well as representatives from other regulators in order to provide our input and express investor-related concerns and issues. These discussions are key to the Panel's role and enhance our ability to influence, impact, and bring about positive changes that will benefit Ontario investors.

- Joanne De Laurentiis, President and CEO, The Investment Funds Institute of Canada
- Jan Dymond, Vice President, Public Affairs, The Investment Funds Institute of Canada
- Expert Advisory Panel responsible for Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario
- Doug Melville, CEO, Ombudsman for Banking Services and Investments
- Neil Gross, Executive Director, Canadian Foundation for Advancement of Investor Rights
- Andrew Kriegler, CEO, Investment Industry Regulatory Organization of Canada (IIROC)
- Advocis Symposium (speaking engagement)

CONSULTATION - ONTARIO SECURITIES COMMISSION STAFF

The IAP had frequent meetings with staff for general issues and issue-specific briefings. Staff briefings and discussions included the following topics:

- Cummings Report
- Whistleblower Program
- IOSCO Principles and OSC Compliance
- CSA's Oversight Review of IIROC
- Mystery Shopping
- Robo Advisors
- CMRA
- Seniors Research
- ETF Facts
- Mutual Fund Fees
- Exempt Market
- CRM2

The IAP met with the following OSC branches:

- Investor Office
- Strategy and Operations
- Executive Director's Office
- Enforcement
- Compliance and Registrant Regulation
- General Counsel's Office
- Investment Funds and Structured Products
- Corporate Finance
- Market Regulation

SUBMISSIONS AND LETTERS

The IAP wrote a total of 14 submissions and comment letters.

1. **December 21, 2015** – Comments on Capital Markets Act: A Revised Consultation Draft
2. **December 18, 2015** – Response to Research Paper: A Dissection of Mutual Fund Fees, Flows and Performance
3. **December 14, 2015** – Review of the Mandates of the Financial Services Commission of Ontario, Financial Services Tribunal and the Deposit Insurance Corporation of Ontario
4. **December 10, 2015** – Proposed OSC Policy 15-601 Whistleblower Program
5. **December 3, 2015** – Re-Publication of Proposed Amendments of Requirement to Disclose Membership in IIROC as a Dealer Member
6. **November 3, 2015** – Response to report on Mystery Shopping for Investment Advice
7. **October 30, 2015** – 21-315 Next Steps in Regulation and Transparency of the Fixed Income Market
8. **September 29, 2015** – Comments on IIROC's Strategic Issues
9. **August 31, 2015** – Comments on Dealer Member Rules
10. **August 17, 2015** – Comments on Financial Advisory and Financial Planning Policy Alternatives
11. **August 6, 2015** – Mandating a Summary Disclosure Document for Exchange-Traded Mutual Funds and its Delivery
12. **June 1, 2015** – Ontario Securities Commission Notice 11-771 – Statement of Priorities
13. **May 4, 2015** – 15-401 Proposed Framework for an OSC Whistleblower Program
14. **March 3, 2015** – 2013-2014 Annual Report of the Ontario Securities Commission Investor Advisory Panel

REPORTS

On November 12, 2015, The IAP published [*Current Practices for Risk Profiling in Canada and Review of Global Best Practices*](#), independent research prepared by Shawn Brayman of PlanPlus Inc., along with co-authors Dr. Michael Finke, Texas Tech University; Ellen Bessner, Babin Bessner Spry LLP; Dr. John E. Grable, University of Georgia; and Dr. Paul Griffin, Humber Institute of Technology and Advanced Learning.

ABOUT THE IAP

The Investor Advisory Panel (the Panel) is an advisory panel to the Ontario Securities Commission.

OUR MANDATE

Our mandate is to solicit and represent the views of investors on the Commission's policy and rule making initiatives. In order to fulfill our mandate, the Panel:

- Advise and comment in writing on proposed rules, policies, concept papers and discussion drafts, including the Commission's annual Statement of Priorities;
- Consider views representative of a broad range of investors through consultation with and input from investors and organizations representing investors in formulating its advice and written submissions to the Commission;
- Bring forward for the Commission's consideration policy issues that may emerge as a result of the Panel's investor consultation activities and comments on the potential implications for investors posed by those issues; and
- Advise and comment in writing on the effectiveness of the investor protection initiatives implemented by the Commission.

OUR MEMBERSHIP

The Panel is comprised of 7 members appointed by the Chair of the Commission following a public application process and on the advice of a selection committee consisting of up to three Commissioners. Members of the Panel are appointed for two-year terms, with possible reappointment for one additional term. (See Appendix A for Bios of panel members) One panel member (Jane Ambachtsheer) resigned during the term of this Annual Report. We extend our thanks and appreciation to Jane for her commitment and contribution to our work.

HOW WE OPERATE

The Panel meets monthly, either in person or by conference call. During the 2015 calendar year, we met 12 times. We maintain frequent contact between meetings to develop our written submissions and to share and exchange views on developments in securities law and other relevant matters. During our meetings, we discuss upcoming submissions and plans for future outreach, research and consultation.

Our work plan is set to a large extent by the Commission's priorities and

current developments in the investment industry. Our meeting agendas often will focus on specific Commission initiatives, including its annual Statement of Priorities and business plan, policy and rule proposals, and ongoing or under-development investor protection initiatives.

INDEPENDENCE

The Panel conducts its activities without direction or influence from the Commission.

The OSC Investor Office serves as the general liaison between the Panel and the Commission and serves as Secretary to the Panel. The Office provides administrative support to Panel activities and facilitates Panel requests for staff briefings or research information conducted by, or available to, the Commission on specific policy and rule making initiatives.

TRANSPARENCY

Transparency of our work is important. We provide regular reporting through our Investor Advisory Panel website (www.osc.gov.on.ca), through our published reports, submissions, letters to the Commission and our Annual Report. We publish all meeting agendas and minutes on our website.

CONSULTATIONS

To assist us in fulfilling our mandate, we regularly consult with organizations and financial and legal experts, industry associations, and investor advocacy bodies.

Appendix A: Member Bios

Connie Craddock

As the former Vice-President of Public Affairs at the Investment Industry Regulatory Organization of Canada (IIROC), Ms. Craddock has considerable experience with issues related to Canadian investors. Ms. Craddock also has experience in consulting and communications in both corporate and government settings.

Since retiring from IIROC, Ms. Craddock joined the Board of Gilda's Club, a non-profit organization dedicated to helping individuals touched by cancer. She also does volunteer work in adult literacy.

Ms. Craddock has a Master's Degree from Concordia University and Degrees from McGill University and Université de Montréal.

Letty Dewar

Mrs. Dewar has been active in the financial industry since 1984, and has a thorough understanding of the mutual funds sector and capital markets. Her experience includes financial planning, Group RSP product design, compliance and operations. She served as Chief Compliance Officer for a major mutual fund company. Subsequently she was the Chief Operations Officer for a portfolio management group that managed approximately \$19 billion of mutual fund assets.

Since her retirement, Mrs. Dewar sits on the CFA Society Toronto's Portfolio Management Committee (Chair September 2014-16). She is a member of the CFA Institute, the CFA Society Toronto and the Genesis Club of Toronto.

Mrs. Dewar holds the CFA designation, a M.B.A. from York University and a Bachelor of Commerce degree from the University of Toronto.

Harold Geller

Harold Geller is a leader in Financial Loss Recovery Group of McBride Bond Christian LLP and an expert on legal issues affecting financial advisors. Mr. Geller assists investors with the analysis of claims and where appropriate, the prosecution and settlement of claims in the civil courts and the Ombudsman for Banking Services and Investments (OBSI). Mr. Geller is a well known consumer's advocate with respect to investor issues as well as a financial industry commentator and a continuing education provider.

Mr. Geller was a 14 year elected member of the Canadian Bar Association (Ontario) and received his L.L.B. from Dalhousie University. He currently sits on the Canadian Bar Association's Elder Law Executive Committee.

Ken Kivenko

As a renowned investor advocate, Mr. Kivenko brings extensive experience of research and advocacy in retail investor issues. He is the president and owner of Kenmar which assists investors with dispute resolution. He has also established a well-used web-site www.canadianfundwatch.com.

Mr. Kivenko holds a Bachelor of Science in Engineering Electronics and a Diploma in Management from McGill University and is a Fellow in the American Society for Quality Control, a Member of the Association of Engineers of Ontario, and is the Chair of the Advisory Committee of the Small Investor Protection Association.

Alison Knight

Alison Knight has demonstrated a career-long commitment to consumer advocacy and stakeholder engagement. Ms. Knight is a life member and former board member of the Consumers Council of Canada. She has served on the boards of numerous professional, regulatory and non-profit organizations and held senior executive positions with companies in the financial services sector.

Ms. Knight received her Bachelor of Commerce degree from Queen's University and is a Fellow of the Institute of Chartered Professional Accountants of Ontario.

Ursula Menke - Chair

Ursula Menke brings more than 30 years of public and private sector experience in finance, management, law, regulatory matters, operations and corporate governance. Most recently she was Commissioner of the Financial Consumer Agency of Canada (FCAC). As a Commissioner of the FCAC, Ms. Menke examined matters relating to federal consumer protection laws and focused on building a competitive marketplace by protecting and informing consumers of financial products and services.

Ms. Menke received her Bachelor of Science and Bachelor of Civil Law degrees from McGill University. She also earned a teaching diploma from the University of Alberta.

Louise Tardif

Ms. Tardif was an investment advisor for 22 years until her retirement in 2008 from National Bank Financial, where she was also manager of their Ottawa branch. She currently sits on several boards including the Board of Trustee of OP Trust, a pension plan with over \$16 billion in assets. Ms. Tardif also chairs the board of the Youth Services Bureau of Ottawa and just ended a mandate as a Governor of the University of Ottawa where she chaired the Finance and Treasury Committee.

Ms. Tardif has a Bachelor of Commerce and a M.A. in Religious Study from the University of Ottawa. She is currently a PhD. candidate at the same institution.