FIVE-YEAR REVIEW OF SECURITIES LEGISLATION IN ONTARIO

Contents and Recommendations

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CAIFA strongly recommends that the period for Ministerial approval of rules remain 60 days.

Canadian Association of Insurance and Financial Advisors

Enhancing the value of financial advisors in the public interest.

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August 15, 2002

VIA E-MAIL

Five Year Review Committee
C/o Purdy Crawford, Q.C., Chair
Osler, Hoskins & Harcourt LLP
Box 50, 1 First Canadian Place
Toronto, Ontario
M5X 1B8

Dear Mr. Crawford:

Re: Five-Year Review of Securities Legislation in Ontario

The Canadian Association of Insurance and Financial Advisors (CAIFA) is pleased to comment on the draft report "Reviewing the Securities Act (Ontario)" (draft report) of the Five Year Review Committee (the Committee), which you kindly sent for our review in May 2002. CAIFA was one of 32 respondents to the Committee's request for comments in April 2000. We are pleased to see that the draft report acknowledges several of the comments which we provided in June 2000.

CAIFA

Founded in 1906, CAIFA has been for most of its history the national professional association for sales intermediaries and advisors in the life insurance sector of financial services. CAIFA now welcomes members from the mutual funds and securities sectors. More than 70 percent of CAIFA's members are current or prospective securities registrants. CAIFA's 15,600 members, all of whom are voluntary, participate in the activities of the Association through 50 local chapters.

Among its principal activities, CAIFA provides professional development programs that extend from pre-licensing courses in life insurance to studies that lead to designations as a Certified Financial Planner (CFP), Chartered Life Underwriter (CLU) and more specialized titles and designations. National, regional and local conferences and seminars, together with a significant publishing program, sustain the continuing education that is mandatory for all CAIFA's members.

CAIFA also maintains a Code of Professional Conduct and a supervised disciplinary process under which members investigate, adjudicate and impose sanctions on their peers. We note at the outset that registrants who are members of CAIFA are subject to our Code and disciplinary process. CAIFA, therefore, is a “self-regulatory organization” (SRO) as defined in section 1(1) of the Ontario Securities Act (the Act). The draft report addresses such SROs. We comment below on the recommendations in the draft report for SROs, at pages 7 to 9 and 16.

The Association's members advise their clients on the short and long-term financial needs of individuals, families and owners of small and medium-sized businesses. CAIFA's members provide an abundance of financial services apart from regulated financial products. Those services include financial planning, estate planning, tax preparation, tax planning and consultation on employee group benefits, pensions and retirement plans. CAIFA is a founding member of the Financial Planners Standards Council.

The draft report addresses financial planning and similar advisory activities provided by registrants, which it characterizes as “ancillary advice”. We comment below on the draft report’s treatment of advisory activities, at pages 6 and 7 and 14 to 16.

GENERAL COMMENTS

CAIFA congratulates the Committee for the breadth and depth of the draft report and its abundance of constructive recommendations. CAIFA can tacitly support the majority of the 85 recommendations. We will, however, comment only on those analyses and recommendations that touch on CAIFA’s direct experience or where we strongly endorse a recommendation.

What the Draft Report Does Not Say—But Should

It appears to CAIFA that the bulk of the intellectual endeavor evident in the draft report is directed to technical improvements in securities law as it applies to corporate finance, mergers and acquisitions, shareholder rights and enforcement. There is relatively little on the regulation of the great majority of market participants—individual salespersons—who directly serve the great majority of investors, that is, the retail sector.

A report of the Ontario Securities Commission (the Commission), "National Registrant Database: A Study of Economic Benefits to the Financial Services Industry" (November 2001) cites "102,000 registrants (excluding Quebec)". The draft report addresses, for example, extending registration to mutual fund managers, but is largely silent on the adequacy of the existing regulatory regime for individual registrants. In CAIFA’s view, that regime now constrains a substantial number of those 102,000 registrants from organizing their business affairs in a manner that is consistent with their practice in other regulated financial activities, notably insurance, and impairs their ability to serve their clients through their businesses. In effect, the draft report reflects the view from Bay Street much more than Main Street.

Notwithstanding the abundant merits of the draft report, CAIFA is disappointed to conclude that it fails to address the critical issues identified in our letter of June 9, 2002. Those issues largely concern the deficiencies of the Act insofar as the regulation of intermediaries contemplated by the Act is confined to the dealer-registrant model, in which a registrant salesperson is reduced to the status of an employee of a dealer.

Registered salespersons increasingly contract with dealers as entrepreneurs and proprietors of professional service businesses, not as employees. The reality for the majority of CAIFA's members and several thousand similarly situated financial professionals is that they engage in a range of financial services. These will typically include life insurance, mutual funds or other securities and a number of advisory activities which utilize those products to achieve the financial goals of their clients. Convergence of financial services in the person of the individual advisor is increasingly the norm. In the perception of the client, product sales are increasingly subordinate to planning for needs.

Our letter to the Committee in 2000 elaborated on these premises and summarized foreseeable developments:

> **Future Needs.** Our earlier comments under "Keynotes of Change" and "Impediments to Change" underlie CAIFA's view that the historical dealer-registrant model of regulation is deficient. It is inappropriate when measured against evolving expectations that a financial advisor engages in a professional relationship with his or her clients characterized by high levels of mutual trust, technical proficiency and fiduciary obligations. By contrast, the dealer-registrant model emphasizes the dealer's policing role over a salesperson who, absent policing by the dealer, may be expected to sell unsuitable products to vulnerable investors.
>
> CAIFA has not yet formally adopted a recommendation for the reform of the dealer-registrant model in the regulation of financial intermediaries that distribute mutual funds or other securities. Nevertheless, CAIFA implicitly believes that applying the dealer-registrant model as a universal norm will frustrate the full development of a financial intermediary who works in a fiduciary relationship with his or her clients founded on mutual trust and the role of advice-giver and who provides the optimum choice of financial products to implement that advice.

We recommended three amendments to allow the Act to reflect existing practices and anticipate future needs:

> **Incorporation of Salespersons.** The observation is sometimes made that life insurance agents incorporate to reduce taxes. In fact, the rules under the *Income Tax Act* attach onerous restrictions to so-called incorporated employees. Incorporation may be sought not only to reduce tax liabilities but also to facilitate succession planning and the disposition of a business upon retirement. An incorporated salesperson whose securities income derives

exclusively from a single dealer may possibly be denied tax-saving opportunities but could nevertheless wish to incorporate for legitimate business reasons.

The Ontario budget of May 2, 2000 announced that "this Government proposes that the right to incorporate be extended to all regulated professionals". The announcement explained that the incorporation of professionals would be subject to the full professional liability of the incorporated individual. The concept appears to follow established provisions in British Columbia and Alberta that allow professional corporations with unlimited liability.

CAIFA is committed to the proposition that, driven by technological disintermediation and rising consumer expectations in financial services, financial services intermediaries must evolve to assume the fiduciary and ethical obligations and standards of proficiency that are characteristic of the traditional learned professions. CAIFA believes that financial services professionals that are registered as salespersons should be able to avail themselves of the promised ability to incorporate.

CAIFA recommends that the definition of "salesperson" in section 1 of the Ontario *Securities Act* be amended to read "a *person or company* that *i*s employed by a dealer…" instead of "an *individual* who is employed by a dealer…". … "Employed", in CAIFA's view, is not limited to the legal relationship of a master and servant but bears the dictionary meaning of "is engaged or utilized for a purpose". … [We now also recommend replacing “employed” with “engaged” to remove any need to debate the meaning of “employed”.]

Full-time Occupation. Section 127 of the Ontario *Securities Regulation* requires full-time occupation as a securities salesperson, subject to certain exemptions. CAIFA recommends that the full-time occupation requirement under the Ontario *Securities Regulation* be amended to harmonize with the Agent regulation under the Ontario *Insurance Act*, which requires a life insurance agent who is subject to a full-time occupation requirement "to have his or her sole business in the provision of financial services".

Holding Out as Registrant. CAIFA recommends that the prohibition against disclosing in writing one's status as a registrant contained in section 44 of the Ontario *Securities Act* be deleted to enable multi-licensed financial intermediaries to disclose to potential clients material information about their competencies and the regulatory oversight to which they are subject.

The need to allow financial advisors who have incorporated as insurance agents (without evident resulting harm to the public) to conduct their securities business through their corporate business is pressing. The order of the Commission (February 2001) that recognized the Mutual Fund Dealers Association (MFDA) as an SRO suspended MFDA rule 2.4.1 for three years to allow MFDA members to pay compensation to the corporations of their representatives while regulators and industry participants develop a permanent solution. Nevertheless, compliance officers consider the concession

to be tentative and inadequate. Meanwhile, the Canadian Customs and Revenue Agency has refused to allow salespersons to report income paid to their corporations solely from their understanding that the practice is contrary to securities law.

Incorporation of salespersons is but one of many areas where CAIFA is actively advocating reforms in the regulation of securities salespersons. We are highly gratified that, in our discussions with securities regulators across Canada, they have come to accept the need for change. The recognition orders of the MFDA as an SRO in British Columbia, Saskatchewan and Ontario, the recent exemption order for the British Columbia Securities Commission to allow compensation to be paid to the corporate businesses of mutual fund registrants and the similar proposals of the Nova Scotia Securities Commission in 2001 all raise expectations of reform in the regulation of registrants. The Uniform Securities Law project of the Canadian Securities Administrators (CSA), the deregulation project of the British Columbia Securities Commission and the Ontario Securities Commission's current "fair dealing" project offer potential venues to effect the reregulation of the relationship of dealer and salesperson.

CAIFA can appreciate that the Committee had to limit the number of issues it could usefully address. The Committee may have decided that other reform projects of the Commission or CSA were better able to consider the issues raised by CAIFA. Nevertheless, CAIFA believes that, as a minimum, the Committee's final report should at least acknowledge the need to reform the regulation of distribution and the relationship of "salespersons" and dealers.

CAIFA recommends that the final report of the Five Year Review Committee acknowledge that the current securities regulatory model that a dealer and salesperson operate in the relationship of an employer and employee is often inconsistent with actual market practice and client expectations and urgently requires reform.

What the Draft Report Does Say—But Should Not

The draft report discloses three related failings to comprehend the market reality of professional financial advisors such as CAIFA's members in their relationships with their clients. These failings appear principally in Part 3 "Regulation of Market Participants".

Relationship of Dealer and Salesperson. The draft report consistently refers to "dealers and employees of dealers" or "dealers and their employees" and the like (cf. page 58). Frankly, this terminology is offensive to the majority of CAIFA's members who have contracted with a mutual fund or other securities dealer. At the very least, it does not reflect their perception of their relation with their dealer, the dealer's perception or the perception of the investing public. The market reality is that, for many registered "salespersons", the salesperson is an entrepreneurial advisor who has developed a clientele through his or her own efforts. The dealer desires access to that clientele to market securities. The advisor desires to make securities available to his or her clients as part of the range of products and services that will achieve the client's objectives. That is the basis for the relationship.

CAIFA has long held that the verb "employed" in the definition of "salesperson" (Act, subsection 1(1)) bears the ordinary dictionary meaning of "engaged" or "utilized for a purpose". Since at least 1998, the Distribution Structures Committee of the CSA has similarly accepted in its position papers that a salesperson need not subsist in the relationship of employee to a dealer, that is, in the legal relationship of master and servant. The rules of the MFDA expressly allow the relationship of principal and agent. We understand that the Investment Dealers Association of Canada (IDA) has accepted the relationship of principal and agent for its members in relation to their sales representatives. In the discussion paper of the British Columbia Securities Commission "New Concepts for Securities Regulation" (February 2002), the authors are careful to note:

> In this paper, we use the term "employees" to include a firm's employees (including personal services corporations), agents, representatives, partners directors and officers (page 26).

CAIFA urges the authors of the final report to similarly acknowledge that salespersons need not be employees of a dealer as the term is commonly understood.

CAIFA strongly recommends that the final report, when referring to the relationship of a dealer and its salespersons, avoid the term "employee" and qualify any usage of the term "employee" in relation to a dealer by clarifying that a salesperson may contract with a dealer in the relationship of an agent to a principal.

Relation of Advice to Trades in Securities. The draft paper recognizes that registrants increasingly provide financial planning and other advice to their clients that is not "solely incidental to their principal business or occupation" as a securities salesperson. The draft paper refers to such advice as "ancillary advisory activities" or "ancillary advice" (page 61). "Ancillary", from the Latin for a maidservant, connotes something that is merely auxiliary or subservient.

In fact, it is the transaction that is often ancillary to advice. Glorianne Stromberg observed as long ago as 1995 in the first Stromberg Report ("Regulatory Strategies for the Mid-90s") that the modern consumer investor seeks, first, advice on how to achieve a financial objective and then a financial transaction that will advance that objective. In CAIFA's 2000 letter to the Committee, we identified five "cornerstone concepts of securities regulation and recommend[ed] that they be re-examined in light of emerging realities". The second cornerstone concept was:

> A narrow regulatory focus on "trades" and a definition of "trade" that reduces all prior and surrounding advisory functions to "activities in furtherance of a trade", notwithstanding that the reality may be that the trade is an activity in furtherance of advice.

CAIFA's members generally regard themselves as advisors who are also licensed or registered to deal in certain financial products. CAIFA's Constitution and By-laws requires its members to qualify to use the title and designation of a financial advisor, specifically, Certified Financial Planner (CFP) or Chartered Life Underwriter (CLU). It is inaccurate to characterize the advisory activities of CAIFA's

members and similar practitioners as “ancillary” to transactions in financial products. As perceived by themselves and their clients, the transaction will often be the activity that is “ancillary” to the advice.

Failure to recognize that advice may be an activity that is distinct from a transaction and may have priority over the transaction has resulted in ill-considered regulatory proposals. One vigorously contested example was the proposition preceding the recognition of the MFDA as an SRO that a mutual fund dealer must supervise, be accountable for and receive compensation for the financial planning activities of its salespersons. Happily, MFDA rule 1.2.1(d)(vii) (“Dual Occupations—Financial Planning”) largely abandoned that proposition. Nevertheless, the ambit of jurisdiction of securities regulation over financial planning remains controversial and unsettled (discussed further below, at pages 14 to 16).

The current Commission project to consider reregulation of advice and develop a “fair dealing” regulatory model acknowledges that the relationship between advisory and trading activities requires careful re-examination. Where the draft paper characterizes advisory activities as “ancillary” to transactions rather than as complementary activities or independent activities conducted by a registrant, it distorts the actual relationship of the activities and clouds clear thinking that may lead to an effective regulatory response.

CAIFA recommends that the final report avoid pejorative terms such as “ancillary” in describing the advice that a registrant may give in the course of providing professional services and use “complementary” or similar terms to clarify that a registrant may engage in advisory activities that are distinct from transactional activities that require registration.

Relation of Voluntary Self-Regulatory Organizations to Statutory Self-Regulatory Organizations. Perhaps the most striking and puzzling lapse in the draft report appears in Chapter 9 “Self-Regulation”. This is the failure of the authors of the draft report to comprehend or, possibly, even be aware of voluntary organizations such as CAIFA that are dedicated to maintaining high standards of professional conduct of their members in the provision of financial services. Those organizations and their members pursue that objective for many reasons, none of which include a desire to duplicate the activities of a regulatory authority or to serve as an agent of the state.

The Act defines an SRO as “a person or company that represents registrants and is organized for the purpose of regulating the operations and standards of practice and business conduct of its members with a view to promoting the protection of investors and the public interest” (s. 1(1)). (Note: footnote 131 of the draft report incorrectly cites “The Act, s.1.1.”)

This letter observed on page 1 that at least 70 percent of CAIFA’s members are registrants. This letter also demonstrates that we represent those registrant members. CAIFA maintains and enforces a Code of Professional Conduct (formerly “Code of Ethics”) that is contractually binding on its members and predates statutory regimes for licensing life insurance agents that commenced in the provinces only after 1956. Over the last ten months, we have conducted 23 investigations of complaints and have held

or scheduled four hearings. CAIFA clearly falls within the definition of an SRO. The Canadian Association of Financial Planners (CAFP) is another voluntary association that similarly falls within the definition. The Financial Planners Standards Council (FPSC) authorizes qualifying individuals to use the title and designation Certified Financial Planner (CFP). It, too, is an SRO if its 14,000 licensees are considered to be "members". Other voluntary organizations may fall within the definition.

A voluntary organization may choose to regulate "the operations and the standards of practice and business conduct of its members" and its members may agree to submit to that regulation for many reasons. A simple altruistic desire to do the right thing in the public interest is one. There will often be an element of self-interest. The members may wish to enhance their reputation and competitive advantage over non-members. Or they may wish to suppress perceived undesirable and destructive conduct in their industry by raising a standard that stigmatizes misconduct and marginalizes its practitioners. All of these objectives have been familiar for millennia in any society that has organized guilds of practitioners in an occupation. They predate and are independent of regulatory objectives.

The apparent reason to define "SRO" is to enable an SRO to apply to be recognized under the Act and thereby serve as an adjunct to the scheme of regulation mandated under the Act. Once an SRO assumes a statutory role as an agent of the state, there is a plausible inference that there will be an insurmountable conflict of interest between lobbying government on behalf of the members of the SRO and enforcing the rules that government mandates in the public interest.

The MFDA, IDA and Market Regulation Services Inc. are SROs that have applied to the Commission and been recognized under the Act. We may speculate that the Committee contemplated similar institutional SROs and not SROs of individual practitioners when it concluded:

> … to the extent an organization wishes to … regulate "the operations and the standards of practice and business conduct of its members" (which would make it an SRO), we believe it should have to be recognized and subject to Commission oversight (page 66).

If so, we may speculate why the draft report appears to be unaware of SROs of voluntary individual practitioners in financial services. Possibly, the pernicious influence of the definition of a "salesperson" in the Act as an employee of a securities dealer obscures the reality of individual registrants who serve their clients as entrepreneurial professional advisors in many capacities. It is a characteristic of entrepreneurial advisors that they participate voluntarily in professional associations, often to enhance their proficiency as advice givers. Such associations frequently require their members to subscribe to a code of conduct.

Organizations such as CAIFA have a role in the private sector that must be independent of government. Government in isolation cannot develop sound policy; it must consider a chorus of competing views. That is why the Committee, governments and their agents seek input from associations. It is simply a non-sequitur to conclude that an association of participants in an industry

cannot develop voluntary standards of conduct for its members unless it is controlled by the regulators of its members.

CAIFA strongly recommends that the final report delete recommendation 28: "The Act should be amended to require that SROs, as defined by the Act, must be recognized to carry on this function in Ontario".

In Recommendation 31, the Committee recommends "that SROs be required to report to the Commission any breaches or possible breaches of securities law that they believe have occurred or may have occurred" (page 68). CAIFA voluntarily reports to relevant regulators across Canada any findings under its internal disciplinary processes that indicate a breach of applicable law. The Commission could not compel CAIFA and similar SROs to report such findings unless the SRO is recognized under the Act and subject to supervision by the Commission. Since we recommend that private-sector SROs such as CAIFA should not be required to be recognized, they should not (and could not) be required to report.

CAIFA recommends that Recommendation 31 be amended to clarify that only SROs that are recognized under the Act be required to report to the Commission any breaches of securities law that may have occurred or that they believe may have occurred.

In Recommendation 32, the Committee recommends that "trade association and SRO functions should be carried out by two separate bodies, each with distinct governance structures" (page 69).

CAIFA recommends that Recommendation 32 be amended to clarify that only SROs that are recognized under the Act be required to carry out their functions as a trade association and an SRO through two separate bodies, each with distinct governance structures.

SPECIFIC COMMENTS

We reference the comments which follow to the recommendations in the draft report.

PART 1 - THE ROLE OF THE COMMISSION IN CAPITAL MARKETS REGULATION

1. We recommend that the provinces, territories and federal government work towards the creation of a single securities regulator with responsibility for the capital markets across Canada (page 28).

Need for National Regulator. CAIFA must here join the chorus of market participants and observers that have long called for the creation of a single regulator for securities in Canada that is also responsive to regional needs and conditions. Canada must have a representative that speaks with a single and authoritative voice in the international forums that address the regulation of capital markets.

2. In the meantime, we recommend that certain steps be undertaken by securities regulators to continue to harmonize securities regulation across Canada. Harmonizing provincial securities legislation would significantly simplify securities regulation in Canada. We also recommend that securities regulators be given the authority to delegate any power, duty, function or responsibility conferred on them to another securities regulatory authority within Canada, and that they actively engage in delegation among themselves. We recommend the Act be amended to give the Commission this authority, and that the necessary consequential amendments to the immunity provisions in the Act be made. In addition, we recommend that securities legislation across the country be amended to provide for "mutual recognition" - that a securities regulator may deem that compliance by a market participant with securities laws in another specified Canadian jurisdiction constitutes compliance with securities laws in the regulator's own jurisdiction (page 28).

Need for Coordinated National Regulation. The draft report quotes CAIFA's account of its own experience with the Mutual Reliance Review System in its letter to the Committee (June 2000) to illustrate the limitations of current efforts to harmonize and coordinate securities regulation (page 25). CAIFA endorses the recommendation.

7. We recommend that the CSA, provincial and territorial governments and the federal government move to adopt a system of harmonized functional regulation across Canada, whereby all Canadian capital market activities, products and conduct are regulated by a single market conduct regulator and fiscal solvency matters are regulated by a single prudential regulator (page 38).

Need for Balanced and Even-Handed Harmonization. CAIFA supports harmonized and, indeed, integrated regulation of financial products and services with one caveat: The principles of regulation that are adopted to extend across currently separate sectors must be balanced and even-handed. No single existing concept of regulation or body of knowledgeable regulators should, without compelling reasons and considerable hesitation, replace another.

CAIFA has elaborated on that caveat in its submissions to the Minister of Finance (Ontario) with the regard to the proposed replacement of the Ontario Securities Commission and Financial Services Commission of Ontario by an integrated regulator, the Ontario Financial Services Commission.

Example of Segregated Funds. The draft report cites the example of "mutual funds and segregated funds [that] are functionally equivalent from the viewpoint of the investor" (page 35). The implication is that both products should be subject to the same scheme of regulation.

The example is itself an example of a comparison that is not balanced and even-handed but views segregated funds (technically, individual variable insurance contracts) from the perspective of a securities regulator only. In fact, the insurance aspects of segregated funds—freedom from

probate, guaranteed payments and potential creditor protection—largely confine these products to specific markets (estate planning, near retirement, professionals and business owners) which value those features and are willing to accept their additional costs.

CAIFA recommends that the comparison of mutual funds and segregated funds on page 35 of the draft report be revised to acknowledge that the two products have distinctive characteristics and are only partially functionally equivalent.

Example of Capital Accumulation Plans. Pages 36 and 37 of the draft report refer to so-called "capital accumulation plans" (CAPs)—generally, defined contribution pension plans, group RRSPs and deferred profit sharing plans—in which a plan participant is able to choose an investment. In its submission to the Joint Forum of Financial Market Regulators on proposed regulation of CAPs (November 2001), CAIFA pointed out that the proposals inappropriately applied existing securities concepts of investor protection that prevail in the individual market. If adopted, those proposals would make group plans no longer viable and would end the benefits of access, convenience and cost which unsophisticated investors of modest means now receive.

PART 2 - FLEXIBLE REGULATION

8. We recommend that section 2.1 of the Act be amended to direct the Commission to have regard to the following additional principles in pursuing the objectives of the Act:

- *Effective and responsive securities regulation should promote the participation of informed investors in the capital markets. … (page 41)*

Need for Effective Education. The public must receive a higher standard of education in financial matters generally and investing specifically, commencing at an early age. Effective consumer protection must begin with an informed and self-reliant consumer.

In its submission on CAPs, CAIFA stressed the need to equip participants in CAPs with sufficient information to make responsible investment choices. CAIFA understands that the Commission's current project to develop regulatory concepts of "fair dealing" will address the need for consumer investors to be aware of and demonstrate their own obligations in dealing with a financial services advisor.

10. The Commission, together with the Ontario government, should seek to streamline the Act by incorporating detailed requirements in the rules. In addition, the Committee believes that the Act should accurately reflect current law. This may result in certain exemptions being removed from the Act altogether where they have been superseded by a rule (page 43).

11. We recommend that the Commission be given "basket" rulemaking authority that is substantially identical to that conferred on the Lieutenant Governor in Council pursuant to clause 143(2)(b) of the Act. The Commission should be given the authority to make rules respecting any matter that, in the opinion of the Commission, is "necessary or advisable for carrying out the purposes of the Act" (page 46).

Concern About Delegated Authority to Override Legislative Intent. CAIFA is deeply concerned that the delegated authority to make rules should not allow the Commission, with the approval or mere acquiescence of the Minster of Finance, to override the will of the legislature as stated in the Act. CAIFA previously objected to proposals by a task force appointed by the Commission to consider so-called "debt-like derivatives" that would, if adopted, have repealed explicit exemptions for certain life insurance contracts and other products from the definition of "security" in section 1(1) of the Act. CAIFA cannot endorse statutory amendment by delegated authority.

12. We recommend that the minimum initial comment period for rules be reduced from 90 to 60 days and that the minimum initial comment period for policies be reduced from 60 to 30 days (page 47).

60 Day Comment Period for Rules is Acceptable. CAIFA would prefer to retain the existing comment period of 90 days for rules. In our experience, the internal review processes of a national association may require 90 days, especially when response dates occur during or shortly after holiday periods. Indeed, our experience is often that regulators will reasonably enough complete and publish proposals before their holiday period commences, so that the resulting comment period coincides with the respondents' holiday period. Also in our experience, regulatory initiatives seem to arrive in batches: sometimes 30 days will be ample; at others, 90 days will be insufficient. Nevertheless, CAIFA will not actively object to a 60 day comment period.

Comment Period for Policies Should Be Comparable. With regard to reducing the comment period for policies from 60 days to 30 days, it is disingenuous to justify the reduction with the explanation that "policies … only set out guidance from the Commission on the interpretation of Ontario securities law" (page 47). The reality is, registrants are subject to the directives of their compliance officers, who are in turn subject to the Commission's interpretation of the law. It is unrealistic to expect that a compliance officer will challenge a policy interpretation or that a registrant will successfully challenge a compliance officer who enforces that interpretation. As a practical matter, interpretative policy and law are functionally equivalent in the field. Both deserve similar opportunities for comment and challenge.

CAIFA recommends that the minimum initial comment period for policies remain 60 days.

13. We recommend that the Act be amended to require that the Commission republish for comment a proposed rule only if the Commission proposes changes to a rule that the Commission considers to be material, having regard to:

> *(a) the nature of the changes proposed to the rule as a whole; and*
>
> *(b) whether the final rule is a logical outgrowth of the rulemaking process when viewed in light of the original rule proposal and request for comments.*

We further recommend that a similar test be adopted for the republication of policy statements (page 48).

Discretion to Republish or Not. The draft report observes that, in considering whether the Commission "proposes material changes" to a proposed rule or policy that require republication, "the Commission has erred on the side of caution in determining whether to republish" (page 47). That is as it should be. CAIFA is concerned that, if the test is not an objective "material change" but what "the Commission considers to be a material change", the motivation for caution will diminish. If excess caution is the concern, CAIFA would prefer that the Act provide suitable guidance as to the meaning of "material change" rather than the Commission be given discretion not to republish, even if subject to guidelines.

CAIFA recommends that the Act be amended to provide guidance as to the objective meaning of "material changes" that require the Commission to republish a proposed rule or policy.

14. We recommend that the period for Ministerial approval of rules be shortened from 60 to 30 days (page 48).

Period for Ministerial Approval of Rules. The Committee justifies this recommendation as follows:

> We understand that the Commission keeps the Minister's staff apprised of its rulemaking initiatives, including the schedule for delivering rules to the Minister for approval. With the appropriate advance notification and briefings, we believe that the approval period can and should be shortened to 30 days. We further note that the Reformulation Project is winding down, which should mean significantly fewer proposed rules being sent to the Minister than has been the case in the last six years.

With respect, from CAIFA's perspective, the issue is not whether the Commission has sufficient opportunity to brief the Minister but whether affected stakeholders will have an effective opportunity to persuade the Minister that a proposed rule is flawed. The need to organize concerted action within an association or industry and the difficulties of obtaining timely access to the Minister and his or her staff demand a period for Ministerial approval of at least 60 days.

Moreover, CAIFA expects that the demands on the Minister's time to consider proposed rules will not decrease. The Commission may be winding down its rule-making activities but all evidence indicates that other regulators subject to the Minister's oversight will acquire and exercise new rule-making powers, beginning with the proposed Ontario Financial Services Commission.

CAIFA strongly recommends that the period for Ministerial approval of rules remain 60 days.

16. The Commission should undertake, as appropriate, cost-benefit analyses to assess the effectiveness of proposed regulations. The Commission should make public these cost-benefit analyses. If no analyses are completed, the Commission should specifically explain why they were not (page 49).

Cost-Benefit Analysis. CAIFA has observed and actively participated in the development of policy and regulation that was founded on a concern raised in the mind of one or more regulators, with no empirical evidence that the concern corresponded to actual or imminent harm. Often, the proposed remedy has been a scheme of regulation whose cost and complexity could bear no proportional relationship to the cure that would be achieved. Neither would there be any method to assess whether, in practice, the proposal had achieved a regulatory objective.

CAIFA strongly recommends that the Committee's final report include a recommendation that regulatory proposals be supported by published cost-benefit analyses.

21. In light of investor protection concerns, the Committee is of the view that it would not be prudent to eliminate the need for registrant involvement in Internet offerings (page 56).

Registrant Involvement in Internet Offerings. CAIFA shares with the Committee its conclusion that "it does not believe that there is anything about an Internet offering that eliminates the public policy rationale for the registration requirement. …[If] suitability and know-your-client assessments are necessary and appropriate protections in the context of offerings which are not conducted over the Internet, we see no reason why they should be unnecessary in the context of Internet offerings" (page 55).

CAIFA recommends that registrants continue to be required participants in Internet offerings.

22. The CSA should begin to consider alternative models for delivery of documents, whether the implementation of an alternative delivery model is feasible, the substantive rules that would underpin an alternative delivery model and how the model could be implemented (page 57).

Electronic Documents. CAIFA's members believe that regulatory requirements should reflect the business practices to which they and their clients are accustomed.

PART 3 - REGULATION OF MARKET PARTICIPANTS

25. The current requirements in the Act to be registered either as an adviser or to trade in a security should be retained. However, the Commission and CSA should carefully review the proficiency, experience and suitability requirements applicable to dealers and employees to ensure that they are sufficiently rigorous to match the increasingly important role of "ancillary advice" delivered by dealers and their employees (page 61).

Financial Planning. The comment on "Financial Planners" at page 61 of the draft report requires revision. It now reads:

> *Financial Planners* - Financial planners are becoming increasingly prevalent in the Canadian marketplace. Financial planners frequently are licensed mutual funds salespersons dually licensed to sell life insurance. In addition to selling these products, they will advise a client on other financial matters including mortgages, car loans, wills, allocation of investments among asset classes, and credit cards. As the range of matters on which they advise exceeds the ambit of the Act, securities regulators have been struggling to find an effective model for regulating financial planners.

Description of Financial Planners. With regard to the description of "financial planners", the draft report appears to reduce them to securities registrants who also advise on a miscellany of unrelated matters such as mortgages, car loans and credit cards. In fact, "financial planning services", in one authoritative definition, means "objective, integrated and comprehensive advice based on an assessment of an individual's current financial situation and current and future financial needs" (unpublished draft Commission rule "Proficiency Requirements for Registrants Holding Themselves Out as Providing Financial Planning Services"). A more accurate description in the Committee's final report would replace "mortgages, car loans and credit cards" with "retirement planning, estate planning and tax planning".

CAIFA recommends that the comments on "Financial Planners" at page 61 of the draft report be revised to replace references to advising on mortgages, car loans and credit cards with a reference to objective, comprehensive and integrated advice, especially with in relation to retirement, estate and tax planning.

Mandate of Securities Regulators. With regard to the struggles of securities regulators "to find an effective model for regulating financial planners" notwithstanding that "the range of matters on which they advise exceeds the ambit of the Act", CAIFA's view is that, where a regulator has no mandate to regulate, it should not regulate.

CAIFA's position on the regulation of financial planners is that financial planning is an emerging professional discipline. The regulation of the emerging professional discipline of financial planning does not and should not fall under existing mandates for the regulation of financial products and services.

Insurance and securities regulators have a statutory duty to regulate the customary fact-finding and advice that lead to the sale of a regulated financial product. An obvious example of advice giving that is regulated under existing law is the requirement under securities law to determine the suitability of an investment for an investor. CAIFA also recognizes that failure to perform a proper needs analysis would call into question the suitability of a life insurance agent under insurance licensing regulations. Financial planning, however, is a related but nevertheless different activity.

CAIFA strongly believes that financial planning as such is not a subspecies of advice leading to a sale of insurance or securities. Rather, it is a structured process that is distinct from trading in a regulated financial product.

For example, a well-conducted review and assessment in financial planning may conclude that the subject's insurance and investment portfolios are appropriate and that the subject should only revise his or her will and pay down existing debts. There would then be no advice that leads to the purchase or sale of a financial product and nothing that falls under the mandate of the Securities Act or Insurance Act. Similarly, fee-only financial planners, by definition, do not sell regulated financial products. A financial intermediary may engage in a hybrid practice and provide financial review and planning for a fee but not complete a sale of product.

At present, only Quebec maintains legislation that governs financial planners and the activity of financial planning regardless of whether they sell a regulated financial product or work for a regulated financial institution. CAIFA believes that a self-regulatory body that upholds uniform standards of proficiency and ethical conduct should govern financial planners.

Nevertheless, CAIFA accepts that existing financial regulators have a mandate to protect the public from their registrants and licensees who, for the purpose of selling regulated products, hold themselves out as financial planners without necessary qualifications.

CAIFA recommends that the comment "securities regulators have been struggling to find an effective model for regulating financial planners" (page 61) be replaced by "securities regulators have been struggling to define the border between securities regulation and the activity of financial planning".

"Ancillary Advisory Activities". Please see the discussion and recommendation at pages 6 and 7 of this letter, under "Relation of Advice to Trades in Securities".

Enhanced Proficiency Standard. CAIFA fully agrees with the Committee that the Commission and CSA should carefully review the proficiency, experience and suitability requirements applicable to registrants to ensure that they are sufficiently rigorous to match the increasing level of advice which they provide beyond the advice which is necessarily incidental to a trade.

As a leading educator of financial intermediaries, CAIFA has participated actively over the last three years in the development of the enhanced Life Licensing Qualification Program (LLQP), which provincial insurance regulators approved at the end of 2001. The LLQP now sets standards for minimal proficiency to act as a financial intermediary.

Securities regulators and SROs may advantageously adopt proficiency standards that emulate the LLQP to license financial intermediaries in the mutual fund and other securities sectors. Those standards, applied to securities registrants, would include a modular curriculum that presents elements of basic financial knowledge and the context of financial services, not confined to securities matters. Since securities registration may constitute a second licence, regulators in securities and life insurance may credit corresponding modules in the LLQP and its mutual fund or securities counterpart.

CAIFA recommends that the Committee's final report recommend that the CSA and Commission consider the Life Licensing Qualification Program as a model for equipping registrants with suitable proficiency to offer advice that exceeds the narrow requirements of advice that is necessarily incidental to a trade.

28. The Act should be amended to require that SROs, as defined by the Act, must be recognized to carry on this function in Ontario (page 66).

31. We recommend that SROs be required to report to the Commission any breaches or possible breaches of securities law that they believe have occurred or may have occurred (page 68).

32. The Committee recognizes that there is considerable potential for conflict between an SRO's role as a trade association and its responsibilities as an SRO. Ideally, we believe that trade association and SRO functions should be carried out by two separate bodies, each with distinct governance structures. In this regard, the body charged with the SRO role should ensure that at least 50 per cent of its directors are independent from its members. We support the model adopted by the Securities Industry Association and the NASD in the United States (page 32).

Self-Regulatory Organizations. Please see the comments and recommendations at pages 7 to 9 of this letter under "Relation of Voluntary Self-Regulatory Organizations to Statutory Self-Regulatory Organizations". CAIFA strongly rejects the concept that a voluntary organization that includes members who are registrants must be recognized and supervised by the Commission if it enforces standards for the business conduct and practices of its members.

PART 4 - THE CLOSED SYSTEM AND SECONDARY MARKETS

CAIFA offers no comments.

PART 5 - ENHANCING FUNDAMENTAL SHAREHOLDER RIGHTS

CAIFA offers no comments.

PART 6 - ENFORCEMENT

CAIFA generally supports the recommendations for enhanced enforcement and remedial powers and investor safeguards described in this Part.

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Thank you for this continuing opportunity to participate in the important work of the Committee. We trust that our comments will be helpful and look forward to providing assistance in future.

Yours very truly,

Ed Rothberg