



## Public Consultation on Product Suitability Joint Standing Committee on Retail Investor Issues

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## **Executive summary**

Created in the spring of 2008, the Joint Standing Committee on Retail Investor Issues (JSC) is made up of the Investment Industry Regulatory Organization of Canada (IIROC), Mutual Fund Dealers Association of Canada (MFDA), Ombudsman for Banking Services and Investments (OBSI) and Ontario Securities Commission (OSC).

The purpose of the JSC is to provide an effective forum for executives of the four organizations to discuss and consider retail investor issues, and to identify opportunities and co-ordinate ways to address ongoing and newly emerging issues that affect retail investors.

The JSC sought public opinion on certain questions relating to the suitability of investment products during the fall of 2008. There were two phases to the consultation process. In phase one, the JSC asked the public to respond to three questions on suitability. In phase two, individuals who responded to the survey were invited to participate in a conference call.

This process marked the JSC's first consultative process with the public. This is one of a number of initiatives that the JSC anticipates it will undertake. This report summarizes what we heard.

### **Survey**

In general, participants that use an adviser said that they rely on their adviser to make recommendations and to provide information on investment products before making a recommendation. They said that some of the information provided is difficult to understand and not very useful.

The majority of participants believed that all investment products should be available to the public. Other participants believed that certain investment products, such as principal protected notes, special-purpose acquisition companies and "high-risk ventures" should not be sold to the public.

The participants were split over whether regulators should focus on regulating specific products, regulating how products are sold and distributed, or regulating both.

### **Conference call**

The following themes emerged from the discussion on the conference call:

1. **Approval of investment products for sale.** Some participants thought that there should be greater accountability for the approval of investment products before they are sold to the public.
2. **Adviser training and supervision.** Some participants said advisers should have better training and supervision.
3. **Regulation.** Some participants commented on how the investment industry is regulated and suggested changes.

There are existing regulatory requirements that relate to a registered representative's obligation to satisfactorily "know their client," product suitability and some of the issues identified in this report. These requirements are set out in the Securities Act (Ontario), its regulations and policy statements. They are also identified in self-regulatory organization regulation and policy statements, such as the MFDA Member Regulation Notices on Suitability Guidelines (MR-0069) and Know-Your-Product (MR-0048), IIROC Dealer Member Rules 1300.1 and 2500; Conduct and Practices Handbook; and Proposed "Best Practices for Product Due Diligence" Guidance Note. In addition, there are a number of initiatives underway that will benefit from the kind of investor input that we heard through this consultation.

## **Investor consultation**

The investor consultation focused on issues related to suitability of investments. Suitability means that the characteristics of the product match the investment objectives and risk tolerance of the investor. Firms should consider a number of factors before they approve the investments their advisers are allowed to sell. However, the fact that a firm has reviewed and approved a product does not mean it is suitable for every investor.

Firms and the advisers who work for them are required by law to ensure that each recommendation made to a client is suitable. In order to do this, advisers should understand the features of the investment product they are recommending. Advisers should explain to the investor why they are recommending an investment product, and the risks and benefits of the product.

### **Outreach**

A description of the consultation process and the survey questions were circulated to the public through a press release with links on the websites of the sponsoring organizations and through media coverage.

The JSC contacted the following organizations to ask for their participation in the consultation, and to request that they inform their membership and contacts about the initiative:

- Canada's Association for the 50Plus (CARP)
- Canadian Foundation for the Advancement of Investor Rights (FAIR)
- Canadian Shareowners Association
- Consumers' Association of Canada (CAC)
- Consumer's Council of Canada
- Small Investor Protection Association (SIPA)

The JSC also contacted former members of the OSC's Investor Advisory Committee (IAC).

### **Survey**

The survey consisted of three questions:

1. What information about an investment does your adviser give you before and after you buy it? Is there any other information you would like?
2. Should specific investment products be prohibited from sale to the public, or should all products be available to investors and investors be allowed to make their own choice?
3. Should regulators focus on regulating specific products or on regulating how products are sold and distributed?

The survey questions were released on September 4, 2008. The deadline for responses was October 9, 2008. Twenty-four people provided feedback to the JSC.

### **Conference call**

Survey participants were invited to take part in an October 22, 2008 conference call to discuss the questions and elaborate on their written submissions. The questions from the initial survey served as a starting point for the discussion. Eric Kirzner, Professor of Finance, Rotman School of Management, University of Toronto, moderated the conference call. Eleven people participated in the call. Members of the JSC and their staff listened to the feedback but did not participate.

There were three parts to the conference call:

1. Participants were each given five minutes to expand on their answers to the survey questions.
2. Participants were each given three minutes to clarify or expand on their initial comments or the comments of others.
3. Participants were invited to discuss various themes identified by the moderator during the call.

Following the call, participants were given an opportunity to submit additional comments to the JSC by October 31, 2008.

## Survey

### **Q1 – What information about an investment does your adviser give you before and after you buy it? Is there any other information you would like?**

There were 24 responses to this question. Six of these participants indicated that they did not use an adviser. Those who had an adviser said that their adviser provided information such as prospectuses, marketing material, summary sheets and analysis, and disclaimers, before making a recommendation. However, they thought that some of the information was badly written and not designed for investors. In some cases, they received too much information and would prefer a summary sheet with key information such as purchase amounts, fees and adviser compensation. They would also like to see better information about risk, returns and liquidity.

### **Q2 – Should specific investment products be prohibited from sale to the public, or should all products be available to investors and investors be allowed to make their own choice?**

There were 23 responses to this question. Fifteen of the participants believed that all investment products should be available to the public. Eight believed that certain investment products should not be sold to the public.

Those who supported giving investors choice suggested that some regulatory requirements should be imposed. Examples included requiring advisers to provide a clear explanation about the risks and costs of each product, and having a minimum purchase price for some investments.

Those who supported banning certain products cited principal protected notes, special-purpose acquisition companies and high-risk ventures as examples.

### **Q3 – Should regulators focus on regulating specific products or on regulating how products are sold and distributed?**

There were 23 responses to this question. Eleven of the participants believed regulators should focus on regulating both products and the sale of products.

Six participants believed regulators should focus on regulating how products are sold. One of these participants suggested that regulators should consider a model where simple products can be sold by anyone while more complex products require a financial adviser designation.

Four participants believed regulators should focus on regulating specific products. Two participants suggested that regulators focus on other areas altogether.

## **Conference call**

The questions from the initial survey served as a starting point for the discussion at the conference call. The original questions were broadly framed and discussion relating directly to the questions centred on a number of general themes, including:

1. **Approval of investment products for sale.** Some participants thought that there should be greater accountability for the approval of investment products before they are sold to the public, which is consistent with the survey response to question 2.
2. **Adviser training and supervision.** Some participants thought that advisers should have better training and supervision, which relates to the survey response to question 3.
3. **Regulation.** Some participants commented on how the investment industry is regulated and suggested changes, which also related to the survey response to question 3.

In addition, discussion around the consultation questions led to comments on the consultation process, and different suggestions for future retail investor consultations.

### **Approval of investment products for sale**

Participants questioned whether certain complex investment products were appropriate for retail investors and whether advisers, even if trained, would ever be able to fully understand complex products. They also questioned whether investment firms had enough resources dedicated to product review and research.

Some participants called for greater accountability from firm management when approving products for sale by their sales forces. Others wanted to see greater control over which products are sold to investors.

### **Adviser training and supervision**

Participants expressed the view that the average investor has neither the time nor the knowledge to assess investment products. For this reason, participants generally believed that investors rely heavily on the advice of their investment advisers.

However, they questioned how well advisers understand the products they recommend. They also questioned whether advisers are properly trained to assess the investment needs and risk tolerance of investors. Many participants suggested advisers should complete more rigorous academic and on-the-job training, and new trainees should be more closely supervised.

### **Regulation**

A number of participants expressed the view that broad regulatory reform is needed to better protect investors. They cited asset-backed commercial paper (ABCP) and certain hedge funds as examples. Participants also questioned the usefulness of the “accredited investor” exemption.

Some participants suggested that all personal financial advice should be regulated, not just investment advice. Some participants supported the idea that a parliamentary committee should consider the broader financial security of Canadians. Several participants supported the creation of a national securities regulator in Canada.

Others said that the creation of investment products should be monitored and approved by the government or some other independent body.

## Appendix A: Written survey responses

	<b>What information about an investment does your adviser give you before and after you buy it? Is there any other information you would like?</b>	<b>Should specific investment products be prohibited from sale to the public, or should all products be available to investors and investors be allowed to make their own choice?</b>	<b>Should regulators focus on regulating specific products or on regulating how products are sold and distributed?</b>
<b>1</b>	If it is a mutual fund or a new issue I get a prospectus. I almost never read the prospectus. My adviser describes the company, how well it has done in the past, what their analysts think the company will do in the future, and how that will affect the stock price. I usually follow my adviser's recommendations, and I think I get enough information. There is too much paperwork already between a long account form, prospectuses, dealer disclosure brochures, monthly statements from dealers, quarterly and annual reports from companies. Most of it is badly written, designed by lawyers to protect the companies instead of provide concise, useful information for investors.	It isn't up to the government to decide what investments should be available. Investors should be able to make their own choices, but advisers and dealers should be held responsible for clearly inappropriate recommendations.	You need both. Mutual funds need some rules about what they can do and what they can't do. Regulators should focus on how products are sold and distributed but should really spend time finding the bad dealers and advisers and getting them out of the business instead of having companies fill my mailbox with documents I don't read. I see very few reports of advisers being punished despite the millions of dollars spent by regulators.
<b>2</b>	he gave us unsubstantiated opinions about the fund he advised which turned out to be fraudulent.	absolutely these investments should be banned.	both

3	I would like a "cheat sheet" of the investment. The prospectus' as of late have much ambiguity and I would like firm answers. Examples are minimum purchase amounts, fees, short term trading fees. The amount in the sales documents are not always the amounts the manager gives. so why have a minimum amount there anyhow?	LSIFS should be prohibited for sale to the public if they are ONLY using them for tax purposes. The product almost never gets a gain and then we lose our money, but our rep said they were great for taxes but never mentioned the zero return.	All should be reviewed! The focus should be on all aspects as they affect each other. But the best part is that investors should be required to complete KYC each year and Dealer/Reps should be required to touch base once a year with their clients.
4	I do not use an adviser but have found that seniors are often not told about fees, expected returns, risks and liquidity.	SPAC's should not be sold to retail investors	Both are necessary given the complexity of all the new structured products
5	None	Yes	Yes
6	None, I'm totally DIY, self-directed.	None should be prohibited.	Focus on how sold and distributed. Some should be sold only by qualified/certified advisors. Try the UK as a model where stakeholder products - relatively benign and safe - can be sold by anyone, but anyone offering advice on and selling others must have a financial advisor designation.
7	- how it fits into my overall financial plan - potential risks and rewards -description of the investment and relevant info Other info - none necessary. Already have information overload.	Leave investors to make their own decisions.	Neither. Financial services is based on trust. Emphasis should be based on weeding out the bad advisors before they get licensed.
8	info provided is enough.	all products should be available and investors should make their own choice no matter how risky of an investment they choose.	specific products

<b>9</b>	too many books and other papers!	all products should be available to everyone	Regulate the products more than how they are sold
<b>10</b>	Latest trading price and volume. Any recently news release of the company. Other information?...no.	All products should be available and investors should be allowed to make their own choice.	Regulating specific products because, once regulated at source, it doesn't matter how the product are sold and distributed. Ie. the product is legitimate.
<b>11</b>	I am a DIY investor have not found a adviser that does not have a conflict of interest.	All products	Yes
<b>12</b>	Prospectuses, Disclaimers etc.	Investors should be allowed to make own choices.	Not specific products only on how they are sold & distributed.
<b>13</b>	The advisor provides VERY LITTLE info and you have to really know what to ask and how to ask it before he/she will provide a transparent answer. The advisor never provides how he/she is compensated or how much on the product he/she is trying to sell you - and only points out the so-called "positives" of purchasing a certain mutual fund or labour sponsored fund. I have asked various advisors to provide a benchmark to how the mutual funds he is suggesting perform compared to a realistic benchmark (such as comparing it to an index AND other mutual fund peers in the industry/category).	All products should be made available BUT with a clear understanding/explanation from the advisor on the risks, costs, etc.	Regulators should focus on regulating BOTH specific products and how products are sold and distributed.

14	<p>Usually a one sheet with what I am buying the rates of return and MERs or fees associated with it I would like a rating how it compares to other investments is a dividend fund risky? it seems to depend on which bank or advisor you ask some firm general guidelines would be nice</p>	<p>investors should be allowed to make their own choices though investors should have to acknowledge certain products are more risky who draws that line I don't know and where that line is drawn I don't know.</p>	<p>Regulate how all products are sold I believe hedge funds have little or no oversight yet the big ones seem to be glorified mutual funds. I also believe deferred service charges should be banned. fine to lock me in for 2-3 years with low load but 7 years and my advisor who sold it is gone and I have to pay bill. I am not sure the charge was ever explained to me this is something that should be regulated</p>
15	<p>Liquidity, disclosure of risk and fees.</p>	<p>High risks ventures.</p>	<p>Regulators should focus on regulating specific products such as high risks venture capital, labor sponsored funds, hedge funds or anything that's require professional knowledge which not an ordinary investor can understand. Regulators seem spend too much time on regulating segregated funds, principal protected notes and mutual funds which an investor can make purchase on-line.</p>

<p><b>16</b></p>	<p>This question is not particularly relevant to the relationship I have with my advisor. The advice process is a continuum and each particular decision to purchase an investment is contextual with respect to my overall portfolio and the financial plan that drives it. I am more interested in the quality of the advice giver and her methodologies, as I am not inclined or likely able to absorb the amount of information that would be necessary to make an appropriate decision. I prefer to do my screening at the process level and delegate the selection of individual investments to my advisor. After all, isn't that what I'm paying her to do for me?</p>	<p>All investment products should be available to all investors. To my mind anything short of this is a form of discrimination which I didn't think was allowed under the Charter of Rights and Freedoms. It doesn't make sense that I can pick up the phone to a discount broker and load up on a speculative stock or option but putting a well managed hedge fund in my portfolio is not allowed. Sophisticated investors should be able to simply declare themselves as such and be able to purchase investments without the assistance of an advisor and take total responsibility for their own outcomes. All others should be required to deal with an advisor who is properly qualified to provide advice on any particular investment product. I get very frustrated when my advisor informs me that I cannot buy a product that meets my objectives because I am not an "accredited" investor.</p>	<p>Regulators should be focusing on both. However, given that I have a trusted advisor, and their dealer appears to be run with integrity, I would prefer that you focus more on regulating specific products. Many of the forms that have to be completed before I can purchase investments make no sense to me or my advisor and accomplish very little. I can see that she is stressed by the demands of all this paperwork in addition to the material and reports that she provides to me by her own initiative. I would rather she spend her energy on meeting my needs rather than those of the regulators. Perhaps your energies would be better spent preventing fraud and theft as this appears to be where the biggest risk is to me and my advisor. I am shocked that there have been no punitive measures taken against the DBRS and the issuers that pay them for the huge breach of public faith in the ABS scandal. I consider it a near miss that I didn't happen to own a money market fund that held these securities. You can hardly blame the portfolio managers and their</p>
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			<p>advisors when an investment is branded triple A. When there is a major market failure such as this, the regulators should be putting all available resources to get to the bottom of this and assist with investor restitution. I also feel there should be some form of regulation over alternative investments such as pooled hedge and private equity funds so that investors are less likely to become victims of fraud and misrepresentation, but still allow these investments the latitude they need to operate freely and make money in a competitive market. Severe penalties should be meted out to those who engage in this type of criminal activity. Do we need to convince the New York Attorney General to set up a branch office in Canada?</p>
<b>17</b>	<p>Usually the name of the investment is sufficient to google it and obtain further information from the internet.</p>	<p>All investment products should be available for sale. I'd be interested in investing in a hedge fund but i'm precluded from doing so. Having a long only strategy in this market has been disastrous. A market neutral hedge fund would be a great addition to the portfolio.</p>	<p>I think investors should have absolute choice on investments and that regulation is only needed on the disclosure, advertising and distribution side. Look at the real estate industry with their endless bullishness on the real estate market saying prices always go up, buy now</p>

			or forever be priced out, they ain't making any more land, get on the property ladder, real estate is a great investment, etc. The problem was not the product but the risks were severely downplayed and the advertising was hugely one-sided.
<b>18</b>	Before, Prospectus After, None	Only those that they understand	Both
<b>19</b>	I do not have an investment advisor.	All products should be available and investors should be allowed to make their own choice. Some protection can be given through the minimum purchase price. Higher risk investments should be geared to those who can afford to potentially lose money. Investors need to be become more educated and take more responsibilities for their decisions.	I think Regulators should regulate how products are sold and distributed. Firms need to have the ability to develop new products and ideas and not be constrained by regulation.
<b>20</b>	I have no adviser	all products be available to investors and investors be allowed to make their own choice	on regulating how products are sold

21	I had an advisor until recently. He sold a hybrid structured product --, to my parents when they were in charge of my account in trust. I believe he represented it as being more similar to a fixed-income investment than it really was. I would have preferred that he inform us up front of fees embedded, including the amount he gets as a trailer.	Investors should be allowed to make their own choice, but I believe that more complicated investment products need a thorough explanation. For example, if a closed-end fund generates income using covered call options, the investor should understand what options are and how this strategy affects the fund both on the up- and downside. If an equity fund holds short positions in stocks, the investor should understand that the mutual fund is betting against a part of the market.	I think a balance of both is useful. I believe it is criminal that while most "A-series" mutual funds include embedded trailers to advisors, the same products purchased by self-directed investors donate those trailers to their brokerages who are by law *not allowed* to give advice. And at the same time, "F-series" funds, which have the trailers stripped out, are kept away from self-directed investors under pressure of advisors who are so desperate not to lose business.
22	None. I'm a do-it-yourself investor.		
23	A) Prospectus and issuers marketing bumpf. B) Specific information on how the expected performance of the recommended investment matches my overall objectives. Specific information supporting why the investment was recommended over a lower cost appropriate alternative index vehicle. The specific reasons for making a recommendation contrary to the vast majority of academic & other unbiased studies indicating low cost passive invests will outperform their equivalent active investment 70-80% of the time.	Yes, expensive actively managed investment funds that mirror readily available low cost investment alternatives. 2. Principle Protected Notes, the industry ought to be ashamed.	Regulators should focus on the potential conflicts associated with a vast imbalance of knowledge and information. Regulators, if they are to be taken seriously by the public need the teeth to prosecute advisors who take advantage of this imbalance in any way, shape or form.

24	<p>We do not see the purpose of this question as regulatory requirements generally mandate the information that is to be provided about an investment. Further, since the types "investments" are so numerous, it is difficult for investors to provide the JSC with useful responses.</p>	<p>Again this question is too open ended and seems to ask whether government should be paternalistic and protect investors and limit choice or whether there should be complete freedom of choice without regulation. Does the JSC mean to ask whether any form of product should be permitted to be sold to investors where a) full disclosure is made about the product; b) the investor is financially literate enough to be capable of understanding the product and does understand the product; and c) the product is suitable for the investor? Clearly products should not be sold by registrants to retail clients where the product is not transparent, where the client is not able to understand the product (including the risks involved) or where the product is not suitable for the client based on the client's circumstances.</p>	<p>Regulators should both regulate the product and how the product is sold and distributed. Regulators should determine the appropriate level of regulation for a product and how and to whom the product is sold before the product is introduced to the market.</p>
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