

Canadian Securities Administrators Consultation Paper 33-403:  
Standard of Conduct for Advisors and Dealers: Exploring the  
Appropriateness of Introducing a Statutory Best Interest Duty  
When Advice is Provided to Retail Clients (the “CP 33-403”)

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## **Overview**

This study was commissioned by The Investment Funds Institute of Canada and the Investment Industry Association of Canada, and written by Torys' lawyer Laura Paglia. Ms. Paglia practices exclusively in securities litigation and regulatory matters.

The terms "best interest" and "fiduciary duty" are interpreted synonymously when used in statute or otherwise. They are vague, ambiguous concepts capable of a variety of meanings. Our study has moved beyond the use of those terms to a review of the sources and content of what informs the actual standard of professional behavior by investment advisors they seek to define.

Amongst the considerations in CP 33-403 were recent developments in the U.S., U.K., and Australia. In light of the reference to these developments in CP 33-403, this Paper expands on them, the reasons for them, their current status and any relevant similarities or differences to Canada. Its findings show that Canada's regulatory system is thorough, progressive, if not superior, to those of these other jurisdictions.

There has also been some reference in CP 33-403 and in subsequent written and oral responses to Canadian caselaw and its role in providing definition and scope for investment advisory relationships. Apart from the Canadian common law, this Paper seeks to better specify and particularize regulatory requirements in Canada and, in particular, those of applicable self-regulatory organizations ("SRO"), namely the Investment Industry Regulatory Organization of Canada ("IIROC") and the Mutual Fund Dealers Association of Canada ("MFDA") and their prior and current responsiveness to issues raised by CP 33-403. These regulatory requirements have a very significant and material impact on the conduct, distribution and supervision of retail investment advice in Canada.

CP 33-403 has also referred to fiduciary duties of directors created by corporate statute in Canada. Direct analogies to directors' duties are not easily made. To the extent that some broad comparisons may be drawn, the enclosed sets out corresponding statutory and common law protections also available to directors in Canada which more fairly balance and inform their statutory obligations.

This Paper concludes that, with specific reference to its current regulatory framework, there is no gap in Canada that need be or could be filled by imposing further statutory obligations on investment advisors and dealers as contemplated in CP 33-403.

A glossary of materials reviewed outside of the Canadian context is included in Schedule C.\*

## **Executive Summary**

The following provides a summary of our findings, as further detailed and explained in this Paper:

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\* This glossary of materials was prepared by Torys, and in particular Sean Adair and Jonathan Lee. In addition to Sean and Jonathan, Torys wishes to thank Henry Kahn and Dominic Hill of Hogan Lovells for their generous guidance and assistance.

CP 33-403 recognized that a fiduciary duty can be created by statute. A statute requiring an individual to act in the best interest of another is generally understood as a fiduciary obligation. The term “fiduciary” carries certain meanings pursuant to agency, trust and common law in Canada and elsewhere. It is a misleading and confusing term.

We have therefore progressed beyond the words to the foundations for and substance of their meaning in other jurisdictions and in Canada.

The obligations of individuals providing retail investment advice in Canada are informed by many sources well beyond statute. These include case law and rules, regulations and policies of IIROC and the MFDA. IIROC and the MFDA are most influential in defining the obligations in the everyday compliance conduct of the industry, their enforcement and their interpretation by the courts and the industry’s legal and compliance advisors.

We have concluded that, in addition to common law obligations that have been previously referred to in discussions surrounding CP 33-403 and are therefore not canvassed in this Paper, the duties of investment advisors and dealers to their retail clients as apprised by their regulatory obligations are as, if not more fulsome to, those of investment advisors and dealers in other jurisdictions.

### The United States

As the greatest and most extensive considerations have been made in the United States, the contents and status of developments there is amongst the points of focus in this submission.

In March 2013, the Securities and Exchange Commission (“SEC”) issued a Request for Information regarding the duties of broker-dealers and investment advisors (SEC Release No. 34-69013; 1A-3558, hereinafter “SEC RFI”). Unlike Canada, the U.S. makes a distinction between “broker-dealers” who provide more incidental and sporadic advice and “investment advisors” who provide ongoing advice on a portfolio basis, each in turn subject to different regulatory and statutory regimes. “Investment advisors” is a term used to refer to both advisors who seek their clients’ prior instruction on accounts and portfolio managers who conduct trades on a discretionary basis. “Broker-dealers” are held to a suitability standard under FINRA rules and “investment advisors” are held to a so-called “fiduciary standard” (as further explained in this paper) under federal and state law. A main premise under the SEC RFI is that retail investors should receive the same or substantially similar protection when obtaining the same or substantially similar service from financial professionals.

“Broker-dealers” as opposed to “investment advisors”, and their corresponding distinctions, do not exist in Canada. In Canada, we do not have “brokers”, but rather “investment advisors” who are licensed to and required to provide ongoing advice on a portfolio basis. Investment advisors are also distinguished from portfolio managers who are subject to higher duties due to their discretionary authority.

*To the extent that individuals registered to provide retail investment advice on a non-discretionary basis are subject to IIROC and the MFDA jurisdiction, they provide consistent protection to investors in respect of matters relating to CP 33-403.*

The SEC is openly considering a variety of options relating to how or whether to act pursuant to its discretionary rule making authority. It is similarly openly sensitive to possible economical costs and impeding investor access. The SEC admits to complex considerations and is willing to take into account its existing regulatory obligations. The SEC is also considering a regulatory model that already exists in Canada in respect of consistent applicable SRO requirements and initiatives for investment advisors.

The SEC RFI defines a fiduciary standard to simply include a duty of loyalty and care. A duty of care is comprised of know your product and suitability obligations along with fair and reasonable compensation. A duty of loyalty requires disclosure of the aspects of the retail client relationship and material conflicts of interests. In addition to and beyond the Canadian common law, IIROC and MFDA requirements in Canada incorporate and detail duties of loyalty and care. The U.S. is therefore either debating or clarifying concepts that have been accepted and developed by Canada's legal and regulatory systems.

There is also recognition by the SEC that a "uniform fiduciary standard" could be understood quite differently by various parties. Some public comments on such standard have assumed it would include a duty to provide the lowest cost alternative, stop offering proprietary products, charge no commissions or continuously monitor all accounts. The SEC has stated these outcomes would not necessarily be the case. Rather, the SEC has provided and this Paper will set out its assumptions regarding what informs an otherwise "murky" standard in the U.S.

A uniform fiduciary standard, according to the SEC, would not generally require a broker-dealer or investment advisor to have a continuing duty of care or loyalty to a retail investor after providing him or her with personalized investment advice about securities. *This is a lesser regulatory standard than exists with Canada's SROs for reasons including but not limited to the Client Relationship Model. The Client Relationship Model is reflected in current IIROC and MFDA rules, both of whom specifically require continuing duties by an investment advisor and his/her dealer beyond the initial purchase, sale or recommendation of any security.*

The SEC assumes the nature and scope of duties would depend on the contractual or other arrangements and understandings between the retail investor and the broker-dealer or investment advisor including the totality of the circumstances of the relationship, and their contractual provisions.

*This assumption is in general accordance with Canadian common law, which, due to the submissions made to date, do not otherwise form part of this Paper.*

The enclosed will also set out the components of the fiduciary standard as defined by U.S. common law pursuant to the *Investment Advisers Act* of 1940<sup>1</sup> (the "Advisers Act"). Like the

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<sup>1</sup> *Investment Advisers Act of 1940*, 15 U.S.C. § 80b (2000).

SEC, the U.S. common law similarly limits a fiduciary duty for both investment advisors *and portfolio managers* to such matters as good faith, disclosure and reasonable prudence. *As some public comment to date has endeavoured to explain, common law fiduciary standards for investment advisors and portfolio managers in Canada demand more.* As this Paper will also show, the characterization of advisor duties as fiduciary in the U.S. is questionable, as these duties are not actually fiduciary in nature and are otherwise abstract and unclear. In contrast, in addition to common law, these duties are defined by and through SROs in Canada.

### The United Kingdom

There is no statute imposing on investment advisors in the United Kingdom a duty to act in the best interest of their clients. Unlike Canada, there is little common law available specific to investment advisors to otherwise inform their standards. Regulatory rules require that investment advisors act “honestly, fairly and professionally in accordance with the best interest of their client”. Substantively similar regulatory duties exist in Canada as informed by Canada’s regulatory system in addition to its common law.

On May 26, 2013, a Law Commission in the United Kingdom received a reference from the Secretary of State for Business Innovation and Skills with terms that included *inter alia* to investigate whether fiduciary duties should apply to all those “in the investment chain”.

A Consultation Paper was published on October 22, 2013 which considered various market participants with some reference to financial advisors. It recognized that the term ‘fiduciary’ could be interpreted in different ways and that therefore the U.K. government had elected to avoid using it in past pronouncements. With due regard to both the approach of the courts and the regulatory rules informing the standards for market participants, it formed the provisional view that the law of fiduciaries should not be reformed by statute. The view was motivated at least in part by a recognition that the difficulties in articulating the meaning of ‘fiduciary duties’ would multiply with the imposition of a statutory obligation, resulting in new uncertainties and possible unintended consequences. A final report is expected in June 2014.

### Australia

Unlike Canada, Australia is subject to a compulsory and mass superannuation guarantee (“SG”), which by 2021 will require employers to make payments of 12% of wages to a superannuation fund of an employee who then has a choice as to where to invest. The use of investment advice by the mass market in Australia is very influenced by this fact. Also, unlike Canada, Australia suffered from various corporate collapses which resulted in the Australian Government’s future of Financial Advice (“FOFA”) return package in April 2010. As part of that initiative, which proved unnecessary in Canada, more recently Australian Parliament revised the *Corporate Amendment (Further Future of Financial Advice Measures)* in 2012 and introduced a statutory best interest obligation. The Australian Securities and Investment Commission (“ASIC”) subsequently sought guidance on the meaning of their best interest duty, which is not readily apparent through statute. In December 2012, the ASIC, following a public consultation process,

issued guidance informing that standard. *Their guidance is neither superior to nor more onerous than SRO requirements in Canada.* It remains new and was not fully mandatory until this past July 1, 2013. In any event, Australia may not have as developed a regulatory system with similar history and precedents as Canada. In particular, Canada's SROs cannot be characterized as industry associations. Rather, they are recognized as regulators by both the CSA who audits, directs and delegates to them and by the industry, from whom and as a result of which, Canada benefits from significant compliance and co-operation.

#### Regulatory Framework In Canada

Canada has an extensive regulatory system. Beyond statutory duties that already exist, National Instruments may be implemented through comprehensive SRO rules and guidance that are responsive to any policy objectives raised by CP33-403.

In particular, Part 13 of NI 31-103 sets out various requirements for registrants providing retail advice in Canada, which includes their obligations as gate keepers to the integrity of the market, their obligations to identify and respond to conflicts of interest and obligations of firms to monitor and supervise investment advisors in an effective manner. Each of IIROC and MFDA have numerous rules and guidance regarding business conduct, the supervision of retail accounts, relationship disclosure and conflict of interest. With respect to conflicts of interest in particular, each of IIROC and MFDA rules require its members to ensure they are addressed with a view to the best interest of the client. The cumulative effect of our regulatory system is that registrants are required to have an in-depth knowledge of both the clients they service and the securities they recommend including their risks and costs.

The Canadian regulatory framework is summarized in Schedule "B" and further outlined in this Paper, both of which provide a comparison of our system with initiatives in the U.S., U.K. and Australia in respect of matters raised by CP 33-403.

#### Directors Fiduciary Duties

To the extent that analogies may be drawn to the statutory "best interest" duties imposed on directors in Canada, it is important to note that directors have corresponding statutory protections limiting liability and providing due diligence defences along with statutory rights of indemnification. When combined with the leading case law, they also have the benefit of both the discretion and protection afforded by the business judgment rule.

## Conclusion

We have not identified any gaps in the Canadian regulatory system and found that appropriate standards of professionalism for investment advisors and their firms are as fulsome if not more fulsome than those of other jurisdictions and are in no way dependent on statutory best-interest language. A glossary of materials reviewed is included in Schedule C.

We therefore ask the CSA to consider evidence of the practical results that may emerge from CP 33-403 across all business models to ensure that retail investors would in fact be better served at every level of income and assets from its proposals.

## **PART I - THE UNITED STATES**

### **A. The Regulators: The SEC RFI**

#### **1. Its Purpose**

In March 2013, the SEC RFI was issued regarding the duties of broker-dealers and investment advisors. Unlike Canada, the United States has broker-dealers (who provide more incidental and sporadic advice) and investment advisors who provide ongoing advice on a portfolio basis, who are subject to different regulatory and statutory regimes. On the face of it, broker-dealers are held to a ‘suitability standard’ under FINRA rules and investment advisors are held to a best interest standard under state law and federal law.

In the U.S., the lines between full service broker-dealers and investment advisors have blurred with both investment advisors and broker-dealers providing investment advice on both a sporadic and ongoing basis resulting in retail investor confusion. One of the main premises of the SEC RFI is that retail investors should receive the same or substantially similar protection when obtaining the same or substantially similar services from financial professionals.<sup>2</sup> *This premise has already been satisfied in Canada through consistent regulatory requirements including SRO requirements to matters and issues applicable to a ‘best interest discourse’ in the United States.*

The SEC is considering implementing a uniform “fiduciary standard”<sup>3</sup> to regulate the conduct of broker-dealers and investment advisors when providing personalized investment advice about securities to retail customers. They are also considering the Canadian regulatory model as a solution, which they describe as ‘harmonizing’ certain regulatory requirements for broker-dealers and investment advisors.

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<sup>2</sup> Securities and Exchange Commission, “Duties of Brokers, Dealers, and Investment Advisers,” Release No. 34-69013, IA-3558 (March 1, 2013) [“SEC RFI”] at p. 7.

<sup>3</sup> The issue of what is actually meant by a fiduciary standard in the United States is more fully canvassed later in this Paper.



Section 913 of the *Dodd Frank Act*<sup>4</sup> granted the SEC discretionary rule making authority under the *Advisers Act* to potentially adopt rules establishing a uniform fiduciary standard of conduct for all broker-dealers and investment advisors when providing personalized investment advice about securities to retail customers. That section provided that the standard of conduct shall be:

1. In the “best interests” of the customer without regard to the financial or other interests of the broker, dealer or investment advisor providing the advice; and
2. No less stringent than the standard applicable to investment advisors under Sections 206(1) and 206(2) of the *Advisers Act* when providing personalized investment advice about securities.

Sections 206(1) and 206(2) of the *Advisers Act* comprise anti-fraud provisions that state as follows:

“It shall be unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly –

“(1) to employ any device, scheme, or artifice to defraud any client or prospective client;

“(2) to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client;

The standards applicable under this section apply to both investment advisors providing consultative advice and portfolio managers exercising discretion.

The SEC RFI fully recognized that Section 913 of the *Dodd Frank Act* did not mandate that they undertake any rule making and the SEC had not yet made a determination as to whether to commence the rule making.<sup>5</sup>

Rather, the SEC requested additional public input to assist in evaluating whether or not to use the authority provided under Section 193 of the *Dodd Frank Act* at all. Among its considerations, the SEC has stated that:

- (i) it is sensitive changes in existing legal or regulatory standards that could result in economic costs and benefits which must be considered in the economic analysis that would form part of any rule making under the discretionary authority provided by Section 913 of the *Dodd Frank Act*;

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<sup>4</sup> *Dodd-Frank Wall Street Reform and Consumer Protection Act*, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>5</sup> SEC RFI, *supra*, footnote 2, at p. 9.

- (ii) it will take into account existing regulatory obligations that apply to both broker-dealers and investment advisors;
- (iii) if it determines to engage in rule making further, the rule making process would provide it with an opportunity to request further data and other information on the range of complex considerations associated with any proposal implementing such a standard including any potential costs and benefits;<sup>6</sup>

The SEC has indicated that any proposal should address goals which include:

- (i) Preserving retail customer choice with respect to the availability of accounts, products, services and relationships with investment advisors and broker-dealers; and
- (ii) Not inadvertently eliminating or otherwise impeding retail customer access to such accounts, products, services and relationships (for example, through higher costs).<sup>7</sup>

## **2. The Fiduciary Standard and its Future is Unclear**

A statutory obligation to act in the best interest of a client is generally understood as a fiduciary obligation. It has been properly and overtly recognized in the U.S. that the term “fiduciary” may be a misleading or confusing term for investors as well as the Courts if incorporated by the SEC because it carries a variety of meanings including under agency and trust law where the duties and remedies may vary. The SEC has been urged to avoid using the term fiduciary in any regulations so as to not further confuse the investing public.<sup>8</sup>

The SEC therefore recognized that their version of a “uniform fiduciary standard” could also be understood quite differently by various parties. It acknowledged that public comments on such

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<sup>6</sup> *Ibid.*, footnote 2, at p. 9.

<sup>7</sup> *Ibid.*, footnote 2, at p. 10.

<sup>8</sup> Cecelia A. Calaby, Senior Vice President, Office of Regulatory Policy, American Bankers Association and ABA Securities Association, Letter to the Securities and Exchange Commission Re: “Request for Information: Duties of Brokers, Dealers, and Investment Advisors; File Number 4-606; 78 Federal Register 14848 (March 7, 2013)” (July 5, 2013), online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3116.pdf>>

The SEC RFI response to The American College Center for Ethics in Financial Services (full cite) states that it is difficult to determine how to define the standard, difficult to determine when the standard has been met and difficult to determine that practitioners held to the fiduciary standard are meeting the standard well while other practitioners held to different standards are not. The American College provides financial education for securities, banking and insurance professionals. They responded to the SEC RFI in a rather distinct manner and made various valuable observations that merit attention. Their response is therefore summarized in some detail below:

The American College further stated that though how to determine, in a positive way, when a person is acting in the best interest of a client is a murky question, to assume that practitioners merely fulfill the strict letter of their legal obligations does not reflect the experiences of many consumers of financial services. Rather, the questions are not new and the problems posed by the ambiguity over the proper definition of best interests and the troubles caused by the disclosure mandate that is not meaningful or helpful to an investor are only exacerbated by an expansion of a murky standard.

a standard contained widely varying assumptions about what a fiduciary duty would require with some comments assuming that a uniform fiduciary duty would require all firms to, among other things, provide the lowest cost alternative, stop offering proprietary products, charge only asset backed commissions or no commissions and continuously monitor all accounts. The SEC explicitly stated that these outcomes would not necessarily be the case.<sup>9</sup>

Rather, the SEC recognized that there are a variety of options relating to whether and how to act with respect to a potential uniform fiduciary standard of conduct or potential regulatory harmonization including taking no action.<sup>10</sup>

### **3. The Assumptions Regarding Uniform Fiduciary Standards Made by SEC**

The SEC provided clarity to and established a common baseline of assumptions in their consideration of description of a possible uniform fiduciary standard of conduct when providing personalized advice to retail investors, upon which they also invited comment. These assumptions are instructive and include the following:

- A uniform fiduciary standard would permit broker-dealers to continue to receive commissions. Firms would not be required to charge an asset based fee but would need to disclose a material conflict of interest, if any, presented by its compensation structure;
- A uniform fiduciary standard would not generally require a broker-dealer or investment advisor to either:
  - Have a continuing duty of care or loyalty to a retail customer after providing him or her with personalized investment advice about securities; or
  - Provide services to a retail customer beyond those agreed to between the retail customer and the broker-dealer or investment advisor.
- Rather, whether a broker-dealer or investment advisor might have a continuing duty as well as the nature and scope of such duty, would depend on the contractual or other arrangement or understanding between the retail investor and the broker-dealer or investment advisor including the totality of the circumstances of the relationship in the course of dealing with the customer and the firm, including but not limited to contractual provisions, disclosure and marketing documents and reasonable customer expectations arising from the firm's course of conduct;
- The offering or recommending of only proprietary or a limited range of products would not in of itself be considered a violation of the uniform fiduciary standard.

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<sup>9</sup> SEC RFI, *supra*, footnote 2, at pp. 11-12.

<sup>10</sup> *Ibid.*, footnote 2, at p. 12.

*In addition to the Canadian common law, the current duty of care and regulatory obligations of investment advisors in Canada registered with either IIROC or the MFDA exceed the assumptions set out by the SEC RFI in respect of a potential uniform fiduciary standard in the U.S.*

#### **4. Discussion of Possible Uniform Fiduciary Standard**

The SEC did not ignore common law. Rather, the SEC properly relied upon the Supreme Court of the United States interpretation of Sections 206(1) and (2) of the *Advisers Act* as requiring an investment advisor to:

“Fully disclose to its clients all material information that is intended to eliminate, or at least expose, all conflicts of interest which might incline an investment advisor, consciously or unconsciously, to render advice which is not in their interest”.<sup>11</sup>

SEC staff recommended that in implementing a uniform fiduciary standard, it should address both components of the uniform fiduciary standard as referenced in U.S. common law: a duty of loyalty and a duty of care. The SEC requested data and information on the benefits and costs of implementing a fiduciary standard entailing these two elements.<sup>12</sup>

*In addition to the Canadian common law, it is important to recognize that the above articulation of a fiduciary standard in the U.S. is reflective of the minimum duty of care and regulatory obligations of investment advisors in Canada registered with either IIROC or the MFDA.*

Like Canadian common law, the SEC further acknowledged that existing guidance and precedent under the *Advisers Act* regarding fiduciary duty turns on the specific facts and circumstances including the type of services provided and disclosures made in any investor relationship.<sup>13</sup>

##### **(i) The Duty of Loyalty**

Section 913(g) of the *Dodd Frank Act* addresses the duty of loyalty by providing that any material conflicts of interest shall be disclosed and may be consented to by the customer such that at a minimum, eliminating material conflicts of interest or providing full and fair disclosure to retail clients about those conflicts of interest is required.<sup>14</sup>

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<sup>11</sup> SEC RFI, *supra*, footnote 2, at p. 29, relying on *SEC v. Capital Gains Research Bureau Inc.*, 375 U.S. 180 (1963), discussed further in this paper.

<sup>12</sup> *Ibid.*, footnote 2, at p. 30.

<sup>13</sup> *Ibid.*, footnote 2, at p. 43.

<sup>14</sup> *Ibid.*, footnote 2, at p. 32.

*Mandatory disclosure of a material conflict of interest is consistent with continuing regulatory obligations in Canada. Additional obligations in Canada regarding conflicts of interest are discussed further in this Paper.*

The following assumptions are made by the SEC regarding the duty of loyalty:

1. Disclosure requirement in respect of:
  - (a) Disclosure of all material conflicts of interest;
  - (b) Disclosure in the form of a general relationship guide to be delivered at the time of entry into a retail client relationship which would contain a description of among other things, the firm's services, fees and the scope of its services with the retail customer including whether:
    - (i) advice and related duties are limited in time or are ongoing or otherwise limited in scope;
    - (ii) the broker-dealer or investment advisor only offers or recommends proprietary or other limited range of products;
    - (iii) and if so the circumstances in which the broker-dealer or investment advisor will seek to engage in principle trades with the retail customer;
  - (c) Oral or written disclosure at the time of personalized investment advice is provided of any new material conflicts of interest or any material change of conflict of interest.
2. Any rule under consideration would treat conflicts of interest arising from principal trades the same as other conflicts of interest;<sup>15</sup>
3. The rule would prohibit certain sales contests (e.g., trips and prizes).

*The aforementioned are also consistent and continuing minimum regulatory obligations in Canada for reasons including but not limited to the Client Relationship Model. There is an extensive regulatory regime in place in Canada regarding the disclosure of all material conflicts of interest at the time of providing personalized investment advice and otherwise. The Ontario Securities Act<sup>16</sup> provides that every registrant shall comply with Ontario securities law and*

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<sup>15</sup> A principal trade refers to a broker-dealer acting on its own behalf and at its own risks as opposed to carrying out trades of the brokerage's clients. As such, principal trading is not a relevant consideration to the Canadian context. Section 206(3) of the *Advisers Act* makes it unlawful for any investment adviser, directly or indirectly "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client ..., without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

<sup>16</sup> R.S.O. 1990 c. S5, section 32.1(g)

regulations relating to conflicts of interests. Part 13 of NI 31-103 requires every registered firm to identify material conflicts of interest and inform investors<sup>17</sup>. IIROC Rule 42 addresses its members responsibilities to both disclose and properly respond to conflicts of interest. Its Guidance Notice 12-0108 provides further explanation of disclosure requirements. A failure to disclose or otherwise properly respond to a conflict of interest is also enforced by IIROC pursuant to its Rule 29.1, requiring its members to observe high standards of ethics and conduct. Similarly, the MFDA requires the immediate disclosure of any conflict of interest pursuant to its Rule 2.1.4 and Staff Notice MSN-0054.

Similarly, relationship disclosure is mandated by IIROC through its Rule 3500 and the MFDA through its Rule 2.2.5.

**(ii) The Duty of Care**

A duty of care is described by the SEC as promoting advice that is in the “best interest” of the retail customer.

Multiple duty of care obligations are owed by investment advisors to their clients in Canada from both a regulatory and common law basis. We do not describe those as fiduciary.

The following assumptions are made by the SEC regarding the duty of care:

1. Suitability obligations: this is a duty to have a reasonable basis to believe that its securities and investment strategies are suitable for at least some customers as well as for the specific retail customer to whom it makes the recommendation in light of the retail customer’s financial needs, objectives and circumstances;
2. Product specific requirements: specific disclosure, due diligence or suitability requirements for certain security products recommended;
3. Duty of best execution;<sup>18</sup>
4. Fair and reasonable compensation.

*The aforementioned are also consistent with continuing regulatory obligations in Canada.*

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<sup>17</sup> National Instrument 31-103 – Registration Requirements, Exemptions and Ongoing Registrant Obligations, amended May 31, 2013, 32 O.S.C.B. (Supp 4) 1, 33 O.S.C.B. (Supp 5) 107, 34 O.S.C.B. 7547, 35 O.S.C.B. 8547 and 36 O.S.C.B. 2619, Part 13.4(1)(3), 13.6

<sup>18</sup> This refers to trade execution and includes where an investment advisor has the responsibility to select broker-dealers to execute trades in the U.S. As such, it is not a relevant consideration to the Canadian context.

## **5. Alternative Approaches to the Uniform Fiduciary Standard of Conduct**

The SEC is open to considering alternative approaches to a uniform fiduciary standard as described by them and has requested comments on the following alternative approaches:

1. Apply a uniform requirement for broker-dealers and investment advisors to provide disclosures about (a) key facts of the services they offer and the types of products or services they offer or have available to recommend and (b) material conflicts they may have with retail customers without imposing a fiduciary standard of conduct. *[Please note this obligation already exists in Canada.]*
2. Without modifying the regulation of investment advisors, apply the uniform fiduciary standard discussed above or parts thereof to broker-dealers. This is a “broker-dealer” only standard to involve establishing a best interest standard of conduct for broker-dealers which would be no less stringent than that currently applied to investment advisors under the *Advisers Act*, Sections 206(1) and (2) when they provide personalized investment advice to retail customers. *[Please note as stated we do not have “broker-dealers” in Canada.]*
3. Specify certain minimum professional obligations under an investment advisor’s duty of care (which unlike Canada are currently not specified by a rule in the U.S.). Any rules or guidance would take into account *Advisers Act* “fiduciary principles” such as the duty to provide suitable investment advice (eg., with respect to specific recommendations about the client’s portfolio as a whole). *[Please note that “suitable investment advice” is described as a “fiduciary principle” in the U.S.]*
4. In accordance with the discretionary authority under Section 193, the SEC is not foreclosing the possibility of determining to take no further action with respect to the standards applicable to broker-dealers and investment advisors and stating that regulatory requirements will continue to apply.

## **6. Regulatory Consistency**

The SEC sought data and other information on the nature and extent to which they should consider ‘harmonizing’ the regulatory obligations of broker-dealers and investment advisors.

*It is important to note that consistent regulatory obligations exist in Canada through IIROC and the MFDA with respect to matters applicable to so called ‘best interest’ standards.*

**B. Responses to the SEC RFI**

**(i) Redundancy**

We have reviewed several responses to the SEC RFI.<sup>19</sup> The following ‘gaps’ in the provision of retail investment advice have been identified as potentially benefiting a “fiduciary standard” in the U.S. in accordance with their definition of that term:

- (i) When an investor follows a broker to a new brokerage firm;
- (ii) The change of circumstance or investment objectives;
- (iii) Investors changing from one broker to a new broker;
- (iv) Not advising about “impending disaster”.<sup>20</sup>

The above gaps do not exist in Canada. They have already been responded to through SRO requirements in Canada, particularly through aspects of the Client Relationship Model, as reflected in IIROC Rules 3500, 1300 (r), IIROC Notice Nos. 12-108 and 12-0109 dated March 16, 2012, MFDA Rule 2.2.1 (e) (f) and MSN-0069 Suitability Guidelines last revised February 22, 2013. These require that suitability analysis be conducted in each of the circumstances (i) to (iii) above. As described in this Paper, a fiduciary standard in the U.S. is not more onerous than this analysis. These also require review of client accounts where there are significant market events or a material change in the risk profile of an issuer.

**(ii) Investor Advocates**

The SEC RFI has its critics particularly with respect to its definition of fiduciary duty in terms of the duties of loyalty and care, as well as disclosure obligations.<sup>21</sup> Despite these criticisms, the following observations and responses of some investor advocate groups are noteworthy for the context they provide regarding the expectation in the U.S. of the standards applicable to retail investment advice:

The Committee for the Fiduciary Standard (“The Committee”) has stated as follows:

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<sup>19</sup> See Glossary of Materials at Schedule C.

<sup>20</sup> Scott C. Ilgenfritz, President, Public Investors Arbitration Bar Association, Letter to the Securities and Exchange Commission Re: “File No. 4-606; Duties of Brokers, Dealers and Investment Advisers (Request for data and other information)” (July 3, 2013), online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3107.pdf>>

<sup>21</sup> For example, Kevin R. Keller, Lauren Schadle, and Geoffrey Brown, Letter to the Securities and Exchange Commission on behalf of the Financial Planning Coalition, comprised of the Certified Financial Planner Board of Standards, Inc., the Financial Planning Association, and the National Association of Personal Financial Advisors Re: “SEC Request for Data and Other Information, Duties of Brokers, Dealers and Investment Advisers, File No. 4-606” (July 5, 2013), online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3126.pdf>>



“The results of the services provided by a fiduciary advisor are not always related to the honesty of the fiduciary or the quality of services. For example, an investment advisor may be both honest and diligent, but the value of the client’s portfolio may fall as a result of market events. Indeed, rare is the instance in which an investment advisor provides substantive positive results for each incremental period over long periods of time – in such instances the honesty of the investment advisor should be suspect”.<sup>22</sup>

This statement recognizes that a portfolio may fall despite honesty and diligence exhibited by the advisor.

The Committee also outlined five core principles of the fiduciary standard which include “putting the client’s best interest first”. Rather than this being specified as a higher or greater duty, it is simply described as flowing from a triad of broad duties to act with:

- (i) Due care;
- (ii) Loyalty;
- (iii) Utmost good faith.

As stated, the aforementioned duties exist in Canada at common law and through regulatory obligations. The Committee’s submission also outlined various professional standards of conduct which appear to flush out the obligation to “act in the best interest of their clients” which is not otherwise defined apart from this trilogy of duties.<sup>23</sup>

Similarly, the Institute for the Fiduciary Standard (“the Institute”) who has also been critical of the SEC’s RFI assumptions has notwithstanding stated:

“It is fair and reasonable to align fiduciary duties with the scope of engagement between the broker-dealer and the client – on this point there appears to be wide agreement”.<sup>24</sup>

It is therefore widely accepted in the United States that the extent of duties owed be aligned with the scope of the engagement. *This is also widely accepted by Canadian case law.*

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<sup>22</sup> Ron A. Rhoades et al., Steering Group, The Committee for the Fiduciary Standard, Letter to the Securities and Exchange Commission Re: “File Number 4-606 Duties of Brokers, Dealers, and Investment Advisers” (July 5, 2013), at p. 6, online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3132.pdf>>

<sup>23</sup> Ron A. Rhoades et al., *supra*, footnote 23.

<sup>24</sup> Knut A. Rostad, President, The Institute for the Fiduciary Standard, Letter to the Securities and Exchange Commission Re: “Rulemaking - Duties of Brokers, Dealers, and Investment Advisers” (July 5, 2013), at p. 11, online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3115.pdf>>

Similarly, the Association of Independent Investors has stated that there is a prevailing misconception that the suitability standard does not offer investors adequate protection with which they disagreed by stating in part as follows:

“Abandoning the suitability model is the regulatory equivalent of dumbing down of individual investors. The Commission needs to resist the temptation of trying to take all the risk out of the markets, as doing so also removes the returns.”<sup>25</sup>

**(iii) Support for Investor Arbitration**

It is significant that, as part of the “best interest debate” in the U.S., there is resounding support for the arbitration of investor disputes. Mandatory arbitration by investment advisors is wide spread through pre-dispute mandatory arbitration clauses and customer agreements. Similarly, nearly all claims brought by retail investors against broker-dealers are subject to mandatory arbitration through either express arbitration agreement or as a result of FINRA rules. Though there was a wide variation amongst these forums regarding procedural rules and some variation as to costs, it is agreed that these programs provide benefits to investor redress.<sup>26</sup>

This support, coming from those who represent investors, have recognized that most claims against broker-dealers and investment advisors generally involve two types:

- (i) Misrepresentation of the risks or characteristics of a particular investment; and
- (ii) Unsuitability for the investor in light of the investor’s financial resources, risks, tolerances, investment objectives, age and other characteristics.<sup>27</sup>

The above also properly describes the types of claims generally brought against investment advisors in Canada. In Canada, unlike the U.S., cost free access to disputes resolution is mandated.<sup>28</sup> Section 13.16 of NI 31-103 requires that every registered firm ensure an independent dispute resolution at the firm’s expense to resolve a complaint. IIROC Rule 2500B and MFDA Policy No. 3 set out the requirements for the investigation of and substantive response to compliance based client complaints within prescribed timelines. Many dealers have internal ombudsman offices prepared to provide a second level of review to the client response at the client’s option. Each of the IIROC and the MFDA have also interpreted their rules to require their members to participate in the Ombudsman for the Banking Services and

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<sup>25</sup> Andrew Haigney, Executive Director, Association of Independent Investors, Letter to the Securities and Exchange Commission Re: “Request for Data and Other Information; Duties of Brokers, Dealers, and Investment Advisers; Release 34-69013; File 4-606” (April 29, 2013), at p. 8, online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3048.pdf>>

<sup>26</sup> Scott C. Ilgenfritz, *supra*, footnote 21.

<sup>27</sup> *Ibid.*, at p. 15.

<sup>28</sup> Though IIROC Rule 37 provides for the mandatory arbitration, at the investors option, of claims of \$500,000 or less, it is rarely used.

Investments, also at the client’s option. In Quebec, independent dispute resolution is also assured by the Autorité des Marchés Financiers (“AMF”).

**C. The Common Law**

A review of the common law interpretation of Section 206(1) and 206(2) of the *Advisers Act* further indicates that a ‘fiduciary standard’ in the U.S. is reflective of matters long considered simply forming part of a duty of care of investment advisors in Canada, as informed by Canadian regulatory standards in addition to common law.

We have reviewed both the leading and recent case law pursuant to Section 206(1) and 206(2) of the *Advisers Act* arising from cases brought against non-portfolio managers for the advice provided to retail investors and a “fiduciary duty” in the U.S. has been found to include:

- A duty of utmost good faith, full and fair disclosure of all material facts as well as an affirmative obligation to provide reasonable care to avoid misleading clients;<sup>29</sup>
- An obligation to eliminate, or at least expose all conflicts of interest so as to render advice disinterested.<sup>30</sup>
- A standard of reasonable prudence which includes an obligation to investigate the information upon which a recommendation is based and to inform investors of the risk.<sup>31</sup>

*There is no debate in Canadian law that duty of care and an investment advisor’s regulatory obligations include the above principles.*

*The conduct considered in breach of Section 206(1) and 206(2) of the Advisers Act when expanded to also include the conduct of portfolio managers (whom denote a higher level of*

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<sup>29</sup> *SEC v. Capital Gains Research Bureau, Inc.*, *supra*, footnote 12. Action by the SEC against a registered investment adviser for his “scalping” practice – purchasing shares of security for his own account shortly before recommending that security for long-term investment and then immediately selling the shares at profit upon rise in market price following recommendation. Held: Judgment reversed (in favour of SEC), as adviser never disclosed material facts (i.e. making securities recommendations to clients before trading in those same securities without disclosure). *Montford and Company, Inc. d/b/a Montford Associates, and Ernest V. Montford, Sr.*, 103 S.E.C. Docket 1795, S.E.C. Release No. ID - 457, 2012 WL 1377372 (Apr 20, 2012). Montford stylized itself as an independent advisor. However, the firm received fees for promoting certain fund managers without disclosing those fees to clients. Held: Montford had a conflict of interest because while they represented that they provided independent investment advice, they recommended an investment manager with whom they had undisclosed dealings that benefited both them and the investment manager.

<sup>30</sup> *SEC v. Capital Gains Research Bureau, Inc.*, *supra*, footnote 12, at p.3.

<sup>31</sup> *Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr.*, S.E.C. Release No. ID - 495, 2013 WL 3379719 (Jul 08, 2013). Lucia and his company (RJL) held seminars highlighting their investment strategies, as they tried to obtain advisory clients who would be charged fees in return for their advisory services. Lucia’s strategy was not as proven as he claimed. Held: Advisers acted at least recklessly in violating ss. 206(1) and (2). Lucia departed from the standards of care by not ensuring the accuracy of the information on which his recommendations were based, and this departure was extreme. Further, Lucia departed from the standards of care in an extreme way by failing to inform seminar attendees of the risks of investing in REITs.

*duty in Canada) would similarly fall within a duty of care and regulatory obligations owed by investment advisors to their clients in Canada. Examples of some such conduct is as follows:*

- Purchasing securities for one’s own account without disclosure or first offering the securities to the funds over which one has investment responsibility;<sup>32</sup>
- Not allocating investment opportunities among eligible clients in an equitable manner;<sup>33</sup>
- Greatly exaggerating the value of assets and performance;<sup>34</sup>
- Operating a scheme to divert profitable securities trades to a personal trading account;<sup>35</sup>
- Lying to clients and intentionally misappropriating money;<sup>36</sup>
- Exercising excess leverage and failing to disclose such;<sup>37</sup>
- Providing false and misleading advice of a material nature;<sup>38</sup>

#### **D. The Existence of a Fiduciary Duty in the U.S. is Ambiguous and Questionable**

There have been multiple observations made that the characterization of statutory and other legal duties owed by investment advisors in the U.S. as fiduciary is highly ambiguous,<sup>39</sup> leaving significant practical questions unanswered, and investment advisors and their clients left to “divine, if not guess, the application in everyday business life of basic fiduciary obligations, such as the duty to provide impartial advice.”<sup>40</sup>

<sup>32</sup> See Barry P. Barbash and Jai Massari, “The Investment Advisers Act of 1940: Regulation by Accretion” (2008), 39 Rutgers L.J. 627 at 634 to 637 (“Taking Investment Opportunities”), discussing *Conan*, Exchange Act Release No. 34,756, Investment Advisers Act Release No. 1446, 57 SEC Docket 1952 (Sept. 30, 1994), and *Ronald V. Speaker*, Exchange Act Release No. 38,161, Investment Company Act Release No. 22,461, Investment Advisers Act Release No. 1605, 63 SEC Docket 1588 (Jan. 13, 1997).

<sup>33</sup> See Barry P. Barbash and Jai Massari, “The Investment Advisers Act of 1940: Regulation by Accretion” (2008), 39 Rutgers L.J. 627 at p.644 to 645 (“Inappropriate Allocations of Investment Positions”) discussing *F.W. Thompson Co.*, Investment Advisers Act Release No. 1895, 73 SEC Docket 486 (Sept. 7, 2000) and *McKenzie Walker Inv. Mgmt., Inc.*, Investment Advisers Act Release No. 1571, 62 SEC Docket 1010 (July 16, 1996).

<sup>34</sup> *Warwick Capital Management, Inc. and Carl Lawrence*, S.E.C. Release No. IA - 2694, 92 S.E.C. Docket 1137, 92 S.E.C. Docket 1147, 2008 WL 149127 (Jan 16, 2008).

<sup>35</sup> *James C. Dawson*, S.E.C. Release No. IA - 3057, 98 S.E.C. Docket 3495, 2010 WL 2886183 (Jul 23, 2010).

<sup>36</sup> *S.E.C. v. Chiase*, 2011 WL 6176209, Fed. Sec. L. Rep. P 96,614 (D.N.J. Dec 12, 2011).

<sup>37</sup> *U.S. v. Lay*, 568 F.Supp.2d 791 (N.D. Ohio Jul 08, 2008).

<sup>38</sup> *Lisa B. Premo*, S.E.C. Release No. ID - 476, 2012 WL 6705813 (Dec 26, 2012).

<sup>39</sup> Arthur B. Laby, SEC v. Capital Gains Research Bureau and the Investment Advisers Act of 1940 (2011), 91 B.U.I. Rev. 1051, 1088.

<sup>40</sup> Barry P. Barbash and Jai Massari, “The Investment Advisers Act of 1940: Regulation by Accretion” (2008), 39 Rutgers L.J. 627 at 654.

The SEC RFI in particular has been described as an admission that neither the duty of care nor the duty of loyalty, as recommended by the SEC study is clear.<sup>41</sup> The abstract nature of the fiduciary concept in the U.S. has led to widespread confusion and disagreement over the exact obligations incorporated in the meaning of “acting in the best interest” and the inconsistent interpretations applied to that meaning.<sup>42</sup>

It has also been recognized that the existence of a fiduciary duty for investment advisors in the U.S. is questionable if not misleading. The U.S. common law and in particular the leading decision of *SEC v. Capital Gains Research Bureau* 375 U.S. 180(1965) simply imposes a duty to disclose material conflicts of interest.<sup>43</sup> The SEC has been advised not to confuse duties of securities professionals by applying a fiduciary label to non-fiduciary relationships particularly where investors are also planning to exercise their own judgment and control over their investment.<sup>44</sup> This is based on a recognition that it makes sense to utilize fiduciary concepts where there is a broad delegation of power to manage another’s property but that should be distinguished from those who exercise lessor power over the properties of others including investment professionals in confidential relationships.<sup>45</sup>

## **PART II - THE UNITED KINGDOM**

There is no statutory duty imposed on investment advisors in the United Kingdom to act in the best interest of their clients. Unlike Canada, there is little common law available to specifically inform the duty of investment advisors to their retail clients.

### [The U.K. Law Commission Consultation Paper](#)

On March 26, 2013, a Law Commission in the United Kingdom received a reference from the Secretary of State for Business Innovation and Skills with terms of reference that included, *inter alia*, the following:

- (i) to investigate the extent to which, under existing law, fiduciary duties apply to those providing advice or other services to those undertaking investment activity;
- (ii) to evaluate what fiduciary duties permit or require such persons to consider when developing or discharging an investment strategy in the best interest of the ultimate beneficiaries;

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<sup>41</sup> Ross Jordan, “Thinking before Rulemaking: Why the SEC Should Think Twice Before Imposing a Uniform Fiduciary Standard on Broker-Dealers and Investment Advisers” (2012), 50 U. Louisville L. Rev. 491. at 505.

<sup>42</sup> Ross Jordan, *supra*, footnote 42, at pp. 502-503, 508, and 512.

<sup>43</sup> James S. Wrona, “The Best of Both Worlds: A Fact-Based Analysis of the Legal Obligations of Investment Advisors and Broker-Dealers and a Framework for Enhanced Investor Protection” (2012), 68 Bus. Law. 1 at 10.

<sup>44</sup> Larry E. Ribstein, Larry E. Ribstein, “Fencing Fiduciary Duties” (2011), 91 B.U. L. Rev. 899, at p. 919.

<sup>45</sup> *Ibid.*, at pp. 919-920.

- (iii) to consult relevant stakeholders in the equity investment chain on their understanding of the content and application of fiduciary duties in this context;
- (iv) to consider whether fiduciary duties, as established in law or as applied in practice, are conducive to investment strategies that are in the best interest of the ultimate fiduciaries;
- (v) to identify areas where changes to fiduciary duties are needed in relation to these criteria and to make recommendation.

The aforementioned terms of reference considered arose in part from a publication by John Kay<sup>46</sup>, where (unlike Canada) little agreement was found on U.K. judge made law on the current legal standard of fiduciary duty or to whom it is applied. It was recommended that the Law Commission be asked to review the legal concept of fiduciary duty as applied to investment advice in order to address uncertainties and misunderstandings on the part of trustees and their advisors. Amongst the questions being asked was whether fiduciary duties apply to all those “in the investment chain” and how far must fiduciaries focus exclusively on maximizing financial return to the exclusion of other factors.

A Consultation Paper was published on October 22, 2013.<sup>47</sup> A final report is expected in June 2014. The Consultation Paper is focused primarily on pension schemes, but considers various market participants with some reference to financial advisors.

The Consultation Paper formed the view that the law of fiduciaries should not be reformed by statute<sup>48</sup> due to difficulties in defining fiduciary duties, which difficulties would multiply with statutory reform and result in new uncertainties and possible unintended consequences. It stated as follows:

*Our provisional view is that the law of fiduciaries as such should not be reformed by statute. As we have seen, fiduciary duties are difficult to define and inherently flexible. We think that is one of their essential characteristics: they form the background to other more definite rules, allowing the Courts to intervene where the interests of justice require it.*

*As we saw in Chapter 1, the uncertainty surrounding the definition of fiduciary duties led the government to avoid using*

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<sup>46</sup> John Kay, “The Kay Review of UK Equity Markets and Long-Term Decision Making (Final Report)” (July, 2012), online: European Corporate Governance Institute <[http://www.ecgi.org/conferences/eu\\_actionplan2013/documents/kay\\_review\\_final\\_report.pdf](http://www.ecgi.org/conferences/eu_actionplan2013/documents/kay_review_final_report.pdf)>

<sup>47</sup> Law Commission, “Fiduciary Duties of Investment Intermediaries”, online: Law Commission [http://lawcommission.justice.gov.uk/areas/fiduciary\\_duties.htm](http://lawcommission.justice.gov.uk/areas/fiduciary_duties.htm); Law Commission Consultation Paper No. 215 (“Consultation Paper”).

<sup>48</sup> Consultation Paper, p. 244, paras. 14.62 and 14.63.

*the word “fiduciary” to provide clarity to the debate. The difficulties of using the word fiduciary would multiply if one were to attempt statutory reform. Any attempt to change fiduciary duties through legislation would result in new uncertainties and could have unintended consequences, especially for trusts. If there is a need for greater certainty in some areas, we think it would be better to enact specific duties rather than attempt to codify an area of law which has always depended on the facts of this case. We ask if consultees agree.*

The Consultation Paper further concluded that there should be no statutory extension of rights to sue within financial markets, as the effect of such change would be uncertain, potentially disruptive and substantially to costs in the investment chain;<sup>49</sup>

In reaching its conclusions, the Consultation Paper recognized at its onset that the term “fiduciary” could be interpreted in several different ways and therefore the U.K. Government had elected to avoid using it in its past pronouncements regarding its principles for equity markets.<sup>50</sup>

In reaching the above views, the Consultation Paper also:

- (i) reviewed case law regarding various providers of financial services in some detail and noted that there were substantial differences between the approach taken by the Courts and the aspirations set out by a previous Law Commission review;<sup>51</sup>
- (ii) had due regard to both the approach of both the Courts and of regulatory rules in informing standards for market participants. It therefore concluded that legal duties need to be embedded in an industry structure which provides the expertise and resources for good governance.<sup>52</sup>

The Consultation Paper stated in part as follows:

*“As we have seen, the FCA imposes various “know your customer” requirements. The Conduct of Business Sourcebook (COBS) requires a firm to take reasonable steps to ensure that the advice it gives and investment management decisions it takes are suitable to the client. The Courts have found that a failure to*

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<sup>49</sup> *Ibid.* at p. 246, para. 14.70.

<sup>50</sup> *Ibid.* at p. 5, para. 1.10.

<sup>51</sup> *Ibid.* at p. 186, para. 11.91.

<sup>52</sup> Consultation Paper No. 215 (Summary) October 2013, p. 3, para. 3.

*advise a retail client on the suitability of investments may also amount to a breach of duty of care.*<sup>53</sup>

The aforementioned is in keeping with the principles of the Canadian common law and regulatory system.

### The U.K. Regulatory Regime

The Consultation Paper refers and relies in some detail on series of regulatory rules in the U.K. In reviewing these rules, the Consultation Paper concluded:

*“Market participants are subject to an extensive regime of regulatory rules. The rules are to ensure that firms deal fairly with their clients. Firms must act with due diligence, skill and care. They should manage conflicts between their clients’ interests and their own or those of others. They should take reasonable care to ensure that any advice they give or decisions they make are suitable.”*<sup>54</sup>

Canada is subject to a similarly extensive regime of regulatory rules and guidance which play a similar pivotal role in managing conflicts and ensuring IIROC and MFDA registrants deal fairly with their clients. Some are outlined at Part IV of this Paper.

Aspects of the U.K. regulatory regime referred to in its Consultation Paper and relevant to CP 33-403 are as per below.

The Financial Services Authority (“FSA”) was replaced by the Financial Conduct Authority (“FCA”) and the Prudential Regulation Authority (“PRA”) on April 1, 2013. All financial services firms are regulated by the FCA for conduct supervision.<sup>55</sup> Prior to this division, the FSA used its powers to create a regulatory regime as set out in the FCA Handbook, which has since been split, one each for the FCA and PRA.<sup>56</sup> The FCA derives its rulemaking authority from the *Financial Services and Markets Act 2010* as amended by the *Financial Services Act 2012* which provides in Part 2, 1C(2) that in considering what degree of protection for consumers that may be appropriate, the FCA must have regard to, *inter alia*:

- (a) *the differing degrees of risk involved in different kinds of investment or other transaction;*
- (b) *the differing degrees of experience and expertise that different consumers may have;*
- (c) *the needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose;*
- (d) *the general principle that consumers should take responsibility for their decisions;*

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<sup>53</sup> Consultation Paper, *supra*, footnote 48 at p. 181, para. 11.64.

<sup>54</sup> *Ibid.* at p. 130, para. 8.77.

<sup>55</sup> *Ibid.* at p. 111, para. 8.3.

<sup>56</sup> *Ibid.* at para. 8.4.



- (e) *the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question;*
- (f) *the differing expectations that consumers may have in relation to different kinds of investment or other transaction;*

The aforementioned is also in keeping with the principles of the Canadian common law and regulatory system.

#### (a) The Client's Best Interest Rule

The FCA Handbook states at Rule 2.1 “Acting honestly, fairly and professionally”:

- (1) *A firm must act honestly, fairly and professionally in accordance with the best interests of its client (the client's best interests rule).*
- (2) This rule applies in relation to *designated investment business* carried on:
  - (a) for a *retail client*; and
  - (b) in relation to *MiFID or equivalent third country business*, for any other *client*.

“Best interest” language is used in Canada’s regulatory rules as well as further detailed in Part IV of this Paper.

Also, the Principles for Business as derived from the FCA Handbook state as follows:

1. **Integrity:** A firm must conduct its business with integrity.
2. **Skill, care and diligence:** A firm must conduct its business with due skill, care and diligence.
3. **Management and control:** A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems.
4. **Financial prudence:** A firm must maintain adequate financial resources.
5. **Market conduct:** A firm must observe proper standards of market conduct.
6. **Customers' interests:** A firm must pay due regard to the interests of its customers and treat them fairly.
7. **Communications with clients:** A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.
8. **Conflicts of interest:** A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
9. **Customers Relationships of Trust:** A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgment.
10. **Clients' Assets:** A firm must arrange adequate protection for clients' assets when it is responsible for them.
11. **Relations with Regulators:** A firm must deal with its regulators in an open and cooperative way, and must disclose to the appropriate regulator appropriately anything relating to the firm of which that regulator would reasonably expect notice.<sup>1</sup>

#### (b) Conflicts of Interest

FCA rules on conflict of interest are contained in SYSC 10. SYSC 10.1.3R requires a firm to take all reasonable steps to identify conflicts between a firm and a client, or one client of the firm and

another client. SYSC 10.1.4AG and BG lists 5 situations that a firm should take into account “as a minimum” to identify whether a conflict of interest may arise. This is where the firm or individual is:

- (i) likely to make a financial gain, or avoid a financial loss at the expense of the client;
- (ii) has an interest in the outcome of a service provided to the client, or of a transaction carried out on behalf of the client, which is distinct from the client’s interest in that outcome;
- (iii) has a financial or other incentive to favour the interest of a client or a group of clients over another;
- (iv) carries on the same business as the client;
- (v) receives or will receive from a person other than the client an inducement in relation to a service provided to the client, other than the standard commission or fee for that service.<sup>57</sup>

(c) “Know your customer requirements”.

In providing advice to a retail client in the U.K., a firm is required to take reasonable steps to ensure that the advice it gives and investment decisions it takes are suitable for the client.<sup>58</sup>

When making a personal recommendation or managing the clients’ investments a firm must obtain the necessary information regarding the clients’:

- (i) knowledge and experience in the investment field relevant to the specific type of designated investment or service;
- (ii) financial situation; and
- (iii) investment objectives

so as to enable the firm to make a recommendation or take the decision which is suitable to the client.<sup>59</sup>

There are other rules, described as highly detailed by the Consultation Paper, regarding the extent of information which must be obtained including the length of time the client wishes to hold the investment, their financial status, and the nature, volume and frequency of previous transactions.<sup>60</sup>

The FCA provides at 9.3.1 G guidelines as to how a firm should assess suitability and states that:

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<sup>57</sup> *Ibid.* at p. 119, para. 8.33.

<sup>58</sup> FCA Handbook COBS 9.2.1 R(1), Consultation Paper, *supra*, footnote 48 at p. 124, para. 8.54.

<sup>59</sup> FCA Handbook, COBS 9.2.1 R(2), Consultation Paper, *supra*, footnote 48 at p. 124, para. 8.55.

<sup>60</sup> FCA Handbook, COBS 9.2.2 R(1-3), 9.2.3 R(2), Consultation Paper, *supra*, footnote 48 at p. 125, para. 8.56.

- (i) a transaction may be unsuitable for a client because of the risks of designated investments involved, the type of transaction, the characteristics of the order or the frequency of the trading;
- (ii) in the case of managing investments, a transaction might also be unsuitable if it would result in an unsuitable portfolio.<sup>61</sup>

### **PART III – AUSTRALIA**

CP 33-403 provided some consideration to the developments in Australia. It is important to put Australian reforms into context with both the Australian experience and the differences that lie in Canada.

Unlike Canada, Australia is subject to a compulsory mass Superannuation Guarantee (“SG”). The mandatory nature of the SG and the advice people access through it has greatly influenced the regulatory developments on distribution.

The SG program requires Australian employers to make payments of a specified proportion of wage and salaries to a complying superannuation fund of the employers’ choice. Failure to make the SG results in a penalty payment by the employer (the SG charge). Therefore most working Australians have money added to their “super fund” by their employer each month which is invested so it earns a return until it is withdrawn in either lump sum or in regular payments as a pension. Since July 2005, most Australian employees have had a choice as to where their “super” is invested such that they may instruct their employer to make their compulsory contributions to any registered “super fund” in Australia.<sup>62</sup> The Australian Government has recently agreed to increase the SG from 9% to 12% by 2021 and abolish age restriction on employer SG contributions.

In April 2010, the former Minister for Financial Services, Superannuation and Corporate Law, the Hon Chris Bowen, announced the Australian Government’s Future of Financial Advice (FOFA) reform package. The FOFA reforms represent the Australian Government’s response to the *Inquiry into Financial Products and Services in Australia* by the Parliamentary Joint Committee on Corporations and Financial Services (PCJ) in 2009. The inquiry examined the issues associated with the collapses of Storm Financial Limited (a financial advisory firm), Opes Prime (a brokerage firm involved in securities lending) and other similar corporate collapses of financial services businesses. Similar collapses did not occur in Canada.

On June 25, 2012 Parliament passed the *Corporations’ Amendment (Further Future of Financial Advice Measures) Act 2012* to give effect to the objectives of the Australian government’s Future of Financial Advice (FOFA) reform package and introduced obligation to

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<sup>61</sup> Consultation Paper, *supra*, footnote 48 at p. 125, para. 8.57.

<sup>62</sup> Tash Hughes, “What is Superannuation?” *Save Time Online* (2007), online: Save Time Online <<http://www.savetimeonline.com.au/articlebank/superexplain.html>>

act “in the best interest” (best interest duty) and related obligations in DV2 of PT7.7A of the *Corporations’ Act* 2001 (*Corporations Act*). The Australian Securities and Investment Commission (“ASIC”) consulted on proposed guidance of the best interest duty in the form of:

- (a) Consultation Paper 182 Future of Financial Advice: Best Interest Duty and Related Obligations - Update to RG175(CP182) and;
- (b) Consultation Paper 183 Giving Factual Information, General Advice and Personal Advice.

In December 2012, the ASIC issued a Regulatory Impact Statement with proposed guidance in setting out its expectation as to how advice providers should comply with their obligations to act in the “best interests” of the client, provide appropriate personal advice and prioritize the interests of the client.

Unlike the CSA who has properly delegated and entrusted Canadian SROs to regulate the distribution of investment advice and products to the retail public, the ASIC has stated that self-regulation was not an appropriate solution for complying with best interest duties and relating obligations in Australia because they require “significant compliance and cooperation” from the industry. Canada benefits from significant compliance and co-operation from the industry.

In contrast to Australia, Canada’s SROs cannot be characterized as industry associations. They are recognized as regulators in every sense by the CSA who both audits them and regularly provides them with direction in respect of the powers they are delegated regarding the distribution of retail investment advice. They are equally recognized as regulators by the industry as they exercise those powers to supervise and enforce the multiple rules, by-laws and guidance they draft and disseminate regarding best and expected practices. As a result, Canada benefits from significant compliance and co-operation from the industry.

The ASIC may not have as developed a regulatory system with similar history and precedents as Canada. While there are professional bodies which set standards and have codes of conduct for their members in Australia, regulatory oversight of distribution is performed entirely by the ASIC. In any event, its “best interest duty” and related obligations remain new and has not fully commenced until July 1, 2013. In addition, a facilitative compliance period is in place for the first 12 months of the new regime.

It is important to note that the ASIC has explicitly stated:

*“Our objectives are not intended to ensure that advice providers give perfect advice to their client. Nor can we guarantee that, even if an advice provider gives good quality advice, that the client will follow that advice or that the end result of the advice will always be favorable to the client. This is because advice providers have no control over the investment performance of market products their clients hold.”*

The ASIC’s proposed guidance informing their “best interest” standard is in keeping with but not superior to SRO rules, guidance and expectations in Canada. The safe harbor procedures

outlining compliance with the best interest standard is very similar to the requirement under CRM. It is summarized by the ASIC as follows:

Key obligations in Div 2 of PT. 7.7A for Advice Providers Providing Personal Advice to Retail Clients<sup>63</sup>

Obligation	Summary
Acting in the best interests of the client: best interests duty (s961B)	<p>One way an advice provider can demonstrate they have done this is by showing they have carried out certain steps in advising their clients. These steps, which act as a ‘safe harbour’ for complying with the best interests duty, are set out in s961B(2).</p> <p>To satisfy the steps for safe harbour in s961B(2), an advice provider must:</p> <ol style="list-style-type: none"> <li>1. identify the objectives, financial situation and needs of the client that were disclosed by the client through instructions;</li> <li>2. identify the subject matter of the advice sought by the client (whether explicitly or implicitly);</li> <li>3. identify the objectives, financial situation and needs of the client that would reasonably be considered relevant to the advice sought on that subject matter (client’s relevant circumstances);</li> <li>4. if it is reasonably apparent that information relating to the client's relevant circumstances is incomplete or inaccurate, make reasonable inquiries to obtain complete and accurate information;</li> <li>5. assess whether the advice provider has the expertise required to provide the client with advice on the subject matter sought and, if not, decline to provide the advice;</li> <li>6. if it would be reasonable to consider recommending a financial product: <ul style="list-style-type: none"> <li>- conduct a reasonable investigation into the financial products that might achieve the objectives and meet the needs of the client that would reasonably be considered relevant to advice on that subject matter; and</li> </ul> </li> </ol>

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<sup>63</sup> Australian Securities & Investments Commission, “Regulation Impact Statement: Future of Financial Advice: Best interests duty and related obligations” (December 2012) [“ASIC Regulation Impact Statement”] at para. 20

- assess the information gathered in the investigation;

7. base all judgments in advising the client on the client's relevant circumstances; and
8. take any other step that, at the time the advice is provided, would reasonably be regarded as being in the best interests of the client, given the client's relevant circumstances.

Providing appropriate advice (s961G)

Assuming the advice provider has complied with the best interests duty in s961B, the resulting advice must only be given if it is reasonable to conclude that it is appropriate for the client.

Warning the client if advice is based on incomplete or inaccurate information (s961H)

If it is reasonably apparent that the advice is based on incomplete or inaccurate information about the client's objectives, financial situation and needs, advice providers must give a warning to the client.

Prioritising the interests of the client (s961J)

Advice providers must prioritise the interests of the client over their own interests and those of some of their related parties, including their AFS licensee or associates of their licensee.

With respect to determining whether an advisor has acted in the best interests of the client, the ASIC has been criticized for any consideration of whether the client was put in a better position for following advice.<sup>64</sup> In response, the ASIC has stated that though it is understood that many clients seek advice with the objective of improving their financial position, a "better position" for the client would include things such as improving the client's understanding of their finances or aligning their finances with their appetite for risk. The ASIC has also stated that this is an objective standard based on what a reasonable advice provider would believe in the circumstances at the time the advice is provided and that it will not examine the performance of an investment product retrospectively.<sup>65</sup>

The ASIC has also clarified that the obligation to prioritize the interest of the client refers to a situation where an advice provider knows or reasonably ought to know that there is a conflict of interest between the client's interest and their own interest or the interests of some other related parties as specified in the *Corporations Act* of Australia (the "Conflict Priority Rule"). It does

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<sup>64</sup> *Ibid.* at p. 27.

<sup>65</sup> *Ibid.* at pp. 13-14.

not apply if the advice provider does not know of a conflicting interest, nor do they expect an advice provider to make inquiries to determine what conflict of interest their related party has. In complying with the obligation, the ASIC's expectation is that an advice provider identify what interest they or one of their related parties have and consider what a reasonable advice provider without a conflict would do. The more material the conflict of interest is for the investment advisor or their related party, the more they would expect the investment advisor to prioritize the client's interest.<sup>66</sup>

*The ASIC guidance as to the content of Australia's statutory best interest standard is neither more onerous nor complete than Canadian regulatory requirements, some of which are outlined in the next section of this Paper.*

Finally, following the recent Australian Federal election held on September 7, 2013, the incoming government has indicated that it intends to make a number of refinements to the regime, including changes to the best interest duty.

It is understood that the proposed changes to the best interest duty will likely narrow and clarify its scope, with the objective of providing a clearer safe-harbour and enabling single-issue/scoped advice to be provided with greater regulatory certainty.

#### **PART IV –REGULATORY FRAMEWORK IN CANADA**

Canada's regulatory system with respect to the distribution of retail investment advice is layered, robust and detailed. As recognized by CP 33-403, securities legislation in Canada already imposes a statutory duty on investment advisors to deal fairly, honestly and in good faith with their clients.<sup>67</sup> Beyond these statutory obligations and through National Instrument, the CSA provides for supporting broad based principles whose implementation is then delegated to IIROC and the MFDA who in turn provide complementary, comprehensive and particularized rules, guidance and enforcement of these principles. The existence of the MFDA is a uniquely Canadian regulatory feature, as it provides a regulator dedicated primarily to the issues surrounding the distribution of mutual funds despite the various regulations specific to and risk management tools inherent in such products themselves. These include the fact that the trades underlying the product are conducted by portfolio managers subject to fiduciary duties. The

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<sup>66</sup> *Ibid.* 65, at p. 16.

<sup>67</sup> See section 2.1 of OSC Rule 31-505, Conditions of Registration; section 14 of the *Securities Rules*, B.C. Reg. 194/97 [B.C. Regulations] under the *Securities Act (British Columbia)*, R.S.B.C. 1996, c. 418 [B.C. Act]; section 75.2 of the *Securities Act (Alberta)*, R.S.A. 2000, c.S-4 [Alberta Act]; section 33.1 of the *Securities Act (Saskatchewan)*, S.S. 1988-89, c. S-42.2 [Saskatchewan Act]; subsection 154.2(3) of the *Securities Act (Manitoba)*, C.C.S.M. c. S50 [Manitoba Act]; section 160 of the *Securities Act (Quebec)*, R.S.Q., c. V-1.1 [Quebec Act]; section 39A of the *Securities Act (Nova Scotia)*, R.S.N.S. 1989, C. 418 [N.S. Act]; subsection 54(1) of the *Securities Act (New Brunswick)*, S.N.B. 2004, c. S-5.5 [N.B. Act]; section 90 of the *Securities Act (Prince Edward Island)*, R.S.P.E.I. 1988, c. S-3.1 [P.E.I. Act]; subsection 26.2(1) of the *Securities Act (Newfoundland and Labrador)*, R.S.N.L. 1990, c. S-13 [Newfoundland Act]; section 90 of the *Securities Act (Nunavut)*, S.Nu. 2008, c. 12 [Nunavut Act]; section 90 of the *Securities Act (Northwest Territories)*, S.N.W.T. 2008, c. 10 [N.W.T. Act]; and section 90 of the *Securities Act (Yukon)*, S.Y. 2007, c. 16 [Yukon Act].

MFDA is formerly recognized as a self-regulatory organization in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan. An application for recognition is pending before the Superintendent of Securities of Newfoundland and Labrador.

The MFDA also participates in the regulation of mutual funds in Quebec and has entered into a co-operative agreement with the AMF and Chambre de la Sécurité Financière (“La Chambre”) as of December 15, 2004. It is a premise of that agreement that the Rules of the MFDA and Regulations of the AMF and La Chambre are substantially similar and have the same regulatory objectives and public interest mandates.<sup>68</sup>

IIROC and the MFDA are audited by the CSA. Each of IIROC and MFDA also regularly audit their members where significant continuing deficiencies may be referred directly to enforcement.

Aspects of this regulatory framework relevant and fully responsive to issues raised by CP 33-403 are as follows:

**1. National Instrument 31-103**

Part 13 of NI 31-103 sets out various requirements for registrants providing retail advice in Canada. Some such requirements as are applicable to CP 33-403 are listed as follows:

13.2 – Know your Client

This requires in part for a registrant to take reasonable steps to ensure sufficient information regarding a client’s information needs and objectives, financial circumstances and risk tolerance in order to meet suitability requirements imposed by the applicable SRO.

13.3 – Suitability

This requires a registrant to take reasonable steps to ensure that before it makes a recommendation to or accepts instruction from a client to buy or sell a security the purchase or sale is suitable for the client, and, if it is not suitable, to so inform the client.

NI 31-103CP explains this obligation in part as follows:

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<sup>68</sup> For example, La Chambre’s Regulation Respecting the Rules of Ethics in the Securities Sector provides at Rule 2, “A representative shall show loyalty toward his client whose interests shall be of the utmost priority when he makes a trade on his behalf. Also, Chapter D-9.2 of Quebec’s Act Respecting the Distribution of Financial Products and Services provides at section 16, “All representatives are bound to act with honesty and loyalty in their dealings with clients. They must act with competence and professional integrity.”



### 13.2 Know you Client

Registrants act as gate keepers of the integrity of the capital markets. They should not, by act or omission, facilitate conduct that brings the market into disrepute. As part of their gate keeper role, registrants are required to establish the identity of and conduct due diligence of clients under the KYC obligation in section 13.2. Complying with the KYC obligation can help ensure that trades are completed in accordance with securities laws.

KYC information/suitability helps protect the client, the registrant and the integrity of the market.

### 13.3 Suitability

To meet this suitability obligation, registrants should have an in-depth knowledge of all securities they buy and sell for, or recommend to, their clients. This is often referred to as the “know your product” or KYC obligation.

Registrants should know each security well enough to understand and explain to their clients the securities’ risks, key features and initial and ongoing costs and fees.

KYC information for suitability depends upon the circumstances. The extent of KYC information a registrant needs to execute a trade will depend on the client’s, circumstances, the type of security, the client’s relationship to the registrant and the registrant’s business model.

NI 31-103CP goes on to provide [that](#) a portfolio manager with discretionary authority will need extensive KYC information while in other cases, the registrant may need less, for example “If a registrant only occasionally deals with a client who makes small investments relative to their overall financial position”. This is in accordance with Canadian common law but not a statutory best interest standard.

NI 31-103 also contains the following provisions relevant to consideration raised by CP 33-403.

#### [Division 2](#) – Conflicts of Interest

##### 13.4 – Identifying and Responding to Conflicts of Interest

##### 13.6 – Disclosure when Recommending Related or Connected Securities

#### Division 4: Loans and Margin

##### 13.2 – Restriction on Lending to Clients

##### 13.3 – Disclosure when Recommending the use of Borrowed Money

#### Division 5: Complaints

##### 13.14 - Application of this Division

##### 13.15 – Handling Complaints

- 13.16 – Dispute Resolution Service
- Part 3: Registration Requirements – Individuals
  - Division 1: Proficiency Requirements
  - Division 2: Education and Experience Requirements
  - 3.4 Proficiency – Initial and Ongoing
  - 3.5 Mutual Fund Dealer – Dealing Representative
- Part 4: Restrictions on Registered Individuals
  - 4.1 Restriction on Acting for Another Registered Firm
  - 4.2 Associated Advising Representatives – Pre-approval of Advice

NI 31-103 addressed other fundamental concepts regarding the requirement to register and ongoing obligations on firms to monitor and supervise registered individuals in an effective manner. The requirements, principles and policies of NI 31-103 are cascaded to, reflected in, mirrored by and enforced through SRO by-laws, rules, policy, guidance and enforcement. Some of these are further outlined below and show that the regulations and expectations imposed on registrants providing retail investment advice in Canada are extensive and may well exceed those of other countries.

## **2. IIROC**

Both in accordance with and in addition to NI 31-103 and NI 31-103CP, there are multiple IIROC Rules, Notices and initiatives that are fully responsive to CP 33-403. By way of example:

### **Rule 29: Business Conduct**

29.1. Dealer Members and each partner, director, officer, supervisor, [registered representative](#), [investment representative](#) and employee of a Dealer Member (i) shall observe high standards of ethics and conduct in the transaction of their business, (ii) shall not engage in any business conduct or practice which is unbecoming or detrimental to the public interest, and (iii) shall be of such character and business repute and have such experience and training as is consistent with the standards described in clauses (i) and (ii) or as may be prescribed by the [Board](#).

### **Rule 1300.1: Supervision of Accounts**

#### **Business Conduct**

- (o) Each Dealer Member shall use due diligence to ensure that the acceptance of any order for any account is within the bounds of good business practice.

#### **Suitability determination required when accepting order**

- (p) Subject to Rules 1300.1(t), 1300.1(u) and 1300.1(v), each Dealer Member shall use due diligence to ensure that the acceptance of any order from a client is suitable for

such client based on factors including the client's *current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts' current investment portfolio composition and risk level*. If the order received from a client is not suitable, the client must, at a minimum, be advised against proceeding with the order.

**Suitability determination required when recommendation provided**

- (q) Each Dealer Member, when recommending to a client the purchase, sale, exchange or holding of any security, shall use due diligence to ensure that the recommendation is suitable for such client based on factors including the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or accounts' current investment portfolio composition and risk level.

**Suitability determination required for account positions held when certain events occur**

- (r) Each Dealer Member shall, subject to Rules 1300.1(t), 1300.1(u) and 1300.1(v), use due diligence to ensure that the positions held in a client's account or accounts are suitable for such client based on factors including the client's current financial situation, investment knowledge, investment objectives and time horizon, risk tolerance and the account or account(s)' current investment portfolio composition and risk level whenever one or more of the following trigger events occurs:
- (i) Securities are received into the client's account by way of deposit or transfer; or
  - (ii) There is a change in the registered representative or portfolio manager responsible for the account; or
  - (iii) There has been a material change to the client's life circumstances or objectives that has resulted in revisions to the client's "know your client" information as maintained by the Dealer Member.

**Suitability of investments in client accounts**

- (s) To comply with the requirements under Rules 1300.1(p), 1300.1(q) and 1300.1(r), the Dealer Member must use due diligence to ensure that:
- (i) The suitability of all positions in the client's account is reviewed whenever a suitability determination is required; and
  - (ii) The client receives appropriate advice in response to the suitability review that has been conducted.

In addition to the above, there is also the following IIROC rules, notices and guidance:

Rule 3500: Relationship Disclosure

Rule 2500(b): Client Complaint Handling

Rule 37: Alternative Dispute Resolution

Due Diligence Guidelines on Principle – Protected Notes, March 28, 2001.

Notice No. 10-0234 dated August 31, 2010 New Product Due Diligence Regulatory Review – Common Deficiencies and Requirements for Written Policies and Procedures and [controls](#).

Notice No. 12-0108 Client Relationship Model – Guidance

Notice No. 12-0109 dated March 26, 2012: Know your Client and Suitability: Guidance: These have been described by IIROC as enhanced suitability requirements. They formalize the long standing expectation of good industry practice. Highlights are summarized at Schedule A.

As outlined above and at Schedule A, investment advisors owe duties beyond a recommendation to purchase and sell. Pursuant to IIROC Rule 1300.1(r) and MFDA Rule 2.2.1(e) there is a continuing obligation to ensure that positions held in a client's account are suitable when one or more of the following triggering events occur:

- securities are received into an account;
- there is a change in investment advisor;
- there is a material change in the client's life circumstances or objectives.

This obligation is explained and amplified by MSN 00069 and IIROC Notice No. 12-0109, the latter of which states that:

- where an unsuitable investment is identified at the time of a recommendation or subsequently, there is an obligation to take 'appropriate action';
- unsuitability may arise as a result of a material change in the issuer or circumstances which cause a shift in the risk associated with the securities;
- appropriate action may include contacting the client in a timely manner to recommend changes. Where the client does not want to sell the investment, it may be appropriate to recommend changes to other investments in the account in order to ensure suitability of the overall portfolio;
- periodic suitability reviews of client accounts should occur particularly where there are significant market events.

In addition to the above, are various obligations on IIROC dealers to supervise investment advisors. These are detailed in IIROC Rule 38 (Compliance and Supervision), IIROC Rule 1300 (Supervision of Accounts) and IIROC Notice 12-0379 (The Role of Compliance and Supervision). With respect to IIROC Notice 12-0379, on November 30, 2006, Staff of Market Regulation Services Inc., the Bourse de Montréal Inc. and the IDA had jointly issued "The Role of Compliance and Supervision Notice, MR – 04 35. This was updated in further joint effort and in response to NI 31-103 on December 17, 2012, regarding the role, responsibility and accountability of firms, their Board of Directors, management and compliance departments regarding their compliance functions.

The above are applied by IIROC and at times, various provincial securities commissions in enforcement. A review of the many resulting decisions goes beyond the scope of this Paper. By way of example only, the following holding by the British Columbia Securities Commission in *Re Lamuereux* [2001] A.S.C.D. No. 613 regarding a registrant's obligation to provide appropriate retail investment advice has been cited by IIROC disciplinary panels. It states, in part, as follows:

"Some of the assessments recorded in the NCAF can have a range of meanings, depending on the context. For example, a wealthy investor indicating a tolerance for "medium risk" might contemplate a tolerance for a larger dollar risk than another investor with a small net worth who selects the same category. In neither case does the term make clear what probability of loss is acceptable to the investor. A registrant must truly 'know his client'."

"Only the factors that are reasonably foreseeable at the time the investment is contemplated are relevant to the suitability determination. If a suitable investment fails due to some unforeseeable circumstance, that does not retroactively make it an unsuitable investment."

Suitability is to be assessed prior to making a recommendation in a 3 stage process:

1. Undertake due diligence steps to know the client and to know the product;
2. Apply sound professional judgment to the information elicited from stage 1 and make a reasonable determination whether investments are suitable to the client;
3. Make the client aware of the negative material factors involved in the transaction as well as the positive ones.

In addition, anticipated and applicable publications by IIROC are as follows:

- Notice No. 12-0218 dated July 4, 2012: Request for Comments on Guidance Regarding Borrowing for Investment Purposes – Suitability and Supervision.
- Guidance Regarding Use of Business Titles and Financial Dealings: March 2014
- Updated Guidance relating to Know Your Client and Suitability Assessment Obligations: June 2014
- Updated Guidance Regarding Compensation Structures for Retail Investment Accounts: March 2014

### **3. MFDA**

Similarly there are rules, notices and bulletins from the MFDA that are also responsive to CP 33-403. By way of example:

Rule 2: Business Conduct

**2.1.1 Standard of Conduct.** Each Member and each Approved Person of a Member shall:

- (a) deal fairly, honestly and in good faith with its clients;
- (b) observe high standards of ethics and conduct in the transaction of business;
- (c) not engage in any business conduct or practice which is unbecoming or detrimental to the public interest; and  
be of such character and business repute and have such experience and training as is consistent with the standards described in this Rule 2.1.1, or as may be prescribed by the Corporation.

Rule 2.2.1 "**Know-Your-Client**". Each Member and Approved Person shall use due diligence:

- (a) to learn the essential facts relative to each client and to each order or account accepted;
- (b) to ensure that the acceptance of any order for any account is within the bounds of good business practice;
- (c) to ensure that each order accepted or recommendation made, including recommendations to borrow to invest, for any account of a client is suitable for the client based on the essential facts relative to the client and any investments within the account;
- (d) to ensure that, notwithstanding the provisions of paragraph (c), where a transaction, including a transaction involving the use of borrowed funds, proposed by a client is not suitable for the client based on the essential facts relative to the client and the investments in the account, the Member or Approved Person has so advised the client before execution thereof and the Member or Approved Person has maintained evidence of such advice;
- (e) to ensure that the suitability of the investments within each client's account is assessed:
  - (i) ever the client transfers assets into an account at the Member;
  - (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
  - (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client;and, where investments in a client's account are determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address any inconsistencies between investments in the account and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations;

- (f) to ensure that the suitability of the use of borrowing to invest is assessed:
  - (i) whenever the client transfers assets purchased using borrowed funds into an account at the Member;
  - (ii) whenever the Member or Approved Person becomes aware of a material change in client information, as defined in Rule 2.2.4; or
- (iii) by the Approved Person where there has been a change in the Approved Person responsible for the client's account at the Member;

and, where the use of borrowing to invest by the client is determined to be unsuitable, the Member or Approved Person so advises the client and makes recommendations to address the inconsistency between the use of borrowed funds and the essential facts relative to the client and the Member or Approved Person maintains evidence of such advice and recommendations.

In addition to and in efforts to further amplify the above the MFDA issued:

MSN-0048 dated October 31, 2005: "Know Your Product";

MSN-0069 dated February 22, 2013: "Suitability"

MSN-0069 sets out extensive and detailed guidance regarding the know your client, know your product, and suitability process. It includes the following statements:

"Members and approved persons should consider risk tolerance to be the lower of the investor's willingness to accept risk and the investor's ability to withstand declines in the value of his or her portfolio. It is not just the client's comfort level or attitude towards risk, but also his or her actual ability to withstand financial losses. Risk tolerances, therefore, should be determined as the lesser of both criteria" (p.8)

An investment suitability analysis is mostly an objective analysis. To the extent there is subjectivity in the analysis, the expectation of the MFDA staff is that the member and AP take the most conservative approach and act in the *best interests of the client*" (p.17)

MSN-0069 therefore provides for 'conservative' assessments in the 'client's best interest'.

In addition to the above and MSN-0069, there are various obligations on MFDA dealers to supervise their advisors. These are also detailed in Policy No. 2 (Minimum Standards for Account Supervision), MFDA Staff Notice MS-0082 (Branch Supervision) and MFDA Bulletin MSN-0057 (The Role of Compliance and Supervision) last revised February 6, 2013.

Like IIROC, the MFDA has also enforced its rules and principles. The multiple resulting decisions are again beyond the scope of this Paper.

#### **4. Conflict of Interest**

There has been discussion in CP-33-103 and in other jurisdictions regarding conflict of interest, with some criticisms as to over-reliance on disclosure. The Canadian regulatory system is not limited to and moves beyond disclosure.

With respect to conflicts of interest, section 32.1(g) of the *Ontario Securities Act* states:

Every person and company registered under this Act shall comply at all times with Ontario securities law, including such regulations that apply to them as may be relating to:

(g) conflict of interest.

Part 13.4 of National Instrument No. 31-103 states in part:

(1) a registered firm must take reasonable steps to identify existing material conflicts of interest that the registered firm in its reasonable opinion would expect to arise between the firm including each individual acting on behalf of the firm and client.

In National Instrument No. 31-103CP, the CSA sets out instances where disclosure of a conflict of interest may not be appropriate and states in part:

Disclosure may not be appropriate if a conflict of interest involves confidential or commercially sensitive information, or if the information amounts to inside information under insider trading provisions in securities legislation.

In these situations, registered firms will need to assess whether there are other methods to adequately respond to conflict of interest, if not, the firm may have to decline to provide the service to avoid the conflict of interest.

In addition to NI 31-103 and NI 31-103CP, each of IIROC and MFDA have rules specific to the consideration and avoidance of material conflicts of interest. Each of their rules explicitly consider “the best interest” of the client. They are as follows:

IIROC Rule 42.2 states as follows:

#### **42.2 Approved Person responsibility to address conflicts of interest**

- (1) The Approved Person must consider the implications of any existing or potential material conflicts of interest between the Approved Person and the client.
- (2) The Approved Person must address all existing or potential material conflicts of interest between the Approved Person and the client in a fair, equitable and transparent manner, and consistent with the best interests of the client or clients.
- (3) Any existing or potential material conflict of interest between the Approved Person and the client that cannot be addressed in a fair, equitable and transparent manner, and consistent *with the best*



*interests of the client* or clients, must be avoided.

MFDA Rule 2.1.4 states as follows:

#### **2.1.4 Conflicts of Interest**

- (b) In the event that such a conflict or potential conflict of interest arises, the Member and the Approved Person shall ensure that it is addressed by the exercise of responsible business judgment influenced only *by the best interests of the client* and in compliance with Rules 2.1.4(c) and (d).

The Canadian regulatory system as simply highlighted, as opposed to fully elaborated on the preceding pages, is very fulsome. It imposes many obligations on individuals providing retail advice from various sources, all of which are particularized and enforced through our SROs. Current statutory and regulatory obligations in Canada are very briefly summarized and compared to those in the U.S., U.K. and Australia at Schedule B.

### **PART V – DIRECTORS’ FIDUCIARY DUTIES**

The CSA Consultation Paper referred to statutory best interest language for directors in Canada.<sup>69</sup> Section 122(1) of the *Canada Business Corporations Act*<sup>70</sup> entitled “Duty of Care of Directors and Officers” states:

- (1) Every officer and director of a corporation and exercising their power and discharging their duties shall:
- (a) Act honestly and in good faith with a view to the best interest of the corporation and;
  - (b) Exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances
- (2) Pursuant to section 122(2), every officer and director shall comply with the Act.

In addition to statutory obligations to act in the best interest of the corporation, directors also have available a statutory due diligence defence. Pursuant to section 123(4) of the CBCA:

A director has complied with his or her duties under section 122(2) if the director exercised the care, diligence and skill that a reasonably prudent person would have exercised in comparable circumstances, relying in good faith as follows:

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<sup>69</sup> Canadian Securities Administrators Consultation Paper 33-403, “The Standard of Conduct for Advisers and Dealers: Exploring the Appropriateness of Introducing a Statutory Best Interest Duty when Advice is Provided to Retail Clients” (2012), 35 OSCB 9558.

<sup>70</sup> R.S.C., 1985, c. C-44.

- (a) Financial statements of the corporation represented to the director by an officer of the corporation or in a written report of the auditor of the corporation failing to reflect the financial condition of the corporation or;
- (b) a report of a person whose profession lends credibility to a statement made by the professional person;

Directors also have statutory rights of indemnification and insurance pursuant to ss. 124 of the CBCA.<sup>71</sup>

The corporate law statutes do not provide guidance on the interpretation of the “fiduciary” duties imposed on directors. When combined with the leading case law, directors have the benefit of both discretion and protection as afforded by the business judgment rule.

The Supreme Court of Canada opined on these issues in each of *Peoples Department Stores Inc. (Trustee of) v. Wise* [2004] 3. S.C.C. 461 and most recently in *BCE Inc. v. 1976 Debentureholder*, [2008] S.C.C. 69 (“BCE”). The BCE decision confirms that in determining what is in the best interest of the corporation, directors should have regard to the need to treat effective stakeholders “fairly and equitably”, however, it is also recognized by the Court that it may be impossible to please all stakeholders. The BCE stands for the proposition that a fiduciary duty is a “broad, contextual concept” not limited to short term profit or share value but relates to the long term interests of the corporation. The directors are entitled to the benefit of the business judgment rule when discharging their duty.

Though precise analogies to directors’ duties are not necessarily easily drawn, nor is it the purpose of this Paper to fully outline and examine them, from a broad-based principled perspective, where business decisions have been made honestly, prudently, in good faith and on reasonable grounds, the courts will be reluctant to interfere with or substitute their judgment for the director’s judgment. In short, directors should not be liable for errors in judgment if they had otherwise acted properly. Investment advisors should be subject to similar protection.

## **Conclusion**

We have outlined in this Paper the facts and particulars informing the standards of investment advisors in the U.S., U.K. and Australia. We have included similar factors and particulars from a regulatory perspective in Canada. In so doing, we have not identified any gaps in the Canadian regulatory framework. Rather, we have concluded that the content and sufficiency of appropriate standards for investment advisors in Canada does not depend on statutory best interest obligations. Based on our review and analysis of investment advisors in the U.S., U.K. and Australia, the Canadian regulatory system is, at a minimum, as fulsome if not more fulsome than as those of the other jurisdictions considered in this Paper.

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<sup>71</sup> Mirror provisions exist in the *Ontario Business Corporations Act* (R.S.O. 1990, c. B.16) and other provincial corporate statutes.

We have provided the CSA with both the sources and results of our research and outlined areas for its future and meaningful consideration.

In light of the above, we ask that the CSA take into account in its future considerations, evidence as to the practical result that may emerge from CP 33-403 across all business models to customer choice, access to advice and practicability. In other words, we ask that the CSA consider evidence that retail investors in fact, not just in theory, will not be better served at every level of income and assets under any new standard than they are under the current regime.<sup>72</sup>

We look forward to working with and supporting the CSA in its ongoing deliberations.

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<sup>72</sup> Julie A. Ragatz, Director, the American College Cary M. Maguire Center for Ethics in Financial Services, Letter to the Securities and Exchange Commission Re: “File Number 4-606, In response to release No. 34-69013; IA-3558, Duties of Brokers, Dealers, and Investment Advisers” (Jul. 5, 2013), online: U.S. Securities and Exchange Commission <<http://www.sec.gov/comments/4-606/4606-3118.pdf>> , at p.11.

## SCHEDULE A

### **IIROC Notice No. 12-0109 dated March 26, 2012: Know your client and suitability guidance**

- Enhanced suitability requirements as of March 26, 2013 require that a suitability analysis be performed when one or the following triggers occur:
  - securities are received into a client account by way of deposit or transfer;
  - there is a change in investment advisor;
  - there is a material change in the client's life circumstances or objectives
- The client's "personal circumstances" are defined to include their current financial situation, investment knowledge, investment objectives, risk tolerance, *time horizon* and *current investment portfolio composition and risk level*.

IIROC's Guidance Notice No. 12-00109 dated March 26, 2012 contains the following by way of highlights:

#### **Risk Tolerance**

- A fundamental obligation to disclose known or discoverable risks to the investor before entering into a transaction;
- A client's net worth, age and experience can readily be obtained from the client but their risk tolerances and investment objectives may require further discussion and assessment. Investment objectives and risk tolerances are separate but related factors and "must be reasonable in light of a client's financial and personal circumstances";
  - For example: designating an 80% high risk tolerance for an elderly client may be unreasonable if the client has a modest net worth and has opened the account to invest a substantial portion of her net worth. On the other hand, the 80% high risk tolerance may not be unreasonable if the elderly client has a substantial net worth and opens an account to invest a small fraction of her net worth.

#### **Time Horizon**

- Time horizon should be determined by considering when the client will need to access some or all of their money;
- Where a client identifies his/her time horizon, the investment advisor has the responsibility to assess its feasibility and reasonableness in comparison to the client's age, investment objectives, risk tolerances and other particular circumstances;

### **Product Suitability**

- Includes product suitability and ability to clearly explain to the client, the reasons that a specific security is appropriate and suitable to the client;

### **Unsuitable Investments**

- When an unsuitable investment is identified at the time of recommendation, or subsequently there is an obligation to take appropriate action;
- Unsuitability may arise as a result of a material change in the issuer or circumstances which cause a shift in the risk associated with the securities;
- Appropriate action may include contacting the client in a timely manner to recommend changes. Where the client does not want to sell the investment, it may be appropriate to recommend changes to other investments in the account in order to ensure suitability of the overall portfolio;
- With respect to unsolicited unsuitable orders, clients must at a minimum be provided cautionary advice with the details of that cautionary advice documented or provide recommendations regarding changes to other investments in their account;

### **Inappropriate Updates**

- Inappropriate updates: It is inappropriate to update or alter a client's Know Your Client information in order to justify the suitability of an investment or a recommendation that is otherwise unsuitable;

### **Periodic Suitability Reviews**

- Periodic suitability reviews of client accounts particularly where there are significant market events or where accounts hold securities of an issuer that has undergone a material change in risk profiles are recommended.

**SCHEDULE B**

**SUMMARY OF STATUTORY AND REGULATORY OBLIGATIONS**

<b>Canada</b>	<b>U.S.</b>	<b>U.K.</b>	<b>Australia</b>
<ul style="list-style-type: none"> <li>• various provincial rules, regulations or statutory obligations to deal “fairly, honestly and in good faith” with the client</li> <li>• fairly, honestly and in good faith standard informed by know your client and know your product obligations in:               <ul style="list-style-type: none"> <li>• common law</li> <li>• NI-31-103</li> <li>• SRO requirements</li> </ul> </li> <li>• <b><u>IROC</u></b> <ul style="list-style-type: none"> <li>• Rule 29.1: requirement to observe high standards of ethics and conduct;</li> <li>• Rule 1300.0 (o) (p) (q) (r) (s): requirement to use due diligence to ensure that every order is within the bounds of good business practice</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• alleged statutory obligation on investment advisors as opposed to broker-dealers to act in the ‘best interest’ of the client;</li> <li>• best interest language not used by <i>Investment Advisors Act</i>;</li> <li>• discretionary authority under Dodd Frank unexercised;</li> <li>• standard of investment advisors informed by common law and may comprise of SEC RFI assumptions:               <ul style="list-style-type: none"> <li>• a duty of loyalty and care;</li> <li>• full and fair disclosure of all material facts;</li> <li>• an obligation to eliminate or expose all conflicts of interest</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• no statutory obligations to act in the ‘best interest’ of the client. U.K. Law Commission has advised against imposing one;</li> <li>• regulatory rules require that investment advisors act honestly, fairly and professionally ‘in accordance with the best interests of the client’;</li> <li>• standard informed by further regulatory rules which require that:               <ul style="list-style-type: none"> <li>• business be conducted with integrity, due skill, care and diligence;</li> <li>• “due regard” be had to the interest of the client who must be treated “fairly”;</li> <li>• conflicts of interests be managed “fairly”;</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• federal statutory obligation to act in the best interest as of June 25, 2012;</li> <li>• informed by ASIC guidance as of December 2012 which outline safe harbor procedures to comply with the best interest standard provide that an investment advisor:               <ul style="list-style-type: none"> <li>• identify objectives, financial situation and needs of client as disclosed by the client and reasonably considered <b>relevant</b> and make reasonable inquiries to obtain complete information if reasonably apparent that information incomplete/inaccurate;</li> <li>• identify the subject matter of the advice and</li> </ul> </li> </ul>

Canada	U.S.	U.K.	Australia
<p>and suitable for such client based on current financial situation, investment knowledge, objectives, time horizon, risk tolerance, current investment portfolio composition and risk level and advise the client against proceeding with an order where appropriate;</p> <ul style="list-style-type: none"> <li>• suitability recommendations apply not only when a recommendation is provided but when securities are received into a client’s account, when there is a change in investment adviser, when there is a material change in client’s life circumstances or objectives;</li> <li>• periodic suitability reviews should also be conducted where there</li> </ul>		<ul style="list-style-type: none"> <li>• “reasonable care is taken to ensure the suitability of advice and discretionary <b>decisions</b> for any customer entitled to rely upon its judgment</li> <li>• further regulatory rules in respect of inducements, conflicts of interest and know your customer obligations;</li> </ul>	<p>conduct a reasonable investigation into the financial products that might meet the client’s needs and reasonably be considered relevant to the advice;</p> <ul style="list-style-type: none"> <li>• base all judgments on relevance and take any other step at the time advice is provided as reasonably regarded in the best interest given the all relevant circumstances.</li> <li>• other related guidance issues which includes prioritizing the interests of the client where the advisor knows or reasonably assumes to know of a conflict of interest. The appropriate response depends upon the materiality of the conflict. Advisor to be guided by what an advisor without a conflict</li> </ul>

Canada	U.S.	U.K.	Australia
<p>are significant market events or material changes in an issuer; (Notice No. 12-019)</p> <ul style="list-style-type: none"> <li>• appropriate action to be taken where unsuitable investment identified; (Notice No. 12-019)</li> <li>• Rule 42.2: requirement to consider the implications of any existing or potential material conflicts of interest, address in a fair, equitable, transparent manner, consistent <i>with the best interest of the client</i>, failing which it must be avoided;</li> <li>• obligations to supervise detailed in Rule 38, 1300, IROC Notice 12-0379;</li> <li>• <b><u>MFDA:</u></b> <ul style="list-style-type: none"> <li>• Rule 2.1: requirement to deal with clients fairly, honestly and in good</li> </ul> </li> </ul>			<p>would do.</p>



Canada	U.S.	U.K.	Australia
<p>faith and observe high standards of ethics and conduct;</p> <ul style="list-style-type: none"> <li>• Rule 2.2.1: requirement to use due diligence to learn essential facts relative to each client and order to ensure order recommendations is suitable. Further requirement to ensure suitability when client assets transferred into account when there is a new advisor or material change in information;</li> <li>• MSN-0069 Know your client – must know your product obligations and process detailed;</li> <li>• Rule 2.1.4: requirement that conflict or potential conflict of interest be addressed with responsible business judgment and <b>influenced</b> only by <i>the best interest</i></li> </ul>			

<b>Canada</b>	<b>U.S.</b>	<b>U.K.</b>	<b>Australia</b>
<p><i>of the client</i></p> <ul style="list-style-type: none"> <li>• obligations to supervise detailed in MFDA Policy No. 2, MSN-0082, MSN-0057, MSN-0069</li> <li>• When investments are unsuitable, client to be so advised with recommendation to address inconsistency;</li> </ul>			

**SCHEDULE C**

**GLOSSARY OF MATERIALS REVIEWED**

**A. United States**

**(1) Case law reviewed in determining the content of the fiduciary duty under sections 206(1) and 206(2) of the Advisers Act**

- (1) *S.E.C. v. Kaleta*, 2013 WL 3821458 (S.D.Tex. Jul 23, 2013)
- (2) *Alonso v. Weiss*, 2013 WL 3810896, Fed. Sec. L. Rep. P 97,573 (N.D.Ill. Jul 22, 2013)
- (3) *S.E.C. v. Kaleta*, 2013 WL 2408017 (S.D.Tex. May 31, 2013)
- (4) *Spring Investor Services, Inc. v. Carrington Capital Management, LLC*, 2013 WL 1703890 (D.Mass. Apr 18, 2013)
- (5) *Belmont v. MB Inv. Partners, Inc.*, 708 F.3d 470, Fed. Sec. L. Rep. P 97,297 (3rd Cir.(Pa.) Feb 22, 2013)
- (6) *S.E.C. v. Kapur*, 2012 WL 5964389, Fed. Sec. L. Rep. P 97,212 (S.D.N.Y. Nov 29, 2012)
- (7) *Douglass v. Beakley*, 900 F.Supp.2d 736, Fed. Sec. L. Rep. P 97,063 (N.D.Tex. Oct 24, 2012)
- (8) *S.E.C. v. Morriss*, 2012 WL 6822346 (E.D.Mo. Sep 21, 2012)
- (9) *William L. Thorpe Revocable Trust v. Ameritas Inv. Corp.*, 2012 WL 4193096, \*2+, Fed. Sec. L. Rep. P 97,021, 97021+ (E.D.N.C. Sep 19, 2012)
- (10) *S.E.C. v. ICP Asset Management, LLC*, 2012 WL 2359830, Fed. Sec. L. Rep. P 96,925 (S.D.N.Y. Jun 21, 2012)
- (11) *S.E.C. v. Gruss*, 859 F.Supp.2d 653 (S.D.N.Y. May 09, 2012)
- (12) *S.E.C. v. Morriss*, 2012 WL 1605225 (E.D.Mo. May 08, 2012)
- (13) *Padilla v. Winger*, 2012 WL 1379228 (D.Utah Apr 20, 2012)
- (14) *S.E.C. v. Lauer*, 478 Fed.Appx. 550, Fed. Sec. L. Rep. P 96,807 (11th Cir.(Fla.) Apr 19, 2012)
- (15) *In re Beacon Associates Litigation*, 282 F.R.D. 315, 52 Employee Benefits Cas. 2352 (S.D.N.Y. Apr 04, 2012)

- (16) *U.S. S.E.C. v. Sentinel Management Group, Inc.*, 2012 WL 1079961 (N.D.Ill. Mar 30, 2012)
- (17) *S.E.C. v. Juno Mother Earth Asset Management, LLC*, 2012 WL 685302, Fed. Sec. L. Rep. P 96,748 (S.D.N.Y. Mar 02, 2012)
- (18) *Fried v. Lehman Bros. Real Estate Associates III, L.P.*, 2012 WL 252139 (S.D.N.Y. Jan 25, 2012)
- (19) *S.E.C. v. Chiase*, 2011 WL 6176209, Fed. Sec. L. Rep. P 96,614 (D.N.J. Dec 12, 2011)
- (20) *S.E.C. v. Chapman*, 826 F.Supp.2d 847, Fed. Sec. L. Rep. P 96,606 (D.Md. Nov 29, 2011)
- (21) *S.E.C. v. Bard*, 2011 WL 5509500, Fed. Sec. L. Rep. P 96,588 (M.D.Pa. Nov 10, 2011)
- (22) *U.S. v. Marsh*, 2011 WL 5325410 (E.D.N.Y. Oct 26, 2011)
- (23) *Van Dyke v. Sovereign Intern. Asset Management, Inc.*, 2011 WL 4631925, Blue Sky L. Rep. P 74,948 (N.D.Ohio Sep 30, 2011)
- (24) *Oliver v. Black Knight Asset Management, LLC*, 812 F.Supp.2d 2, 52 Employee Benefits Cas. 2777 (D.D.C. Sep 26, 2011)
- (25) *U.S. v. Marsh*, 820 F.Supp.2d 320 (E.D.N.Y. Sep 14, 2011)
- (26) *Sterling Asset Management, LLC v. VTL Associates, LLC*, 2011 WL 3652330 (E.D.Pa. Aug 19, 2011)
- (27) *Hsu v. UBS Financial Services, Inc.*, 2011 WL 3443942, Fed. Sec. L. Rep. P 96,521 (N.D.Cal. Aug 05, 2011)
- (28) *S.E.C. v. Daifotis*, 2011 WL 2183314, Fed. Sec. L. Rep. P 96,325 (N.D.Cal. Jun 06, 2011)
- (29) *S.E.C. v. Mannion*, 789 F.Supp.2d 1321 (N.D.Ga. Jun 02, 2011)
- (30) *Thomas v. Metropolitan Life Ins. Co.*, 631 F.3d 1153 (10th Cir.(Okla.) Feb 02, 2011)
- (31) *In re J.P. Jeanneret Associates, Inc.*, 769 F.Supp.2d 340, Blue Sky L. Rep. P 74,900, Fed. Sec. L. Rep. P 96,204 (S.D.N.Y. Jan 31, 2011)
- (32) *Goodman v. Goldman, Sachs & Co.*, 2010 WL 5186180 (D.N.J. Dec 14, 2010)
- (33) *Grede v. Bank of New York Mellon*, 441 B.R. 864 (N.D.Ill. Nov 03, 2010)

- (34) *In re Beacon Associates Litigation*, 745 F.Supp.2d 386, Blue Sky L. Rep. P 74,877, Fed. Sec. L. Rep. P 95,929 (S.D.N.Y. Oct 05, 2010)
- (35) *U.S. v. Lay*, 612 F.3d 440 (6th Cir.(Ohio) Jul 14, 2010)
- (36) *S.E.C. v. McGinn, Smith & Co., Inc.*, 752 F.Supp.2d 194 (N.D.N.Y. Jul 07, 2010)
- (37) *S.E.C. v. Brown*, 2010 WL 1780144 (D.Minn. Apr 30, 2010)
- (38) *Boyce v. Wachovia Securities, LLC*, 2010 WL 1253737, Fed. Sec. L. Rep. P 95,665 (E.D.N.C. Mar 29, 2010)
- (39) *S.E.C. v. Tambone*, 597 F.3d 436, Fed. Sec. L. Rep. P 95,721 (1st Cir.(Mass.) Mar 10, 2010)
- (40) *Boyce v. Wachovia Securities, LLC*, 2010 WL 1253744 (E.D.N.C. Feb 17, 2010)
- (41) *S.E.C. v. DiBella*, 587 F.3d 553, Fed. Sec. L. Rep. P 95,528 (2nd Cir.(Conn.) Nov 25, 2009)
- (42) *In re Citigroup Auction Rate Securities Litigation*, 700 F.Supp.2d 294, Fed. Sec. L. Rep. P 95,507 (S.D.N.Y. Sep 11, 2009)
- (43) *Christopher v. U.S.*, 2009 WL 2762651 (N.D.Tex. Aug 31, 2009)
- (44) *Welch v. TD Ameritrade Holding Corp.*, 2009 WL 2356131 (S.D.N.Y. Jul 27, 2009)
- (45) *DeBlasio v. Merrill Lynch & Co., Inc.*, 2009 WL 2242605 (S.D.N.Y. Jul 27, 2009)
- (46) *Gibson v. S.E.C.*, 561 F.3d 548, Fed. Sec. L. Rep. P 95,087 (6th Cir. Mar 11, 2009)
- (47) *Dommert v. Raymond James Financial Services, Inc.*, 2009 WL 275440 (E.D.Tex. Feb 03, 2009)
- (48) *Grede v. Bank of New York*, 2009 WL 188460 (N.D.Ill. Jan 27, 2009)
- (49) *Kassover v. UBS AG*, 619 F.Supp.2d 28, Blue Sky L. Rep. P 74,746, Fed. Sec. L. Rep. P 95,025 (S.D.N.Y. Dec 19, 2008)
- (50) *S.E.C. v. Tambone*, 550 F.3d 106, Fed. Sec. L. Rep. P 95,016, 72 Fed.R.Serv.3d 263 (1st Cir.(Mass.) Dec 03, 2008)
- (51) *S.E.C. v. Seghers*, 298 Fed.Appx. 319, Fed. Sec. L. Rep. P 94,889 (5th Cir.(Tex.) Oct 28, 2008)

- (52) *Charles O. Bradley Trust v. Zenith Capital LLC*, 2008 WL 3400340 (N.D.Cal. Aug 11, 2008)
- (53) *U.S. v. Lay*, 568 F.Supp.2d 791 (N.D.Ohio Jul 08, 2008)
- (54) *Malone v. Clark Nuber, P.S.*, 2008 WL 2545069, 102 A.F.T.R.2d 2008-5006 (W.D.Wash. Jun 23, 2008)
- (55) *U.S. v. Lay*, 566 F.Supp.2d 652 (N.D.Ohio May 13, 2008)
- (56) *S.E.C. v. Northshore Asset Management*, 2008 WL 1968299 (S.D.N.Y. May 05, 2008)
- (57) *Swartz v. Deutsche Bank*, 2008 WL 1968948, Fed. Sec. L. Rep. P 94,716 (W.D.Wash. May 02, 2008)
- (58) *Broadhead Ltd. Partnership v. Goldman, Sachs & Co.*, 2008 WL 920308 (E.D.Tex. Mar 31, 2008)
- (59) *S.E.C. v. Dibella*, 2008 WL 6965807 (D.Conn. Mar 13, 2008)
- (60) *Schrage v. Israel*, 2008 WL 808614 (Conn.Super. Mar 07, 2008)
- (61) *Thomas v. Metropolitan Life Ins. Co.*, 540 F.Supp.2d 1212 (W.D.Okla. Jan 10, 2008)

Securities Releases:

- (62) *Alfred Clay Ludlum, III*, S.E.C. Release No. IA - 3628, 2013 WL 3479060 (Jul 11, 2013)
- (63) *Raymond J. Lucia Companies, Inc. and Raymond J. Lucia, Sr.*, S.E.C. Release No. ID - 495, 2013 WL 3379719 (Jul 08, 2013)
- (64) *Lisa B. Premo*, S.E.C. Release No. ID - 476, 2012 WL 6705813 (Dec 26, 2012)
- (65) *John W. Lawton*, S.E.C. Release No. IA - 3513, 2012 WL 6208750 (Dec 13, 2012)
- (66) *Montford and Company, Inc. d/b/a Montford Associates, and Ernest V. Montford, Sr.*, S.E.C. Release No. ID - 457, 103 S.E.C. Docket 1795, 2012 WL 1377372 (Apr 20, 2012)
- (67) *Francisco Illarramendi*, S.E.C. Release No. IA - 3257, 101 S.E.C. Docket 2904, 2011 WL 3318427 (Aug 03, 2011)
- (68) *Sherwin Brown and Jamerica Financial, Inc.*, S.E.C. Release No. IA - 3217, 101 S.E.C. Docket 1444, 2011 WL 2433279 (Jun 17, 2011)
- (69) *James C. Dawson*, S.E.C. Release No. IA - 3057, 98 S.E.C. Docket 3495, 2010 WL 2886183 (Jul 23, 2010)

- (70) *Maria T. Giesige*, S.E.C. Release No. 34-60000, Release No. IA - 2886, 95 S.E.C. Docket 2641, 95 S.E.C. Docket 2647, 2009 WL 1507584 (May 29, 2009)
- (71) *Brendan E. Murray*, S.E.C. Release No. IA - 2809, Release No. IC - 28519, 94 S.E.C. Docket 2022, 94 S.E.C. Docket 2032, 2008 WL 4964110 (Nov 21, 2008)
- (72) *Maria T. Giesige*, S.E.C. Release No. ID - 359, 94 S.E.C. Docket 1019, 2008 WL 4489677 (Oct 07, 2008)
- (73) *Robert Radano*, S.E.C. Release No. IA - 2750, 93 S.E.C. Docket 1889, 2008 WL 2574440 (Jun 30, 2008)
- (74) *John A. Baldo*, S.E.C. Release No. IA - 2735, 93 S.E.C. Docket 708, 2008 WL 2018272 (May 12, 2008)
- (75) *Jeffrey L. Gibson*, S.E.C. Release No. 34-57266, Release No. IA - 2700, 92 S.E.C. Docket 1591, 2008 WL 294717 (Feb 04, 2008)
- (76) *Warwick Capital Management, Inc. and Carl Lawrence*, S.E.C. Release No. IA - 2694, 92 S.E.C. Docket 1137, 92 S.E.C. Docket 1147, 2008 WL 149127 (No. Jan 16, 2008)
- (77) *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963)

**(2) Additional case law reviewed in search of cases under sections 206(1) and 206(2) of the Advisers Act brought against non-portfolio managers for advice provided to retail investors**

- (78) *S.E.C. v. K.W. Brown and Co.*, 555 F.Supp.2d 1275, Fed. Sec. L. Rep. P 94,736 (S.D.Fla. Dec 19, 2007)
- (79) *S.E.C. v. Trabulse*, 526 F.Supp.2d 1008, Fed. Sec. L. Rep. P 94,537 (N.D.Cal. Dec 07, 2007)
- (80) *S.E.C. v. Smith*, 2007 WL 6956489 (C.D.Cal. Nov 19, 2007)
- (81) *S.E.C. v. Bolla*, 519 F.Supp.2d 76 (D.D.C. Oct 29, 2007)
- (82) *U.S. v. Lay*, 2007 WL 2816208 (N.D.Ohio Sep 27, 2007)
- (83) *Alexander v. Allianz Dresdner Asset Mgmt. of Amer. Holding, Inc.*, 509 F.Supp.2d 190, Fed. Sec. L. Rep. P 94,386 (D.Conn. Sep 18, 2007)
- (84) *S.E.C. v. Merrill Scott & Associates, Ltd.*, 505 F.Supp.2d 1193, Fed. Sec. L. Rep. P 94,336 (D.Utah May 21, 2007)

- (85) *Financial Planning Ass'n v. S.E.C.*, 482 F.3d 481, 375 U.S.App.D.C. 389, Fed. Sec. L. Rep. P 94,185 (D.C.Cir. Mar 30, 2007)
- (86) *Dommert v. Raymond James Financial Services, Inc.*, 2007 WL 1018234 (E.D.Tex. Mar 29, 2007)
- (87) *Broadhead Ltd. Partnership v. Goldman, Sachs & Co.*, 2007 WL 951511 (E.D.Tex. Mar 28, 2007)
- (88) *U.S. S.E.C. v. Eldridge*, 2007 WL 7654404 (N.D.Ga. Mar 20, 2007)
- (89) *S.E.C. v. Jones*, 476 F.Supp.2d 374, Fed. Sec. L. Rep. P 94,161 (S.D.N.Y. Feb 26, 2007)
- (90) *S.E.C. v. SBM Inv. Certificates, Inc.*, 2007 WL 609888, Fed. Sec. L. Rep. P 94,166 (D.Md. Feb 23, 2007)
- (91) *S.E.C. v. Washington Inv. Network*, 475 F.3d 392, 374 U.S.App.D.C. 383, Fed. Sec. L. Rep. P 94,152 (D.C.Cir. Feb 06, 2007)
- (92) *Drenis v. Haligiannis*, 452 F.Supp.2d 418, 422 (S.D.N.Y. Sep 25, 2006)
- (93) *Hughes v. LaSalle Bank, N.A.*, 2006 WL 1982983 (S.D.N.Y. Jul 14, 2006)
- (94) *Parmenter v. Rollins Financial Counseling Inc.*, 191 Fed.Appx. 197 (4th Cir.(S.C.) Jun 29, 2006)
- (95) *Goldstein v. S.E.C.*, 451 F.3d 873, 371 U.S.App.D.C. 358, Fed. Sec. L. Rep. P 93,890 (D.C.Cir. Jun 23, 2006)
- (96) *In re Merrill Lynch Investment Management Funds Securities Litigation*, 434 F.Supp.2d 233 (S.D.N.Y. Jun 12, 2006)
- (97) *Morris v. Wachovia Securities, Inc.*, 448 F.3d 268, 274, Fed. Sec. L. Rep. P 93,858 (4th Cir.(Va.) May 17, 2006)
- (98) *S.E.C. v. Treadway*, 430 F.Supp.2d 293 (S.D.N.Y. May 09, 2006)
- (99) *Zurich Capital Markets Inc. v. Coglianesi*, 236 F.R.D. 379, 64 Fed.R.Serv.3d 1069 (N.D.Ill. Apr 25, 2006)
- (100) *S.E.C. v. Jones*, 2006 WL 1084276, Fed. Sec. L. Rep. P 93,855 (S.D.N.Y. Apr 25, 2006)
- (101) *In re Morgan Stanley and Van Kampen Mut. Fund Securities Litigation*, 2006 WL 1008138 (S.D.N.Y. Apr 18, 2006)



- (102) *In re Blackrock Mut. Funds Fee Litigation*, 2006 WL 4683167 (W.D.Pa. Mar 29, 2006)
- (103) *Phoenix Four, Inc. v. Strategic Resources Corp.*, 2006 WL 399396 (S.D.N.Y. Feb 21, 2006)
- (104) *Wuliger v. Eberle*, 414 F.Supp.2d 814 (N.D.Ohio Feb 10, 2006)
- (105) *Wuliger v. Bock*, 2006 WL 144404 (N.D.Ohio Jan 19, 2006)
- (106) *In re Lord Abbett Mut. Funds Fee Litigation*, 407 F.Supp.2d 616, 634 (D.N.J. Dec 28, 2005)
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