



INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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April 23, 2007

Mr. Joseph J. Oliver
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Investment Dealers Association of Canada
121 King Street West
Suite 1600
Toronto, Ontario
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RE: Client Relationship Model

Dear Mr. Oliver:

This letter is a follow up to our November 22, 2006 letter in which we expressed concern on behalf of our membership with respect to draft rules that have been prepared by the Investment Dealers Association of Canada (IDA), relating to the Client Relationship Model (CRM) (Rules).

While the proposed rules have not yet been issued for formal comment, we are making this submission at this time to assist in the ongoing rule formulation process and to highlight issues and concerns based on the IDA's recently circulated draft Board Papers and CRM Proposals. We understand that the IDA has been encouraging ongoing comment as part of various industry consultations which have taken place. Please accept this letter as part of that consultation and feedback process. In addition to this letter, we are submitting an alternative client relationship model for consideration as a possible solutions t these concerns. It is set out generally on page four.

We anticipate that further comments will be forthcoming once the draft rules are issued for formal comment. However, we are hopeful that this communication will be helpful at this time by highlighting the initial concerns and recommendations expressed by our members, including how the current approach in the rule formulation process is overly

prescriptive and a principles-based approach is best suited in regulating the advisor-client relationship.

As previously stated, the members of the Investment Industry Association of Canada (IIAC) generally support the three core principles set out in the CRM. However, one must not lose sight that any proposed rules must be practical to meet the intended objectives, minimize the cost burden and avoid unintended consequences.

While our members are supportive of this initiative, they do have concerns with the Relationship Disclosure Documents (RDDs), which are overly prescriptive, lengthy and require individual customization depending on the type of account and type of client.

As we understand it, the purpose of the RDDs was to assist the client in understanding the client-advisor relationship. However, the intricacy demanded involves an incredible amount of advisor and client time and effort, which will not result in client clarity of the relationship, therefore failing to meet the intended objective.

We believe that the CRM would benefit from greater focus on principles-based regulation, an approach the IDA has publicly endorsed. The industry committee of the IIAC could make an important contribution in a rule reform process that would focus on outcomes for clients and the capital markets as a whole.

Regulation has always existed as a way to address the potential economic and social effects of financial instability and the desire to maintain markets that are efficient, productive and fair. Regulation has also been seen as a key component of investor protection in the financial services industry.

The IIAC agrees with the fundamental premise for establishing regulation. However, in Canada, the core issue that must be addressed is the extent of regulation and how regulation is conducted.

Current Regulatory Regime

The current regulatory regime in Canada is far too prescriptive in terms of detailed rules that govern the advisor relationship with clients as well as the internal operations of firms. The proposed CRM simply adds to the regulatory burden instead of addressing underlying issues.

The state of regulation in Canada is expensive due in part to unnecessary rules that were historically required but no longer serve the public interest. In addition to increased

costs, the current approach to regulation constrains how firms service their clients. This regulatory system stifles creativity, innovation and competition by focusing attention on minute details instead of allowing firms to exercise judgment to achieve the best results for clients. Static rules also tend to solidify the regulatory system to reflect industry concerns at one point in time. This makes it harder to adapt when industry conditions change. For instance, IDA Proposed Regulation 2500 dealing with day trading was proposed at a time when day trading was prevalent in the marketplace. Many of the concerns addressed by that Regulation are no longer common in today's marketplace. Why then is the Regulation in its final drafting stages and on the verge of being implemented? Likewise, IDA By-law 29 dealing with pro-group reporting came about as the result of a single case in British Columbia a decade ago, yet remains under consideration even though it is not clear that there is, or ever was a need for such a regulatory solution. Rules should only be retained when they clearly add value in maintaining efficient, orderly and fair markets or in helping clients secure a fair deal.

An imbalance exists between the regulations aimed at protecting the investor and the detailed mass of paper generated by these regulations that most investors do not read. This imbalance has been exacerbated as more regulation is introduced without evidence supporting the need for it. The CRM initiative is a prime example of this. It has been underway for years with draft Rules now being proposed, yet no cost benefit analysis (CBA) has been completed to date. The Task Force to Modernize Securities Legislation ("Task Force") stated that all new securities regulation be subjected to a rigorous CBA and recommended that "prior to enacting rules to address a market failure, a thorough and systematic review of existing rules should be undertaken to determine whether if enforced, existing rules are adequate."

It is important to execute the CBA in a suitable manner to ensure that appropriate rules are developed. While we understand that a CBA is currently underway, it should not have been undertaken at the end of the rule-making process. Rather, an effective CBA is an iterative process that includes a CBA analysis commencing at the formative stages to shape and frame an effective rule.

What Can Be Done: A Principles-Based Approach

The CRM is the perfect example of an initiative that could embrace the concept of principles-based regulation.

We believe that a principles-based approach, comprised of core rules and principles, and relying on effective, discretionary regulatory oversight reduces costs, enhances market efficiency and promotes innovation. Proactive regulatory involvement that assists firms

to meet defined rules and principles, contributes to an improvement in the integrity of the marketplace.

The IIAC proposes that there needs to be a shift in focus to the principles which center on the types of behaviour that firms and individuals are expected to exhibit. This could exist in the form of a statement that firms must conduct their business with due skill, care and diligence. Certain key rules will be built into the over-arching principles to provide guidance and certainty, so that the result is an appropriate balance of specific rules and general principles.

The Task Force strongly supported the adoption of a more principles-based approach and recommended that securities regulation be based on clearly enunciated regulatory principles which do not need a detailed set of interventionist rules for sound implementation. This same view was recently enunciated by the Crawford Panel which released a document on March 9, 2007 entitled "Growing Support for Principles-Based Regulation". This document highlights the U.K. approach and indicates that the U.S. is also starting to take the issue of principles-based regulation seriously.

A shift to principles-based regulation will require regulators to stop focusing on the process carried out by firms, and start emphasizing the outcomes they seek to achieve. Regulators need to exercise discretion in measuring how well firms are meeting defined rules and principles, to assist those firms that are making solid progress and punish those firms that are abusing the principles.

Regulators must set clear mutual expectations so that firms are permitted to produce outcomes in a flexible, innovative and competitive manner recognizing that there is more than one way to achieve a desired outcome. The responsibility should be placed on senior management of the firm to determine the right path involved in achieving the desired outcomes. This will involve greater contact between the regulator and senior management at a firm. IDA Member Regulation Notice 0435 which looks at the role of compliance and supervision reiterates that the compliance responsibility belongs to the member generally and that senior management including the board of directors must be involved in fulfilling the compliance function.

The first step in the process is to determine what clients want. Clients want good service, confidence in their advisor, products and services to meet their needs, suitable advice taking into account their circumstances and clear and concise information. The question that must be answered is does the current proposal give clients what they want?

IIAC Proposal - Alternative Model

In order to develop a more principles-based approach, members of the IIAC have prepared an alternative RDD to help clients better understand the relationship with their advisor. The IIAC and our members are proposing a single industry-wide RDD document be created for all account types, which includes broad concepts instead of minute details. The alternative RDD would focus on principles such as:

- clear and concise information to all clients;
- increased onus on the client to take an active role in managing the successful relationship advisor;
- explicitly limited to a descriptive function rather than establishing new regulatory and contractual obligations through the RDD, representing a service level arrangement between the client and advisor;
- providing documents and information only if the client wants it: availability would constitute receipt; and
- policies and procedures surrounding supervision would be left to each member to determine;

If clients wish, an annual portfolio review can occur to review the client's account holdings and investment strategy.

The RDD would not mandate the method of delivery or the requirement for an acknowledgment. Members would be required to ensure clients are made aware of the RDD and clients could then determine if they would like to receive the document at which time it would be made available to them.

Other disclosures that are currently mandated would be listed in the RDD so that all requirements are contained in one document for ease of reference. Likewise, the documents are accessible to any client upon request. The detail contained in the RDD will be kept to a minimum but firms may choose to have additional schedules attached to the RDD that fit their business model.

The scope and application of the RDD should be explicitly limited to being descriptive in nature. In other words, it will address the intended policy objective of providing clients with information without establishing new regulatory standards or contractual obligations. We submit that the existing regulatory regime is sufficient in that regard. In addition, the industry has extensive and well-developed dispute resolution standards and mechanisms in place to address those isolated incidents where clients perceive that they did not receive appropriate or satisfactory services. Further, and as a general comment, advisors and firms have a keen economic interest in meeting the needs and ensuring the ongoing satisfaction of their clients. The significant power held by financial services consumers through their ability to redirect their business if their needs are not met to

their satisfaction seems to have been largely downplayed or disregarded throughout the CRM rule-making process to date.

The IIAC and our members believe that a standardized RDD will lead to greater consistency of common understanding across the investing public. This would give firms the freedom to deal with their clients in a way that meets their objectives and provides satisfaction to clients. Similarly, a firm may choose to develop a customized RDD.

Comments on the Draft CRM Rules

1) Relationship Disclosure Documents (RDDs)

The RDDs that have been drafted to date were presented to certain committees for comment. However, many relevant concerns raised by member firms have not been properly addressed. We re-iterate these concerns below:

- We support the objective of providing clients with a clear and concise description of key aspects of the relationship. However, the RDDs are overly prescriptive and they require individual customization, depending on the type of account and type of client. While the intention of the customization was to assist clients in understanding the relationship with their advisor, the numerous details and information that the RDD contains does not result in client clarity in the relationship.

Currently, clients receive excessive quantities of material in the course of establishing and maintaining their relationship with a firm and advisor. This volume detracts from the concept of disclosure as clients are unable to assimilate all such materials and it is often disregarded or discarded. Furthermore, over the years, increased regulatory client disclosure has been mandated from increased general disclosure in mutual fund prospectuses to general disclosure relating to leverage, notwithstanding the fact that a client may not employ a leverage strategy to increased general disclosure related to potential conflicts. Our members have advised us that clients have already responded negatively to increased disclosure. This raises concern that as a result of the volume and complexity of required regulatory disclosure clients do not review such disclosure in detail or at all. An additional layer of disclosure will only increase the complexity for the retail investor, particularly smaller investors, to open an account and invest. The RDD proposal as currently constructed adds to that volume and there is a very real risk that it will be viewed as an additional administrative burden and disregarded by clients.

- There appears to be a requirement on the RDDs for a client signature or acknowledgment. Clients often refuse or forget to sign or return signed documents to the firm. No direction has been offered as to what a firm should do in any of these situations. If a client refuses to sign does the account need to be closed? If it takes months to get a signature, can transactions continue to take place? This requirement may create an undue burden on members for clients that have many accounts and relationships within a firm. We do not believe that restricting client accounts for lack of acknowledgment of receipt of additional general disclosure is in the best interest of clients. Furthermore, the RDD contained in proposed National Instrument 31-103 does not contain a requirement for a client signature or acknowledgement. Requirements for all registrants should be standardized and harmonized and there is no justification for this requirement for IDA members.
- The proposed RDD incorporates an awkward amalgamation of some existing KYC form information (such as objectives and risk factors) and other disclosures. The interplay and potential duplication of information captured through the RDD, KYC form and other documents has not been addressed. As an example of the implications, clients are forced to be categorized in one of the three defined risk profiles and objectives in the sample RDD under “Your Personal Investor Risk Profile”. This ignores the complexities of a typical client relationship, where clients are not so easily pigeon-holed. Any one client may want a combination of risk levels, either within one account over various accounts. Is a client who wants to peruse an aggressive investment program in their cash account while adopting a low risk strategy for their RRSP account a “high risk investor” or a “low risk investor”? This complexity is addressed in the current regulatory standards for KYC form documentation at the account level. However, the RDD as proposed would create a duplicative and seemingly contradictory documentary requirement.
- There has been no guidance provided in regards to the frequency that the RDD must be revised and updated. Must a new RDD be sent to a client every time a firm makes minor changes to its fee schedule? If the firm includes as part of the RDD a section on client obligations, must a new RDD be sent every time the client informs the firm of a material change? There has been no discussion of these important key issues. Furthermore, would this then require a new client signature or acknowledgement every time a revised RDD is sent to the client?
- We question how much consideration has been given to the retroactivity of these requirements? Will all existing clients be required to enter into a RDD? If so, the industry would require significant time to repaper all existing clients accounts as

some firms have hundreds of thousands of clients. This would also entail significant cost to industry and, ultimately, clients.

2) Performance Reporting

While the IIAC supports the concept of performance reporting, the Draft CRM Rules leave many unanswered questions as to how the information can be presented in a standardized and consistent format between dealers which will not be misleading to clients. We also believe that there is significant administrative and operational complexity associated with the proposals and these implications have not been fully identified and addressed. The overall result may be a significant cost burden which will translate into higher costs to clients. Potentially, this may result in reduced access to investment products and services for clients with limited assets as the economics of servicing that segment of the market are altered.

Performance reporting is an area where we also believe that less than adequate consideration has been given to existing services and practices in the current market. Many firms currently provide or make available such information. The overall unintended effect of new regulation, in the absence of a clearly defined market deficiency, may be to adversely impact a client demand which is currently being satisfactorily met.

Our members have a number of other material concerns that have not been addressed. These include:

- How are unsolicited trades, flow through shares and DSC mutual funds to be valued when calculating performance information?
- Would a consolidated or individual report be sent?
- What format is it reported in (many clients have already indicated that monthly statements are “unfriendly”)?
- What if a client’s objective changes?
- What about clients with multiple accounts clumped into more than one objective?
- What would be the benchmark? A focus on a benchmark does not mean that the selected investments are not meeting the client’s objectives. For instance, while high risk products may achieve the goal of beating the benchmark, those same securities may not meet the client’s objective of capital preservation, particularly

in a down market. The difficulties in terms of technology, costs, disclosure and client confusion connected with choosing a benchmark appropriate for comparison purposes with a particular client's portfolio outweighs any benefits that may be derived from including a benchmark. We do not believe that chasing a benchmark promotes an appropriate approach for clients.

- There are many issues surrounding security valuation. For many securities there is a transparent and liquid secondary market where a value is readily obtainable. However, there are also many other securities where this is not the case. This performance reporting proposal needs to address this fundamental issue and the corresponding standards to be applied.

IDA Board Draft Papers: Issues and Concerns

1) Proposed Relationship Disclosure Document

The IIAC has a number of concerns with matters outlined in the IDA Board Paper draft, dated February 2, 2007, entitled "Client Relationship Model – Proposed Relationship Disclosure Document – Establishment of Policy Nos. 12, 13 and 14".

Under Section B - Issues and Alternatives Considered, the IDA lists numerous issues raised during the course of their rulemaking consultations and the IDA response to these issues.

The IIAC, through consultation with our members, believes that many of the IDA staff comments do not appropriately address these issues. The IIAC will examine each issue in turn.

No identifiable demand for enhanced disclosure

In response to this comment from members, the IDA refers to the research study, *How Are Investment Decisions Made?* and cites the study's analysis that 51% of Canadian investors want access to more specific investment information. However, the percentage of 51% is far from a persuasive number. More importantly, the survey was not looking at the Relationship Disclosure Document and its content but corporate disclosure documents i.e. documents from the issuer. These have no relevance to the CRM proposal.

In addition, an important aspect of posing such a question would have to include whether clients would be willing to pay for this information. If clients were asked if they would like more information from their advisor at a cost, the response would be far different if the issue of cost was not raised at all.

Members have never been presented with data that indicates that investors have demanded or sought the industry-wide changes that the new RDD would impose. Have there been documented instances where investors suffered because they did not have the information in the RDD? What was the nature and extent of those situations? The IDA needs to provide evidence if this is in fact something that investors have demanded rather than anecdotal information.

Furthermore, these proposals have been put forward without identifying either the market failure or regulatory failure. In the case of the former, we are unaware of any cogent position having been articulated as to why consumer preferences have not driven a market response. For example, if RDD-type disclosure, performance reporting and cost reporting are important to clients and there is a service gap, one would assume that clients would migrate their business to firms that provide such offerings. Similarly, the process has failed to adequately capture and define the perceived failure in the existing regulatory regime which warrants further intervention. This analysis needs to be conducted and articulated in advance of rule formulations; otherwise, the regulatory proposal cannot be measured against the failure which it is intended to address.

Information dissemination is not the same as information assimilation

The IDA states that this issue is addressed through the plain language requirement and flexible format outlined in the RDD.

Firstly, we are unclear how a “flexible format” would lead to the assimilation of information by investors. Secondly, we do not believe that the RDD represents a flexible format. The RDD in its present format is overly customized, detailed and lengthy. With respect to length, the Draft Sample Document circulated during the Advisor/IDA Consultation on Wednesday, August 16, 2006 was *nine* pages and did not include the multitude of other disclosures which are required to be provided. Since the proposed Rules require customization, the document provided would still need to be customized based on a client’s circumstances, further lengthening the RDD. In addition, if a client has a number of different types of accounts at one or more firms, a client could end up with a multitude of RDDs, all which are different. This would only add to client confusion and create a massive amount of work for the IDA compliance department which would have to approve each and every customized RDD.

The SRO Account Opening Group Direction Document, approved by the CSA in May, 2005 states on page six that “If provided as a stand-alone document it should not exceed *a page or two.*” [emphasis added] While the original objective of the Fair Dealing Requirements, as it was referred to in the Direction Document, was to convey key

pertinent information, in a concise and easy-to-understand document, the length and details required in the RDD will frustrate the objective of the assimilation of the information by the client.

The further lack of flexibility is also evident in Sections II and III of Part 1 of the Policies. The RDD must still be in a form acceptable to the IDA and Section II(1) states that the RDD “shall include” certain information. This required information lists eleven mandated items.

The only optional information that leaves a determination of relevancy in the hands of the members is whether to include the name of the advisor and the nature of the employment relationship between the Member and advisor. These items are hardly substantive in nature.

Furthermore, while the Member can determine if the client’s roles and responsibilities section is separate from other information or integrated, there is a list of minimum items in section III(3) that a member must advise the client about.

Consequently, we question where is this purported flexibility to be found?

Increased costs with the implementation of the policies and ongoing maintenance

As the IIAC has asserted numerous times, our members do not believe that the costs are proportionate to the benefits. For example, since content requirements for the RDD will create an extensive and lengthy document, high mailing costs to and from clients will result.

Furthermore, we believe the CBA is a key component to the CRM and are troubled by the delays involved in completing this essential aspect of the project. The IDA is aware that members have repeatedly queried as to why a CBA is being undertaken after the fact rather than prior to embarking on rule drafting. Policy decisions should flow from the results of a cost-benefit analysis. However, in the current situation it appears that the CBA is simply meant to justify the CRM.

We now understand that the early stages of the CBA will not be completed until May at the earliest. We should point out that one of our members did a rough cost estimate of the newly proposed CRM requirement for an annual suitability review. The member did this cost-benefit analysis by examining the annual salary of an employee, the activities this employee would have to undertake for an annual suitability review per account and assumed total number of accounts. This document is attached. If one of our members

could do this in a short period of time, certainly many aspects of the CRM could have already been examined by IDA staff to develop similar cost assessments.

Furthermore, there has been a lack of articulation as to what the cost benefit is meant to achieve. How will the benefits be quantified? How will they be measured against the costs? The objectives of the CBA should be clearly set out.

The IDA has responded to these comments by stating that “benefits may be nebulous and more challenging to assess”. This response indicates that even before the CBA is completed, the IDA appears to be disqualifying the results as not being a useful gauge. A true and complete CBA must be able to state that there are clear benefits. Red flags should be raised regarding the advantages of implementing the CRM if benefits are found to be too unclear and nebulous to assess.

Additional information on roles and responsibilities may create a supervision challenge

The IDA’s response to this question, that compliance/supervisory staff will have a more accurate record of advisors’ duties, does not address the comment regarding the challenges that will exist.

In order to address this challenge, the supervisory responsibilities should be more principles-based because as currently proposed, it is far too prescriptive. The detailed rules required under the CRM undermine the expertise and the resources a firm has acquired. Firms have knowledge and experience that the regulators may not possess and as such should use their skills instead of just ensuring that a box is ticked. We should allow firms to develop their own policies and procedures to determine the best course of action to ensure that clients are satisfied.

Increase in legal liability

While the IIAC agrees with the IDA statement that the essential nature of the liability of the firm and the advisor to deal honestly and in good faith with clients will not change, this does not respond to the comment regarding the potential increase in legal liability with the RDD. In fact, page ten of the Direction Document comments that there will be implications regarding the RDD and clearly states that, “Additional information may change the scope of liability for that additional information.”

With the requirement for a client signature or acknowledgment, the RDD would not be a simple disclosure document but an integral part of the contractual relationship with the client and may end up being used against firms in every type of complaint or litigation situation.

Prescriptive

The IDA responds that there are optional elements in the RDD. Yet as discussed above, there are only two optional elements (name of advisor and nature of employment relationship). These are hardly important aspects that merit praising the optional components of the RDD. Furthermore, while there is some flexibility in the method of delivery, this again is not a sufficient response that supports the existence of flexibility.

In addition, the flexibility with respect to customization is only limited to the type of account service model. However, when a client has only one service model, very limited flexibility exists.

Page six of the Direction Document states that the RDD could be part of other account documentation processes or a separate letter afterwards or part of the welcome kit. However, because so much information is required in the RDD, it would be difficult to encompass it in the current account documentation processes. The mandated core content almost necessitates making the RDD a separate disclosure document.

In this section, the IDA also comments that clients that understand the information they must supply to the firm will assist in managing client expectations. This seems to imply that advisors do not do this now or that clients do not have fulsome relationships with their advisor. Our criticism is that it is not ideal to prescribe this relationship in minute detail but rather it is best to let the relationship develop and have firms prescribe customer service in the ways they see fit.

Furthermore, in the Advisor/IDA Consultation the survey response indicates that 71% of advisors stated that they were NOT confident that the disclosure would enhance communication with their clients. This same number also indicated that the document left room for misunderstanding.

Standardization v. customization

The IDA states that “Members do not necessarily have to create new processes to meet the minimum standards”. However, it appears new processes will in fact need to be created. For example, the policies clearly state under Sections II (2) and (3) that the RDD must be approved by a partner, director, officer or branch manager and that an audit trail must be maintained. These requirements will lead to whole new processes being developed to ensure that the right RDD is used by the correct client, that the document is completed correctly, that audit trails evidence that the client has received the information and that the client acknowledgements have been received.

In addition, the response by the IDA does not even address the issue of standardization versus customization raised by members in the first place.

Material changes to products and services

As currently drafted, members are required to disclose changes to their products and services. This is a perfect example of a rule that is not necessary and is contrary to a principles-based regulation regime. Firms should develop their own policies to let clients know of products and services that are changing which affect them directly. Clients want products and services that meet their needs and are looking for a firm that can provide this. If a Member changes from offering commodity futures to offering single stock futures, would the firm have to notify 50,000 clients of this change in product?

Instead, if the advisor knows their client, they should know what products they are interested in and what products are appropriate for them. Consequently, a requirement for members to advise clients of a change in products and services is not warranted.

The IDA comment states that various methods of communication may be permitted to advise all clients “who may have considered” investing in a discontinued product or service. How can the advisor possibly know that a client may have considered the idea, but then dismissed it? This could encompass an unbelievably large number of clients.

The IDA also states that “Disclosure likely to occur for marketing reasons”. However, it would be in fact, very poor marketing to notify all clients of the discontinuance of a product.

These comments go right to the heart of the key concepts of principles-based regulation. It is up to the advisor to know what their client needs and wants and ensures that services are tailored to that particular client.

Monitoring of investment suitability

The ongoing monitoring of suitability is a huge change from current practice and has not been adequately explained in detail. It is referred to in a few sentences in the IDA’s Account Performance Reporting and Risk Proposals Board Paper, but with the implication this has for firms, there should be a more fleshed out discussion. Furthermore, the information that is provided is somewhat problematic.

For example, the proposed change to IDA Regulations contains a new Regulation 1300.1(r) which states that “Each Member shall...make available customer accounts where the Member uses due diligence to ensure that the positions held in the customer’s account or accounts, as determined on a periodic basis but no less than annually, are

suitable for such customer...” It is unclear what “make available customer accounts” means and seek to have the language amended to provide clarification.

This ongoing suitability requirement also supports the argument above that the proposed changes will result in significant new processes to meet the prescribed requirements.

Dealing with one-time clients

Our members have stated that the proposal does not deal with one-time clients and the ensuing paperwork. The IDA responded that there is no assurance that a client will not undertake further transactions at a later time and it is an opportunity to market products and services to potential long-term clients.

We raise the issue that if an advisor is spending the time required with one-time clients, how are they appropriately servicing on-going clients? What if the one-time client is clearly a one-time client and does not want to be “marketed to”? This is an example of when reliance should be placed on the advisor to use their best judgment to determine if this client is in fact one-time or whether there may be an opportunity to become a long-term client.

This situation also demonstrates potential unintended consequences. Firms could decide not to deal with certain clients when they do not feel the time commitment is worth the effort in light of all the required paperwork

While it is important to spend time with clients, the process and amount of time should not be mandated by a regulator, but left up to firms and advisors to determine what is best for servicing their clients. Firms are in the best positions to know the needs of their clients and that the services they are offering are designed to meet these identified needs.

Drafting error

We would like to draw the IDA’s attention to a discrepancy in the agreements listed in Policy No. 12, Part 2(II) 6(a) and Policy No. 13, Part 2(II) 6(a). These should be reviewed to ensure consistency where warranted.

2) Proposed Performance Reporting Requirements

In addition to our concerns expressed above, the IIAC has a number of issues with the matters outlined in the IDA Board Paper draft, dated February 2, 2007, entitled “Client Relationship Model – Account Performance Reporting and Risk Proposals – Amendments to Regulation 200.1 and 1300.1”.

Under Section B – Issues and Alternatives Considered, the IDA again lists numerous issues raised during the course of the rulemaking consultations and the IDA responses to these issues.

The IIAC through consultation with our members believe that many of the IDA staff comments do not appropriately address the issues listed.

Maintaining accurate book cost information will be a challenge

While we are pleased that the IDA recognizes that this is currently a significant challenge to members who provide cost information and will continue to be a significant challenge when implementing this proposal, we question whether this has been appropriately considered in conjunction with the CBA and the importance of making sure this is considered.

It will be difficult to get this information for transferred accounts

How will the correct cost base be determined when securities have been acquired in one account at one firm and transferred to another account at another firm? The cost base of the original transactions do not transfer from one firm to another and as such using the original cost for some securities and market at the date of transfer for others results in client confusion, especially for those who hold accounts at numerous firms.

Providing an account cost report should be optional not mandatory

The IIAC supports the IDA's proposal of considering the alternative of making the proposed performance reporting requirement optional. On page six of the IDA's draft Board Paper, the IDA outlines an alternative which would give the client the choice to either pay and receive enhanced performance reporting information or continue to receive current account disclosure information. The IIAC and its members wholeheartedly support the IDA comment, "We believe, however, it is an alternative worth considering as it would ensure that additional performance information is provided to those clients that want the additional information rather than to all clients whether or not they want the information." This type of alternative is considered more fully in the IIAC's alternative model which will be forwarded to you shortly.

The IDA states that they believe that providing all clients with some form of performance reporting should be a minimum industry standard. However, this comment fails to recognize that there are significant costs associated with mandating an industry standard,

which will undoubtedly be passed on to clients. Furthermore, there are three types of clients that firms encounter each with different wants, needs and understanding. The first is a client who would understand this type of information and be willing to pay for it. The second is a client who would take this information if available but may not want to pay for it. The third is a client who does not care about this information, would not understand it if provided to them and would not want it even if provided free of charge. The proposed Rules should include flexibility in order to deal with these types of clients to better serve their needs.

Most clients do/do not understand rate of return

Members of the IIAC indicate that clients often complain about the complexity of current documents and disclosures they receive and the fact that they get little or no ‘real’ value from them. The documents as proposed are detailed and complex and may be insurmountable for most clients to understand and obtain real value from. We cannot emphasize enough that there has not been adequate consideration as to whether clients will be willing to pay for this type of service. As such, it is unreasonable for this type of requirement to be mandated and should continue to be available to clients as it currently is today, for those who feel that the service is valuable and worth the cost.

Certain accounts should be exempt from a periodic suitability review requirement

The IIAC supports the IDA’s position set out on page nine of the draft Rules which states that “The proposal exempts accounts held by clients who either do not wish to have their advisor perform a periodic suitability review or do not wish to pay for such review.” While the IDA has taken into account whether clients will want to receive and pay for a periodic suitability review, we question why the same type of consideration was not similarly considered with respect to mandating other aspects of performance reporting.

Reduce Regulatory Requirements

The IIAC proposes that the IDA conduct a comprehensive assessment of all written materials and disclosures currently provided in the course of a relationship, with the objective of streamlining the documentation. In fact, the Account Opening Direction Document clearly states on page one that the Direction Document Working Group was asked by the CSA Steering Committee to examine the “removal of any requirements no longer necessary.” Unfortunately, the Working Group along with the SRO Rulemaking Committee failed to reduce and remove redundant and unnecessary requirements and disclosures that are currently part of the account opening process.

For example, members have repeatedly stated that the leverage risk disclosure statement is of little value to clients. In addition, the strip bond information statement which was meant to inform clients has instead become so complex that it is rarely read nor understood.

Consistent Application of IDA and MFDA CRM Rules

The CRM Rules applies to both investment dealers and mutual fund dealers; however, there is significant discrepancy between the IDA and MFDA with respect to a number of fundamental issues, resulting in less onerous rules for MFDA members. For instance, the MFDA is comfortable not including client name positions when determining performance figures, whereas the IDA plans to include all positions for which the firm receives compensation.

The IDA Board Paper draft on performance reporting details numerous differences between the MFDA and IDA proposals.

It is imperative that the self-regulatory organizations, reach agreement on the content of the Draft CRM Rules and the implementation process, to ensure clients dealing with MFDA firms receive the same protections in terms of mandated services and disclosure as the clients of IDA firms. If the MFDA staff have fundamental disagreements on the content of the IDA Rules or the timing of implementation, these differences must be resolved before the CRM Rules are promulgated.

The CSA could play a useful role in promoting uniformity and standardization in the MFDA and IDA Rules related to the CRM. Moreover, the lack of uniformity in the CRM Rules and differences in the timing of implementation create an unfair playing field between MFDA and IDA member firms. The regulators have an obligation to ensure the equity of regulatory treatment among investment dealer and mutual fund dealer registrants, given the substantial burden of regulatory compliance.

Comparison with National Instrument 31-103 RDD

NI 31-103 also proposes a Relationship Disclosure Document for non-SRO registrants. However, there are some fundamental differences in this RDD. For example, the RDD in NI 31-103 does not require a client signature or acknowledgment. This RDD also does not require partner, director or officer approval or the creation of an audit trail to ensure that the information has been provided to a client. The IIAC alternative model is more aligned with the approach taken in the National Instrument.

Furthermore, the RDD in NI 31-103 allows for an exemption for accredited investors. We would recommend a similar waiver or exception in the SRO RDD.

It is imperative that the RDD is consistent and harmonized for all registrants before implementation.

Cost Benefit Analysis: Client Survey and Interviews

Members appreciated the opportunity to participate at the IDA/MFDA/OSC information session held on April 2, 2007 with the Allen Research Corporation (ARC). While some member concerns were addressed at that time, there are still a number of outstanding issues that require resolution.

Members are also concerned that the RDD that will be given to clients during the face-to-face interviews is the same one that was provided at the August 16th consultation. Members continue to have issues with that document and do not feel that it is appropriate in its current form.

Furthermore, members contend that the RDD should not be provided to clients in isolation and should be provided with the other multitude of documents that clients are required to be provided with in order to ensure the client has a clear understanding of what is involved.

Questionnaire focus

Members feel that the survey is attempting to canvass general KYC issues and ensuring that IA's are meeting the standard of care owed to clients rather than focusing on the RDD issue. The focus needs to be shifted back to the direct question at hand. An indirect approach to this issue is not likely warranted because there is a lack of any 'self-incrimination' issues surrounding this topic and therefore no real threat of having biased answers through self-reporting direct questions.

Questionnaire length

Members are concerned that the questionnaire is too long. The longer the questionnaire, the more likely the surveyor will only receive results from people who either had a very good experience or very bad experience ('two-tail bias'), thereby giving the results the image of being a representative sample. By shortening up the questionnaire through focusing it solely on the benefit of the added RDD, there will likely be an increased response rate and will allow the surveyor to increase the sample size if desired because with a shorter survey, more can be completed in the same amount of time.

Questionnaire sample size

Members are concerned that the in-depth interview sample size is far too small given 12 people will represent the views of all the clients of IDA member firms. With these 12 individuals likely be chosen at random, the 6 financial institution owned broker/dealers (representing the vast majority of the market) will undoubtedly be under-represented. Even if all 12 were selected from clients of the 6 FI broker/dealers, 2 clients per FI is hardly an adequate representation; and that situation leaves smaller members of the IIAC completely unrepresented, which is clearly not desirable. A similar situation exists with the advisor interviews. Only 4 advisors from financially owned FI's will be interviewed. Assuming an even split between IDA and MFDA members, leaving only 2 IA's from an FI broker/dealer being interviewed. This sample size, like that of the client interviews, appears to be excessively leveraged, especially when taken in light of the potential for the 'two-tail' bias mentioned previously.

Questionnaire wording

At this time, we will not comment on the specific wording of the survey questions as it was determined at the information session that a revised survey will be distributed which incorporates drafting suggestions made by members.

However, in general, there are a number of key questions that should be posed or posed differently. For example, the results from the survey may not accurately represent the benefits of a RDD as some questions in the survey refer to client satisfaction regarding the information provided by the advisor. However, members already know the answer to this question as clients repeatedly state that they receive too much information. ARC must consider the fact that most of this information will still be required to be provided to the client in addition to the RDD, so this question will not help in a true comparison of the process now and once the RDD is implemented.

Questions to be asked in Questionnaire

- What and how much of the documentation do clients actually read;
- The client's willingness/need to receive more information than they already do about roles and responsibilities at the time of account opening;
- The client's willingness to receive this information at a cost;
- The client's level of understanding of the material at the time of account opening; and
- What, if any, alternatives would the client like to see as it relates to account documentation.

The IIAC would be pleased to assist in the execution of the survey and would like an opportunity to work with the IDA on the alternative RDD so that the end result is beneficial for clients in understanding the relationship with their advisor and for the Canadian capital markets as a whole.

We suggest that it would be beneficial to the CRM rule-making process to discuss our proposals with your staff. We look forward to meeting with you at your convenience.

Yours sincerely,



cc:

Paul Bourque, Senior Vice-President, Investment Dealers Association of Canada
Richard Corner, Vice-President, Regulatory Policy, Investment Dealers Association of Canada
Ronald Lloyd, Chair, Investment Dealers Association of Canada
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John Morton, Scotia Capital Inc.
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ANNUAL SUITABILITY REVIEW – ROUGH COST ESTIMATE

Assume performed by \$100,000 employee (annual salary plus benefits)
Cost per hour = \$100,000 / 225 business days / 6 productive hours = \$ 74 per hour

- Involves:
- Obtain account documentation, activity and current holdings, client notes and all other relevant information (e.g. IPS).
 - Conduct analysis and review.
 - Conduct any further inquiries as required (e.g. contact relationship manager, research specific security attributes).
 - Document the review process and conclusion arrived at, record in a retrievable manner and file records.
 - Communicate results to client and internally.
 - Ensure any required corrective actions implemented (e.g. discuss with client, obtain updated client documentation, modify portfolio).
 - Follow-up to ensure corrective actions tracked, implemented and status is accurately recorded.

- Other Costs:
- Supervisory resources.
 - Operational process resources, documentation handling and similar.
 - Allocation for cost of required technology systems and support.
 - Allocation for premises and other overhead.

Assume other costs equals direct hourly cost of review = \$ 74

Average Time to Review One Account		<u>1 Hour</u>		<u>2 Hours</u>		<u>3 Hours</u>
Total Cost Per Account	\$	148	\$	296	\$	444

Assumed Total Number of Accounts	Total Annual Costs		
10,000	\$ 1,481,481	\$ 2,962,963	\$ 4,444,444
100,000	\$ 14,814,815	\$ 29,629,630	\$ 44,444,444
500,000	\$ 74,074,074	\$ 148,148,148	\$ 222,222,222
1,000,000	\$ 148,148,148	\$ 296,296,296	\$ 444,444,444
5,000,000	\$ 740,740,741	\$ 1,481,481,481	\$2,222,222,222
10,000,000	\$ 1,481,481,481	\$ 2,962,962,963	\$4,444,444,444