OSC Investor Advisory Panel
Email: iap@osc.gov.on.ca

November 3, 2015

VIA EMAIL

Maureen Jensen
Executive Director and Chief Administrative Officer
Ontario Securities Commission
20 Queen Street West
Toronto, ON M5H 3S8

Dear Maureen:

Re: Response to the OSC's Report, "Mystery Shopping for Investment Advice"

On September 17, 2015, the OSC, together with the Mutual Fund Dealers Association (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC) released findings of its mystery shop research. The goal of the research was to gain a line of sight into the advice process through the eyes of potential investors.

The mystery shop research was meant to be an important gauge for how current rules around advice - know your client (KYC), know your product (KYP) and suitability -- are working in practice. In the Panel's view the research results give regulators a clear answer to this question: the current rules are not working. The results of this research reveal worrying deficiencies in the advice giving process along with serious gaps between the rules and the reality of how advisors deal with potential new clients.

The know-your-client process is at the heart of advice giving - without it, how can consumers know that they are getting suitable advice? And yet the mystery shop results reveal that in many cases the KYC process is not being followed. KYC information was gathered in just 32% of shops - worse, in shops leading to a recommendation, 29% did not gather KYC information at all and 14% of recommendations were found to be unsuitable. These findings point to significant issues in compliance with existing rules (KYC, KYP) and a culture of advice giving that is product-focused rather than focused on the needs of the investor/consumer.

The OSC, IIROC, and the MFDA state up front that they are collectively "*committed to advancing regulatory reforms that put investors first.*" But the results of the mystery shop research reveal investors' interests are not being put first - in fact investors are being put at risk by advisors who are not following the rules.

Rather than outlining concrete steps to address these failings, the OSC, IIROC and MFDA promise more of the same in the "next steps" section. As they state: "*We must* *build on our past efforts to enhance practices in the advice process. We plan to increase our focus on KYC, KYP and suitability in our respective compliance programs and in our guidance, outreach and education efforts."*

This reaction is unacceptable. Past efforts have clearly not worked as the research results show - increasing guidance, outreach and education will not fix what are systemic issues. As the saying goes, the definition of insanity is to do the same thing again and again and expect different results.

As the Panel has stated on numerous occasions a best interest standard is a necessary part of a system where the interests of investors come before those of the industry that serves them. Individuals who provide investment advice should be professionals, bound by professional standards, including in-depth and ongoing educational requirements. The mystery shop results show this is not the case.

Advice giving remains primarily a sales-focused job where making a sale takes priority over the needs of the client.

We reiterate the key findings of the research below.

Key findings from the Mystery Shop research

Costs/fees not discussed.
When it comes to shopping for investment advice, costs and fees are all too often not part of the conversation. Investors do not ask - and advisors certainly aren't raising the topic during most first meetings. According to the mystery shop results, advisor compensation was discussed in just 25% of shops -- product fees in just 56% of shops.

In cases where shoppers were presented with products or specific recommendations, only 63% of shops included a discussion of fees and costs.

These results are unacceptable especially when one considers the impact fees can have on an investor's returns, especially over the long-term. According to Morningstar, for example, the average management expense ratio of equity mutual funds sold in Canada is 2.42%. Investors must be able to understand and compare the cost of different products and services such as advice. Based on the above example, an investor with $100,000 invested in an equity mutual fund could end up paying around $2,420 a year on the MER alone (not to mention other possible fees involved).

Investors are entitled to know how much they are paying and to be able to shop around based on the cost of the service being provided. This is not the case right now.

Products, not client needs, come first in discussions

The research notes that collecting information about individuals and their personal circumstances is central to an advisor's ability to make suitable recommendations, notes the research. "This should involve a discussion of risk tolerance, investment goals, and a thorough KYC process to collect critical information."

This is not happening in many cases.

According to the research advisors asked about shoppers' account-specific objectives in 89% of shops. In only 32% of shops did advisors gather thorough KYC information and the risk-return relationship was discussed in only 52% of shops.

In shops where a product or specific recommendation was made, 14% were not suitable due to asset concentration issues. And only 71% complied with KYC, KYP and suitability requirements - 29% did not. And in just 50% of shops advisors gave a verbal explanation of how the recommendation related to the shopper's circumstances and goals.

The research goes on to make the following statement: "*In initial meetings advisors tend to focus on what they can sell and what investors may be interested in purchasing based on a general discussion of their investment goals*."

In the Panel's view the research shows significant failures to engage in an adequate discussion of client goals, the risk-return relationship, and other critical information needed to make sound recommendations. There is clearly no uniform standard for when and how this conversation should happen with clients - at what point in a discussion with a potential advisor should these issues be addressed?

Moreover, investors appear to be completely unaware of the shortcomings of the advisors they deal with -- in 88% of shops, shoppers indicated they received sufficient information to make an informed decision. Of those who felt sufficiently informed, 33% had an experience that did not meet compliance expectations.

These findings point to significant issues in compliance with existing rules (KYC, KYP) and a culture of advice giving that is product-focused rather than focused on the needs of the investor/consumer.

It's impossible to shop around for advice

Ontarians are able to comparison shop for most goods and services - except for investment advice. This is a key finding of the mystery shop results. As the research notes: *"Advisors' practices in the advice process vary and the elements of the process may occur in a variety of ways and at different stages. This makes it challenging for an investor to understand what to expect when dealing with an advisor."*

The research also notes the difficulty investors wishing to comparison shop for financial advice face, particularly around fees and costs. This finding is, again, unacceptable.

Lack of clarity around titles
In all, the shoppers encountered no fewer than 48 different business titles during the shops. The Panel is dismayed by the lack of consistency of business titles and the question marks around whether those titles are actually tied to specific skills and qualifications. As we have pointed out before, imagine if regulators in the health care field allowed individuals with the training and experience of massage therapists to call themselves physiotherapists or heart surgeons. And yet this is what the average investor faces when seeking important investment advice.

Investors need better protection than a standard that permits registrants to choose their own business titles based on meeting minimal standards of accuracy and misrepresentation.

Next steps:

The Panel reiterates its position that more of the same is not going to fix this problem. Hence, we expected a better set of next steps from the OSC, IIROC, and MFDA - steps that address these significant issues in a meaningful way.

We encourage the OSC to do more monitoring to see what is going on in the marketplace from a consumer perspective. At the same time, if the system were truly putting investors first there would be no conflicted advice. The key takeaway from this research is that conflicted advice is rampant. In the absence of an appropriate action plan on the part of regulators, then, we will again reiterate that a best interest standard would be a welcome addition to this list of next steps.

In addition, the Panel urges a review of titles and their associated proficiencies. Titles used in the marketplace should be limited to and aligned with titles of registration and, importantly, they should be reflective of the associated proficiency.

Finally, the Panel believes a definitive action plan should be developed that sets out clear timelines to address the deficiencies in the KYC process. This should be publicly disclosed and checked against those milestones.