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**9 Oriole Parkway - Toronto Ontario - M4V 2C8**  
Tel: 416.487.2281 • Fax: 416.544.1030 • E-Mail: ross.nazzer@sympatico.ca

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June 30, 2000

Purdy Crawford  
Osler, Hoskin & Harcourt LLP  
Barristers & Solicitors  
Box 50, 1 First Canadian Place  
Toronto, Ontario M5X 1B8

Dear Sir:

Re: Five-Year Review of Securities Legislation in Ontario

I am responding to the request for comments published by the Securities Review Advisory Committee regarding the five-year review of securities legislation in Ontario. The issues I would like to address relate to the regulation of registrants.

In my view, the current registration regime is outdated. The know your client and suitability rules are not adequate to address the conflicts of interest inherent in commission based trading compensation and the distribution of underwritten securities to clients. Registrant regulation should focus more on what services the registrant is offering and what clients are led to expect. Furthermore, advice and trade execution services should be unbundled, particularly with mutual funds, to enable investors to evaluate whether they are receiving value for the compensation paid to registrants, both directly in commissions and indirectly through trailer fees.

Most importantly, the registration categories should be simplified and harmonized nationally. Serious consideration should also be given to harmonizing with U.S. requirements. The following is a brief outline of some changes that I think the Committee should consider in this area.

### **Registration Categories**

#### *1. Resident Dealer Categories*

There are currently 10 dealer categories set out in the Ontario Securities Act Regulation, some of which are no longer used or are identical to other categories. This leads to significant confusion for registrants and their solicitors. The only resident dealer categories that should remain are:

- a) unrestricted dealer (for IDA members)
- b) restricted dealer (for MFDA members)

With regard to scholarship plan dealers, the high commissions charged on their products (generally about 25%) and the very low proficiency requirements for salespersons and, even more so, their supervisors and compliance officers are major investor protection

concerns. There have been some serious compliance issues associated with scholarship plan dealers in the past. I would suggest at a minimum that these dealers be regulated by the MFDA as a sub category of mutual fund dealers, or better yet, be full mutual fund dealers.

The security issuer category should be eliminated and a conditional exemption be provided for direct trading by issuers. The conditions for such trading might include having qualified individuals on staff to supervise the trading and making certain disclosures or disclaimers to investors at the time of the trade.

## *2. Universal Registration*

Universal registration never achieved what it was intended to achieve (regulation of the exempt market) because the registration requirements actually imposed on the dealer categories it created are so minimal (they are exempt from capital, insurance, proficiency, audit and financial statement filing requirements, among others) that there is no real regulation occurring, only a costly yet virtually inconsequential administrative process. To rethink the issue two questions must be answered: does the exempt market need to be regulated? If so, is registration the appropriate way to regulate?

The OSC's concept paper, *Revamping the Regulation of the Exempt Market*, is a step in the right direction, in that it proposes redefining the exempt market and eliminating the limited market dealer category. It would reduce regulation of some trades and would increase the requirements (by requiring IDA member involvement) for other trading that is now being done with virtually no regulation.

However, there are small transactions that IDA members are not interested in because it would not be profitable for them. Yet issuers of small offerings may need assistance from persons (many of whom are currently LMDs) who are knowledgeable about the market for small offerings. The issuers may need to pay commission based compensation in order to retain such assistance. In order to fill this gap, which may be significant to small and medium sized businesses, additional exemptions should be available to facilitate the hiring of market expertise and allow these persons to assist in direct offerings by issuers without being registered as investment dealers.

## *3. Adviser Categories*

The exemption from adviser registration for dealers should be eliminated and all advising traders should be required to register as advisers as well as traders. The registration categories for advisers should be reduced to the following:

- a) portfolio managers (who may manage with discretionary authority)
- b) investment advisers (who give advice)

Requirements for the first category should remain similar to the existing ones for portfolio managers. The second category should reflect the proficiency requirements currently proposed for salespersons and registrants holding themselves out as financial planners. Fiduciary duties applicable to both categories should be codified in a restatement of the know your client and suitability requirements and include an ongoing obligation to monitor investments in the account. Know your client and suitability requirements should not be imposed on salespersons registered only to trade who do not provide advice,

except to the extent information is needed to assess creditworthiness or protect the markets (i.e. insider trading or manipulation).

The existing category of Securities Adviser should be replaced with a conditional registration exemption which would allow the giving of advice not tailored to specific clients where the adviser clearly discloses his or her education and experience, and any financial interest in the securities or the issuer or any compensation or benefit that may be received in respect of the advice. These exempt advisers should be deemed to be market participants so that record keeping obligations are imposed and the OSC is able to examine their records.

#### *4. International Dealer/Adviser*

The International Dealer category was introduced as part of Universal Registration, which removed the ability of foreign dealers to operate freely in the exempt market. Both the International Dealer and International Adviser categories were created to permit large foreign dealers and advisers who are regulated in other jurisdictions to have limited operations in Ontario. They are restricted in their activities but do not need to comply with most local registration requirements. Few other Canadian jurisdictions have codified similar categories but virtually all have permitted, on a case-by-case basis, conditional registrations that mirror the Ontario categories. Often these registrants offer sophistication and expertise that is not available locally and they are adequately regulated in their home jurisdiction. The vast majority are headquartered in the U.S.

It has been recognized that local investors should be able to have access to a wide variety of investment services, provided there is adequate protection. The restrictions imposed on International Dealers and Advisers appear to have been influenced more by local competitive and reciprocity concerns than by investor protection concerns. Consideration should be given to lowering these restrictions. For the same reason, consideration should also be given to permitting dealers located in the US or UK to be registered as investment dealers (unrestricted dealers) without requiring an office and personnel in Canada.

#### **Conclusion**

Many of the suggestions made above are not new and in fact are consistent with the direction in which the OSC already appears to be moving. It is also clear that full consideration of the issues involved will require a great deal of background work and consultation to flesh out workable proposals, particularly in trying to achieve a national consensus. I hope that this letter may be of some assistance in that process.

I would like to thank you for providing the opportunity to comment and would be happy to address any questions or comments you may have.

Yours truly,

Nancy Ross