

# Intelligence MEMOS



From: Joanne De Laurentiis

To: Canada's Security Regulators

Date: January 22, 2020

Re: **MODERNIZING THE REGULATION OF FINANCIAL ADVICE**

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Canada's investment advisory industry has evolved through consolidation and new products to meet the needs of a more demanding and active investing public over the past two decades. Unfortunately, its regulatory structure has not kept pace. Overlapping regulatory organizations and outdated rules are limiting innovation and efficiency.

Unlike sectors in which industry must petition government agencies for regulatory relief, companies in the investment and mutual-fund industry can propose a better solution for the sector and Canadian investors because they have a direct governance role over the regulatory organizations. And, as I argue in my recent C.D. Howe Institute [report](#), the time is ripe for a merger.

First, a little background. The bulk of the financial advice industry – Quebec has its own regulator – operates through dealer companies that are governed by one of two self-regulatory organizations (SROs): the Mutual Fund Dealers Association of Canada (MFDA) and the Investment Industry Regulatory Organization of Canada (IIROC).

At the behest of their members, the boards of the MFDA and IIROC could agree to merge without waiting for government regulators to take the initial step. They could then ask the Canadian Securities Administrators to recognize the new organization to carry out the combined regulatory duties of its predecessors.

The current multi-SRO structure was created when the products and services the advisers offered had clear lines of separation. But the lines have been blurring. The [42 per cent](#) of Canadians who rely on a financial adviser for investment decisions are demanding more holistic advice and a range of options, not just a narrow set of products. The lines indicating who can sell what are blurring as well. For example, only a third of the [\\$1.47-trillion](#) of mutual fund sales each year are going through the MFDA, the SRO built for such transactions; most are going through IIROC.

In particular, steps taken by provincial securities commissions and the SROs together have created the conditions to facilitate consolidation. Rules designed to enhance consumer protection, such as requirements for investment suitability, to know your client, know your product, and conflict-of-interest procedures are being harmonized. So why should two separately funded organizations administer them? Members of those organizations are themselves consolidating and creating more efficient oversight structures. The duplicative SRO regime only adds confusion and unnecessary cost to an already complex regulatory system.

The industry and its SROs are clearly out of sync. Merging would create a more finely tailored, fit-for-purpose and consistent pan-Canadian regulatory regime. Such a regime will remove unneeded operational complexity and costs for companies and free up resources to dedicate to client-focused innovation. Research indicates consumers of financial advice are embracing digital and voice-enabled assistants much faster than expected to improve convenience and flexibility, while reserving the human touch for the conversations on important issues.

A merger would streamline and bring greater efficiency to the regulatory oversight process and give advisers the flexibility to grow and expand to respond to their clients' needs. This would help the industry deliver a more affordable, responsive and reliable service and reduce its overall regulatory burden while preserving investor protection.

A merger would also support the modernization of the regulatory compliance function – the core of the SROs' mandate. Implementing audit tools that would allow 100 per cent of trades to be reviewed for investment suitability, for example, could help better address a large, and long-standing, area of consumer complaints.

Serious merger discussions between MFDA and IIROC took place in 2011. The main reason they faltered was a valid concern that smaller MFDA companies could be forced to meet more onerous IIROC requirements not commensurate with their service offerings. This could easily be dealt with by maintaining divisions with a graded regulatory framework that allows smaller companies to evolve and grow. A single agency with a broader mandate could apply the appropriate level of regulatory oversight while giving companies the opportunity to evolve into more complex organizations on their own timetable.

The ultimate beneficiary would be the investor, who could rely on a single regulator with a laser focus on all issues related to the distribution of investment products and services and ensure the public interest is served.

Since the publication of the CD Howe report, the CSA has announced it will publish a consultation paper in mid-2020 that will review the underlying policy justification for the current structure, as well as its strengths and weaknesses. The consultation will open the door for a thoughtful rethink of what the current market players and consumers need. Creating a more streamlined and cost-effective regulatory body focused on investors is a worthwhile goal.

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