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Ripe for Reform: Modernizing the Regulation of Financial Advice

As the number of Canadians seeking financial advice has burgeoned, the investment advisory industry has been transformed. It's time that the regulatory bodies overseeing the industry eliminate rule overlap with a merger.

Joanne De Laurentiis

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About The Author

Joanne De Laurentiis is a board member of the Financial Services Regulatory Authority of Ontario and former President and CEO of The Investment Funds Institute of Canada. Currently, Ms. De Laurentiis also serves as Chair of the PIMCO Independent Review Committee and sits on the boards of Dealnet Financial, BeWhere Holdings, the Toronto Transit Commission and the Canadian Foundation for Economic Education. She is a member of the Peak Financial Advisory Board.

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Daniel Schwanen
Vice President, Research

The Study In Brief

Over the last 25 years the investment advisory industry has evolved and expanded its services to meet the needs of a more demanding and active investing public. Canadians have increasingly shifted their preferences away from putting their money into deposit accounts and moved it into market securities, which has led to a significant increase in the demand for the services of investment advisers.

To meet the growing demand for advice and serve a broader range of customers efficiently, many traditional investment dealers have consolidated, merged with larger financial institutions, or restructured into single, multi-disciplinary firms. Adding to the pace of change, advisory firms have responded to increased consumer demand by creating new service models, including digital forms, to provide their clients with new offerings and more convenient access.

Many dealer firms support advisers that are registered with a range of regulators including the Mutual Fund Dealers Association (MFDA), the Investment Industry Regulatory Organization of Canada (IIROC) or the l'Autorité des marchés financiers (AMF) in Quebec, where the MFDA is not recognized.

As they combine the management and operations components of previously separate regulated firms, dealers must respond to, and manage multiple regulators, meaning overlapping and sometimes competing requirements. And as their advisers increasingly seek greater flexibility outside the narrow rules they must operate under, a blurring of lines is developing across regulatory bodies. As a result, the industry and its Self Regulatory Organizations (SROs) are somewhat out of sync and no longer a good fit for each other.

A merging of SROs would create a more finely tailored, fit-for-purpose oversight regime. Such a merger is relatively simple to accomplish. The Boards of the MFDA and IIROC could decide to merge without having to seek regulatory permission to do so.

Such an initiative would remove operational complexity and costs for dealers; streamline and bring greater efficiency to the regulatory oversight process; and give advisers the flexibility to grow and expand to respond to their clients' financial service needs as they move through their life-stages. This would help dealers and advisers deliver a more affordable, responsive and coordinated service to their investor clients and reduce the overall regulatory burden on the industry.

In fact, a longer-term assessment of regulatory effectiveness could measure how accessible and affordable regulated advisory services are for the individual consumer and how successful those services are in getting consumers to develop good financial habits and build wealth.

This paper does not provide an exhaustive assessment of all the changes that would lead to a thoroughly modernized framework. A full effort can only be mounted with resources from all of the regulatory bodies concerned and all of its industry players, which must manage the multiple regulatory relationships. It also requires the full political support of the government ministers to whom these bodies report and who have a strong interest in improving the efficiency and productivity of the agencies they regulate.

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Over the last 25 years the investment advisory industry has evolved and expanded its services to meet the needs of a more demanding and active investing public.

Canadians have increasingly shifted their preferences away from putting their money into deposit accounts and moved it into market securities, which has led to a significant increase in the demand for the services of investment advisers. It is estimated that 4-in-10, or 42 percent of Canadians rely on a financial adviser for investment decisions.[1]

The need for financial advice increases and evolves as individuals progress through their life-stages. With responsibility to save for retirement continuing to shift to individuals, the need is critical to make advisory services more accessible, responsive and affordable. In fact, research[2] shows that access to long-term financial advice increases financial literacy and fosters the development of good savings, spending, and investment habits, all of which are critical elements for building financial wealth and security.[3]

Overview: An Evolving Industry

To meet the growing demand for advice and serve a broader range of customers efficiently, many traditional investment dealers have consolidated, merged with larger financial institutions, or restructured into single, multi-disciplinary firms. Adding to the pace of change, advisory firms have responded to increased consumer demand by creating new service models, including digital forms, to provide their clients with new offerings and more convenient access.

The financial advice community is also changing. To meet their clients' needs, advisers are seeking to provide more holistic advice rather than just selling them a specific product. Increasingly, Canadians can do one-stop shopping for financial planning advice, individual securities trading, buying mutual funds and more at their bank, insurance company

The author thanks Jeremy Kronick, Phil Howell, anonymous reviewers and members of the C.D. Howe Institute's Financial Services Research Initiative for comments on an earlier draft. She retains responsibility for any errors and the views expressed.

1 A survey conducted for the Canadian Securities Administrators (CSA) by The Innovative Research Group in 2017 found that 4-in-10 (42 percent) Canadians have a financial adviser, including 76 percent of Frequent and 65 percent of Non-frequent Investors. A small majority of Canadians are non-investors (53 percent), either with or without savings, 32 percent are advised investors, and 15 percent are do-it-yourself investors, who invest without the help of an adviser. https://www.securities-administrators.ca/uploadedFiles/Investor_Tools/CSA07%20Investor%20Index%20Deck%20-%20Full%20Report%20-%2020171128.pdf.

2 See IFIC's summary of seminal research conducted by Cirano https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/ and a follow up study by Cirano https://www.cirano.qc.ca/files/publications/2016s-35.pdf.

3 See also further research on the value of advice conducted by Vanguard https://www.vanguard.com/pdf/ISGQVAA.pdf.

or independent wealth manager. If the adviser can't provide the service himself, he has other in-house or affiliated experts who can.

Many dealer firms support advisers that are registered with a range of regulators including the Mutual Fund Dealers Association (MFDA), the Investment Industry Regulatory Organization of Canada (IIROC) or the l'Autorité des marchés financiers (AMF) in Quebec, where the MFDA is not recognized. Many dealers also support advisers licensed to sell insurance products.

As they combine the management and operations components of previously separate regulated firms, dealers must respond to, and manage multiple regulators, meaning overlapping and sometimes competing requirements. And as their advisers increasingly seek greater flexibility outside the narrow rules they must operate under, a blurring of lines is developing across regulatory bodies. As a result, the industry and its Self Regulatory Organizations (SROs)[4] are somewhat out of sync and no longer a good fit for each other.

A merging of SROs would create a more finely tailored, fit-for-purpose oversight regime. Such a merger is relatively simple to accomplish. The Boards of the MFDA and IIROC could decide to merge without having to seek regulatory permission to do so. If the Boards reached a merger agreement, they would approach the Canadian Securities Administrators (CSA) – the umbrella organization of Canada's provincial and territorial securities regulators – and ask them to issue a new recognition order for the new organization and move ahead with an orderly transition.

Such an initiative would remove operational complexity and costs for dealers; streamline and bring greater efficiency to the regulatory oversight process; and give advisers the flexibility to grow and expand to respond to their clients' financial service needs as they move through their life-stages. This would help dealers and advisers deliver a more affordable, responsive and coordinated service to their investor clients and reduce the overall regulatory burden on the industry.

Over the last decade, the focus of regulators has largely been on beefing up rules to plug perceived holes in the system brought on by the financial crisis of the last decade. This included harmonizing rules across regulatory regimes to give consumers a more consistent level of protection. However, regulators have spent less time engaging with the industry on what should be removed, streamlined or modernized to more efficiently and effectively regulate an evolving, consolidating, dealer network. While harmonization of rules is always a positive accomplishment, it can also create overlaps and redundant structures particularly when there are multiple organizations with similar roles as is the case with the MFDA and IIROC. Harmonization has also helped to blur the lines across separate regulatory bodies and created the conditions where a merger makes sense.

Overlaps and redundancies also exist between the SROs and CSA member rules.[5] Consolidation of all rules applying to market distribution activities into one regulatory structure opens up the opportunity to download certain regulatory oversight powers applying to distribution currently

4 While the MFDA and IIROC are legislated SROs, the CSA, through recognition orders, oversees the public interest activities of the SROs. It could be argued, therefore, that in practice they function as agents of the provincial securities commissions since all rules proposed by the SRO boards must be approved by the members of the Canadian Securities Regulators and reflect the public-interest intent of the securities rules.

5 The CSA consists of securities regulators of the 10 provinces and three territories of Canada. It is an informal body that collaborates on the creation of harmonized securities rules.

executed directly by CSA members. Some of these rules would have a more natural home in a consolidated distribution regulatory agency. Removing overlaps will allow the provincial securities regulators to concentrate their expertise on evolving issues such as facilitating technological innovations in distribution and stimulating higher productivity levels in the industry.[6]

Regulators have acknowledged industry calls for restructuring but have not acted on them. A unique opportunity to tackle the question has emerged in Ontario, the largest market in the country, where the new provincial government is directing its ministries and agencies to engage all stakeholders in a red-tape reduction and modernization exercise. The Ontario Securities Commission (OSC) has engaged the industry and admirably stepped up to identify initiatives that are already finding support across the CSA (OSC 2019a, 2019b).

As the CSA members consider the initiatives coming out of Ontario, they should include one they can all support: encouraging the industry to rationalize the SROs, and working with them to make it a high priority.

The main beneficiaries of such rationalization will be the 4-in-10 Canadians who rely on financial advisers to build their wealth. Such an initiative will create the peace of mind that behind their adviser there is an integrated regulator who is imposing a fit-for-purpose set of rules that focuses the adviser on the holistic needs of their customer rather than on selling a particular product. And because the adviser and dealer are not locked into a particular regulatory framework that allows them to sell only certain products and services, they can be more responsive to the evolving needs of their customer.

The purpose of this paper is to demonstrate the necessity of proceeding with this initiative.

Current Regulatory Structure

Over the last two decades, the regulatory rule-book applying to the financial advisory channel has expanded significantly. This has followed the growth in Canadians' use of, and dependence on, financial advice as they shifted to purchasing investment products to build their wealth.[7]

The heavier regulatory requirements were a response to the significant asymmetry in the information and knowledge possessed by largely unsophisticated investors seeking services, and the professional advisers providing them with those services. As noted earlier, 4-in-10 Canadians use advisers and they are relying heavily on those advisers to provide them with suitable financial advice and products to help grow their wealth.

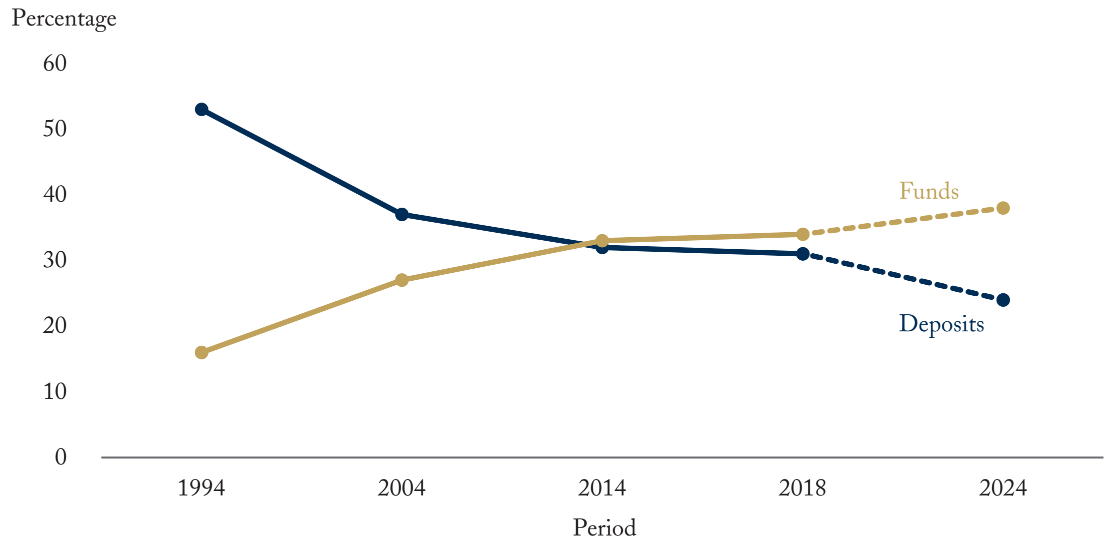
The decrease in workplace retirement savings plans, and a greater awareness of the need to take personal responsibility to save for a retirement that may last for decades, has contributed to the growth of the financial advice industry. The federal government provided further spurs through tax-advantaged programs such as RRSPs and Tax-Free Savings Accounts (TFSAs), which financial institutions marketed heavily to their clients.

Canadians have become more comfortable with risk as they seek to earn greater returns to build their savings. This is best illustrated by the dramatic shift away from holding deposits to investing in retail mutual funds. The shift began in the mid-90s when banks started to sell mutual funds through their branches and effectively democratized participation in the markets, which until then had

6 In his 2018 report entitled *Productivity and the Financial Sector – What's Missing?* Jeremy Kronick discusses the link between regulators and competition and productivity.

7 The number of advisers serving Canadians has been growing to meet the need and reliance on advice https://www.advocis.ca/pdf/Financial-Advice-Industry-Economic-Profile.pdf.

Figure 1: Market Share of Deposits and Mutual Funds, Strategic Insight



Source: Strategic Insight, Household Balance Sheet Data 2019 Report.

been the preserve of a wealthier and smaller group of Canadians. The wealth management industry responded with an array of investment fund products designed for the less sophisticated investor.

As the graph above shows, in 1994 Canadians held 53 percent of their wealth in deposits and only 16 percent in investment funds (Figure 1). By 2014, investment funds surpassed deposits, and by 2024, Canadians are expected to hold 38 percent of their savings in investment funds and only 25 percent in deposits.[8]

This shift created a corresponding demand for financial advisers as investment products could only be purchased through a duly registered adviser, or through a self-directed discount brokerage account. It also led to the creation of a new category of adviser selling only mutual funds and a new regulatory agency, the MFDA, to regulate them.[9] This new regulatory body joined the long-established Investment Dealers Association (IDA), the precursor to IIROC, which regulated the intermediation activities between dealers and clients.

The regulatory framework governing firms and advisers who deliver retail financial advice, and which protects consumers who rely on that advice, is based on a number of well-established principles

8 See https://www.ific.ca/wp-content/uploads/2015/12/Investor-Economics-Analysis-of-Factors-Influencing-Fund-Flows-September-2015.pdf/12353/.

9 Before landing on the creation of the MFDA, there was much debate as to whether regulation of mutual fund distribution should be rolled into the Investment Dealers Association (IDA) or given to the Investment Funds Institute of Canada (IFIC). Both options were rejected.

that are set out as highly prescribed standards.[10] They require firms (dealers) wishing to deal with retail investors in securities to become registered members of one of two SROs, the MFDA or IIROC. Dealers in Quebec, who would otherwise qualify as MFDA members, must register with the AMF, the senior securities regulator in the province since the MFDA is not recognized there.[11]

Individual advisers must be an employee or agent of a registered dealer. They must register with the provincial securities commission and be approved by the applicable SRO in accordance with the products and services they are providing to the market.

Once registered and operating, dealers and their advisers are subject to continuous oversight by the SROs that are tasked with enforcing the prescribed standards. The current regulatory structure has full-service brokerage organizations selling a broad range of securities regulated by IIROC. More narrowly focused dealers with advisers selling mutual funds are generally regulated by the MFDA, except in Quebec where they are regulated by the AMF.

Several other bodies have been added over the last 20 years to safeguard the interests of investors as the complexity and reach of the retail investment industry has grown. These include Quebec's Chambre de la sécurité financière (CSF) and the Ombudsman for Banking Services and Investment (OBSI).

CSF: The 32,000 financial advisers serving Quebecers must register with the CSF individually, notwithstanding they may be part of a dealer regulated by IIROC or one directly regulated by the AMF. Created in the late 1990s, the CSF is an SRO responsible for protecting the public in maintaining discipline and ethics among its members who sell insurance, financial planning, group savings plans, investment contracts, and scholarship plans. It also imposes compulsory continuing education requirements on its members and adjudicates consumer complaints.

The CSF, MFDA, and AMF have entered into a co-operative agreement[12] to keep their roles straight. The agreement preserves the jurisdictions of each of the signatories but is designed to reasonably align the AMF/MFDA requirements that advisers and dealers operating in Quebec must follow. It also allows them to share information about the firms they regulate.

OBSI: All MFDA and IIROC dealers outside Quebec must become members of the Ombudsman for Banking Services and Investments (OBSI). OBSI is not a regulator, but provides an independent dispute resolution service for investors and operates nationally. Through National Instrument 31-103, the CSA mandates registered firms to make available the services of OBSI for disputes that fall within OBSI's mandate. Investors in Quebec have the option of taking their complaints to OBSI or the AMF if they can't get

10 A complete discussion of these principles is contained in Cowdery and Paglia (2015). See Appendix A in the submission to be found at: https://www.ific.ca/wp-content/uploads/2015/09/Joint-IFIC-and-IIAC-Submission-Ministry-of-Finance-Consultation-on-Financial-Advisory-and-Financial-Planning-Policy-Alternatives-September-21-2015.pdf/11641/.

11 The MFDA is formally recognized as a self-regulatory organization (SRO) by the provincial securities regulatory authorities in Alberta, British Columbia, Manitoba, New Brunswick, Nova Scotia, Ontario, Prince Edward Island and Saskatchewan (Recognizing Regulators). It has entered into a Co-operative Agreement with the Autorité des marchés financiers.

12 For a copy of the agreement see https://www.osc.gov.on.ca/en/8788.htm.

them resolved through their adviser or dealer.[13]

Has the Multi-layered Regulatory Structure Run its Course?

While the MFDA was set up to regulate mutual fund dealers and advisers, as the industry matures it has been pushing against the confines of the MFDA rules to seek more flexibility in the products and services it can provide to clients. The MFDA has responded positively by making rule changes allowing advisers to sell exchange traded funds (ETFs) and, more recently, by looking to accommodate members wishing to engage in discretionary trading.[14]

These activities have traditionally been allowed only within the IIROC structure for a number of reasons. Sale of ETFs requires access to exchanges and clearing houses, an ability that was not built into the traditional MFDA platforms. With respect to discretionary trading, significant parts of the industry express strong concerns over the ability of the MFDA to create a suitably robust regulatory regime to govern MFDA member activities in this area.[15]

While the MFDA accommodations are constructive developments for the industry, in making the changes the MFDA is also blurring the line that separates its registrants from those approved under IIROC. It is expected that MFDA registered advisers will continue to seek more rule flexibility, and as they do so they are moving into fields traditionally occupied by full-service brokers. Many industry organizations support the moves as they foster innovation and provide greater flexibility to advisers, others are raising concerns, particularly with the discretionary trading rule, that the change will create a 'back door' to an activity that is regulated more stringently elsewhere and lead to regulatory arbitrage.[16]

The existence of a multi-layered regulatory framework, with multiple structures, means that

13 It is important to note that in addition to growth in formal regulatory bodies, the financial advisory industry also recognized the importance of properly accrediting not only advisers, but also those who develop comprehensive financial plans for clients and has supported a voluntary industry-created standards and accreditation body, FP Canada https://www.fpcanada.ca/. There are currently 23,000 professional financial planners who meet FP Canada's stringent certification standards. The "Financial Planner" title conveys a high level of knowledge and professionalism on the part of the holder to create and deliver a comprehensive and complex financial plan. It is used both by regulated and non-regulated individuals. Only Quebec has regulated use of the title. Ontario has recently introduced legislation to regulate use of the titles "Financial Planner" and "Financial Advisor." It proposes to regulate the professional accreditation aspects through the Financial Services Regulatory Authority (FSRA) but keep the advice-related securities distribution roles regulated through the MFDA and IIROC.

14 "On April 4, 2019, the British Columbia Securities Commission ("BCSC") published for public comment proposed amendments to MFDA Rule 2.3.1(b) (Discretionary Trading). The proposed amendments would allow Members to engage in very limited discretionary trading, so that they are able to directly perform fund substitutions, and make changes to portfolio asset allocations within the pre-established parameters of the mutual fund model portfolios offered by them. The proposed amendments are intended to respond to Member requests for regulatory flexibility, improve client service, and reduce regulatory burden, while maintaining or enhancing investor protection. Conforming consequential amendments to MFDA Rule 2.2.5 (Relationship Disclosure) are also proposed" https://mfda.ca/wp-content/uploads/Bulletin0782-P.pdf.

15 The Portfolio Management Association of Canada (PMAC) has been the strongest critic of the MFDA proposal – see their submission to the MFDA https://pmac.org/wp-content/uploads/2019/07/MFDA-limited-discretionary-trading-letter.pdf.

16 In its submission PMAC noted "We respectfully submit that the current proficiency requirements for registration as a dealing representative of an MFDA Member are objectively considerably less stringent…"

each separate license or registration, whether through a government or professional agency, comes with its own distinct oversight, audit, and record-keeping regime.

Meanwhile, cost pressures have caused many mergers among dealers in the last decade. These larger dealers have multiple registrations. Such dealers will face separate audits by IIROC, MFDA, and their provincial securities regulator. Many merged dealers have moved their operations onto a single technology platform, which helps to streamline their operational activities but does not remove the need to track and manage activities along the specific rules of the multiple regulators where they are registered.

While many of the regulatory standards are similar, they are not necessarily applied consistently by each regulator. For example, IIROC advisers selling mutual funds will face a less detailed regulatory audit than MFDA advisers selling mutual funds. IIROC classifies retail mutual funds as less risky investments relative to individual equities. However, as a counterbalance, IIROC imposes higher professional credentials and training on the individual adviser than are required by the MFDA.

In Quebec, the dealer does not have a clear line of sight into CSF's investigations of advisers attached to that dealer. The reason is to maintain confidentiality because only a small number of complaints go to adjudication, but it does leave the dealer somewhat in the dark about an adviser it is required to ensure is in compliance.

Dealers have argued that too many regulators doing the same function points to an inefficient regulatory framework that is more fragmented than it needs to be with plenty of overlaps, duplications, contradictions and gaps. It also consumes a lot of resources and time that could be more usefully redirected to focusing on the needs of the investor.

Arguably, the overlapping regulatory framework and structure has become mired in significant "regulatory sludge," to use a term coined by Richard Thaler (Thaler 2018). The time seems ripe to clear out the sludge and streamline the framework.

Eliminate Overlapping Regulatory Structures

As noted above, the regulation of financial advice has many players. It includes three SROs – IIROC, the MFDA and the CSF – as well as all of the securities regulators. The SRO structure contains the most regulatory overlaps and intersections and is therefore the primary focus of this paper.

The History: IIROC is the longest standing organization. It was renamed in 2008 with the merger of the Investment Dealers Association[17] (IDA) and the Market Regulation Services Inc (MRS), leaving it with a broader role. IIIROC is recognized by all provinces.

The CSF was created in 1998-99 and grew out of predecessor organizations that oversaw agents who distributed insurance. In its expanded incarnation, it was given the mandate to oversee advisers distributing a broader range of financial services including investment funds. Its jurisdiction is limited to Quebec.

MFDA was created in 1998 in response to the growth of mutual funds sales. While a number of options were considered it was determined that mutual fund sales distribution needed its own unique regulatory body. Making it part of the old IDA (IIROC today) was rejected by the industry over, among other things, concerns that the IDA would not provide the fit-for-purpose regulatory oversight required by the narrower role

17 IDA has existed since 1934 and further back to 1906 when it was the Bond Dealers Section of the Toronto Board of Trade.

of distributing mutual funds. It was argued that retail mutual funds would be bought by a less sophisticated market segment and should be sold by narrowly licensed mutual fund sales advisors who would not be able to sell any other securities product. It was determined that only a dedicated regulatory body could do the job.

The Shifting Landscape: The MFDA and the CSF both played an important role in professionalizing the practices of the mutual fund sales industry. All advisers and dealers who distribute mutual funds, however, are not captured under the MFDA and CSF umbrellas. It is interesting to note that the value of mutual funds being sold through MFDA advisers has fallen to just over a third of the industry total retail sales. At the end of 2017, total retail mutual fund sales stood at $1.477 trillion.[18] Total assets under administration by MFDA regulated dealers stood at $525 billion (MFDA 2017). A higher percentage of retail mutual funds are now likely being sold by IIROC regulated dealers than by MFDA regulated dealers. Some firms specializing in mutual funds have chosen IIROC registration because they feel the regulatory structure is less complex, more streamlined and investor-friendly than that provided under the MFDA.[19]

Dealers regulated by both the MFDA and IIROC channels have also been merging to achieve scale, diversify their services, broaden their geographic reach and manage growing cost pressures. This has created dually licensed MFDA/IIROC dealers who must ensure they follow the regulatory requirements of both regulatory bodies, must prepare and respond to separate audits, and have compliance staff knowledgeable in both sets of rules.[20]

The non-recognition of the MFDA in Quebec points to more overlaps and inefficiencies.[21] While many of the MFDA rules are mirrored within the AMF rules, there are variations. Mutual fund dealers operating across Canada are subject to audits by the AMF in Quebec and by the MFDA in the rest of Canada. The separate detailed audit reports the dealer receives from each organization may require different remedies for similar infractions. The separate reviews conducted by the AMF and the MFDA occur at different times and therefore double the time the dealer must devote to a process that, intuitively, should take place only once.

A further example of overlap concerns the CSF. Its mandate is to oversee individual advisers operating in Quebec and ensure they follow a code of conduct and have the necessary professional credentials. The regulation of these functions also exists within the MFDA and IIROC. The CSF also receives consumer complaints and disciplines members where infractions are found. Quebec consumers have been given the option of taking their unresolved complaints to OBSI or the CSF.

To be fair, the Quebec authorities have engaged the industry on recognizing the MFDA several times over the last decade. The last was in 2015

18 See https://www.ific.ca/wp-content/uploads/2019/02/News-Release-IFIC-Releases-Monthly-Statistics-Mutual-Funds-and-ETFs-January-2019-FINAL.pdf/21913/.

19 For example, Aligned Partners Inc. is an IIROC registered firm that distributes only mutual funds.

20 Dealers have also been consolidating to become more efficient. At the end of 2018, there were 91 MFDA dealers (compared to 139 in 2010) and 176 IIROC dealers (compared to 208 in 2010). The number of advisers, however, has been growing to meet demand for financial advice and products. In 2018, there were 82,457 MFDA advisers (compared to 73,291 in 2010) and 29,284 IIROC advisers (compared to 28,380 in 2010). Advisers offering full-service financial planning services are not all captured in these numbers if they are not also selling products, which many do not. Many professional financial planners only provide the plan and send clients to others for purchasing the products themselves.

21 MFDA is also seeking to be recognized by Newfoundland and Labrador.

when Finance Minister Carlos Leitão tabled a report seeking comments about folding the CSF into the MFDA and recognizing the MFDA in Quebec.[22] While the proposal received strong industry support, including from Quebec-based organizations, Desjardins and the National Bank, smaller independent dealers rejected the idea, fearing that a Toronto-headquartered body would not understand their needs and would impose new fees and requirements that might force them out of business. Ultimately, the government determined it was not prepared to pay the political price such a move might exact.

The adviser industry has consolidated and converged to create business structures that are more financially sustainable. Dealers with multiple registrations are combining their operational and administrative backrooms, including compliance teams, to achieve efficiencies. Meanwhile, the MFDA is being responsive by seeking to harmonize rules.[23] Thus, the regulatory system and the industry are blurring the regulatory differences and distinct business lines that once characterized them and justified the need for separate regulatory organizations.

Interestingly, securities regulators have been creating the conditions that may facilitate the consolidation of the current multi-layered structure. Proposals to update key consumer protection requirements set out in National Instruments governing securities products and services[24] will cascade, in a harmonized way,[25] down into both the MFDA and IIROC. These rules regard the important requirements to determine Suitability of an investment, the Know Your Client and Know Your Product responsibilities, Conflict of Interest rules, etc. This begs the question: if rules are being largely harmonized, why do they need to be administered by multiple funded organizations? Particularly when members of those organizations are themselves consolidating and creating more efficient management and oversight structures to achieve efficiencies? What is logical about having to create memoranda of understanding across organizations with similar purposes to ensure that the similar purpose stays clear?

Harmonization of rules across related regulatory bodies is a valuable first step. It is of enormous benefit to the end-consumer and helpful for dually licensed dealers. It can also prevent regulatory

22 See pages 21-23 in the report: http://www.finances.gouv.qc.ca/Documents/Autres/en/AUTEN_loidistriprodservfin.pdf.

23 MFDA introduced changes that would allow its investigators to enter a dealer's offices without notice and copy electronic records. In its notice its makes the following statement: 'The proposed amendments would also maintain investor protection by ensuring that the MFDA examination and investigation powers are harmonized with equivalent powers under the Rules of the Investment Industry Regulatory Organization of Canada ("IIROC").' https://mfda.ca/wp-content/uploads/PropAmend-ByLaw1.pdf.

24 These include proposed changes to the best interest standard proposed in CSA's 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. They also include changes to Know Your Product (KYP), Know Your Client (KYC) and Suitability provisions in CSA's Client Focused Reforms - Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP October 19, 2018 and Ongoing Registrant Obligations (NI 31-103) and to Companion Policy 31-103 CP Registration Requirements, Exemptions and Ongoing Registrant Obligations.

25 Recognition that harmonization of financial services rules across sectors is necessary is also occurring in several provinces, including Quebec, New Brunswick, and Saskatchewan, which have created a single regulatory body for insurance and securities (and other financial sectors) to give themselves the ability to better harmonize rules where it makes sense to better safeguard consumer interests.

arbitrage by practitioners. However, harmonization of rules is not a panacea because it requires effort, time and expense for the regulated firms to satisfy two separate masters. It also requires the various regulatory bodies to stay in a perfectly harmonized state. Such a state is rarely achieved. With separate leadership and structures there is often regulatory drift that develops in the rules. The remedies imposed as a result may differ for various reasons including the different perspectives of human examiners during firm audits. Invariably, overlaps and inconsistencies will develop. The regulated entities will chafe against the rules and push for more flexibility. And the regulators will seek to create more binding memoranda of understanding to keep their roles straight. It can all leave dealers and advisers trying to figure out "who's on first?"[26]

Digital Advances: The effort to achieve harmonization and/or gain flexibility from restrictive rules also siphons away valuable resources and energy that could be channeled to more fruitful endeavours such as meeting the needs of new digital advice entrants. As it is, regulators have declared themselves ready to help new firms come to market. Several jurisdictions have created sandboxes for experimentation.[27] And yet, the new digital players entering the market have been frustrated by the process. The NestWealth leadership has complained about the lengthy certification process it had to go through to on-board clients through its website. The options the company was offered were (i) to get an exemption from the rule, or (ii) to scale up more slowly to allow the regulator to amend the rule. Neither made sense for a company looking to enter and disrupt an industry using new technology norms and processes.[28]

The pressure on regulators and traditional industry players to accommodate digital advances will intensify. Research[29] is pointing to consumers of financial advice embracing digital and voice-enabled assistants much faster than expected and preferences for digital advice channels are far exceeding expectations. Product-led service offerings are falling out of favour and the feature-rich offerings that can be provided through digital advice channels are gaining ground particularly with millennials, a growing force in consumers of wealth management services.[30] More focus by regulators on facilitating the move by dealers and advisers to harness the benefits of technological advances will serve the public interest much better than propping up inefficient regulatory structures built for a different time.

A further initiative is to modernize the adoption, by regulators, of technology tools that will allow them to conduct reviews and audits much more efficiently and less intrusively – examples include applying automated processes to trade reviews that can go beyond a sampling of paper files, and look at 100 percent of trades to determine suitability. This would revolutionize the conduct of suitability analyses because it would allow a more accurate measure of a client's tolerance for risk (derived from answers to questions the investor answers in the

26 "Who's on First" is a comedy routine made famous by comedians Abbott and Costello.

27 See https://www.osc.gov.on.ca/en/osclaunchpad.htm; https://lautorite.qc.ca/en/general-public/media-centre/news/fiche-dactualites/the-canadian-securities-administrators-launches-a-regulatory-sandbox-initiative/.

28 Oral comments made by Randy Cass, CEO Nest Wealth Asset Management, at the OSC's March 27, 2019, Roundtable on Reducing Regulatory Burden. See Transcript: https://www.osc.gov.on.ca/documents/en/Securities-Category1/sn_20190327_11-784_transcript-roundtable-burden-reduction.pdf.

29 See https://www.ey.com/en_gl/wealth-asset-management/how-financial-advice-is-digitally-evolving-from-screens-to-voice.

30 Report conducted by Accenture for IIROC entitled "Enabling the Evolution of Advice in Canada. https://www.iiroc.ca/industry/Enabling-the-Evolution-of-Advice-in-Canada/Pages/default.aspx.

KYC form) against the actual risk in the client's portfolio of investments.[31] Financial audit firms are already offering this service on financial transaction reviews providing boards and investors with a much higher level of comfort on the integrity of financial statements. Applying the technology tool to trades would ensure advisers are recommending suitable investments to their clients and reduce one of the largest areas of consumer complaints that go before OBSI.[32]

Ensuring Consolidation Does Not Disadvantage Small Firms

The idea of an MFDA and IIROC merger is not an original idea. Serious merger discussions between the two organizations in fact took place in 2011 but were called off. The timing was not deemed right but there was a recognition that it was 'inevitable' at some point, particularly after the common securities regulator was established.[33] The fate of the common regulator is not clear. Chances are it may sit in limbo for a long time or never happen. Its unresolved state should not deter pursuit of the creation of a new distribution regulatory agency that a significant part of the industry wants and will have a salutary impact on consumers of advice.

The main reason the earlier merger discussions faltered was over valid concerns that smaller MFDA firms could be forced to meet more onerous IIROC requirements not commensurate with their service offerings in the market. This concern can be eliminated by having the new merged Agency structured to create fit-for-purpose rules to accommodate narrower roles of advisers that will preserve the current requirements. For example, educational qualifications for advisers who sell only mutual funds can continue to be differentiated from qualifications required of advisers who sell a wide range of more sophisticated and risky investment products. A new merged Agency should, in fact, adopt a graded regulatory framework that allows smaller firms to evolve and grow their services without pushing them into a new regulatory category and require potentially costly system and management changes at the dealer. In the long run, rather than disadvantaging smaller firms a new Agency with a broader mandate could provide a significant advantage to them by bringing them along the growth curve on their own timetable.

Steps to Consolidation

Only consolidation of regulatory bodies and functions can ensure true harmonization of rules and free up resources and energy to be redirected to more productive activities.

The obvious first step is to collapse IIROC and the MFDA into a single organization, creating a new Agency with a new name to reflect a broader consolidated mandate and role. As SROs operating under a recognition order of the CSA, the Boards of the MFDA and IIROC do not need permission of the CSA or from the political level to merge. They do however, need strong support and encouragement from their regulators.

31 Investment advisers are required to complete a Know Your Client analysis for each client to collect personal information and establish the client's risk tolerance, investment knowledge, and financial position so that only suitable investment products are recommended.

32 See page 31 of the report: https://www.obsi.ca/en/news-and-publications/resources/AnnualReports-English/AR2017_EN.pdf.

33 See a report on the aborted discussions by James Langton, October 17, 2011 in *Investment Executive* https://www.investmentexecutive.com/newspaper_/news-newspaper/iiroc-and-mfda-call-off-merger-talks/.

A second step is to identify those oversight functions regarding the distribution of equity and debt products to investors currently performed by provincial securities commissions, or which are shared between SROs and commissions, and transfer them into the new Agency. These include, among others, oversight of exempt market dealers (EMDs), digital-advice providers, titles used by advisers, education and certification of registrant categories not currently falling under IIROC or the MFDA.

A third step is to consider rationalizing the roles of the CSF. Adviser accreditation, oversight of ethical standards, etc. can be moved into the new Agency giving Quebec dealers a more streamlined and simplified set of regulatory requirements. All consumer complaints can be channeled to OBSI to give consumers across Canada a single body through which to file complaints and dealers a consistent set of requirements to meet in dealing with their clients' concerns.

This new Agency would report to the provincial and territorial securities commissions, which will set its mandate and operating rules. The commissions can conduct annual audits to ensure the Agency is fulfilling its responsibilities. Both the MFDA and IIROC are currently subject to such an oversight regime by securities regulators including an annual audit and report. Ontario has taken the lead on IIROC as has BC on the MFDA on behalf of all the CSA members. The CSA can designate one of their members, or create a joint team to conduct the annual audit of the new Agency.

The impact of such consolidation on dealers would be salutary. Let's consider a dealer headquartered in Quebec but operating across most Canadian provinces. Such a dealer is currently regulated by the MFDA, IIROC and the AMF and will undergo three separate audits by those entities and receive three reports to which it must respond. Its advisers are subject to oversight from the CSF in Quebec and various provincial insurance regulators when they have insurance licensed advisers. Investors can choose to file their complaints with the OBSI or the CSF in Quebec and the OBSI in the rest of Canada.

Consolidating IIROC, MFDA, and the relevant elements now in the AMF and the CSF would mean a single regulator conducts the annual audit of the dealer and sends the dealer a single report. The new regulator has the advantage of seeing across all parts of the business and the dealer gets one audit and an unambiguous single set of marching orders from its regulator once that audit is done. Investors have one body to which they can turn to file their complaints when they are not satisfied with the responses they get from their dealer. The dealer has one consumer complaint agency to respond to if it needs to take disciplinary action against an offending adviser and adopt preventive measures to improve customer service.

More importantly, a single regulator will have a significant impact on advisers and their ability to meet their clients needs and develop as professionals. An individual starting her career as an adviser could begin with registering and being accredited to sell mutual funds. As her practice develops, she would have the flexibility to seek accreditation to distribute other products and services without having to register with a different regulatory body. Consumers would not be limited to certain investment products, regardless of their needs, because the advisor was registered to sell a narrow set of products and moving out of that category was complicated or inconvenient.

Any concerns with ensuring regional sensitivity and contacts can be addressed by having the new Agency open offices in provinces as needed and its regulatory oversight could be done through a team of all of the provincial securities regulators.

Consolidating related regulatory functions will deliver a number of substantial benefits including:

- The creation of a strong, single centre of excellence for financial advice regulatory expertise;

- Fit-for-purpose, graded levels of regulation within one regulatory entity;
- A single audit and compliance report for dealers;
- Elimination of regulatory arbitrage where registrants seek the least onerous regulator;
- A single complaint resolution entity for consumer complaints;
- Lower compliance and administrative costs for all;
- Fully harmonized documentation procedures and disclosure for investors;
- A regulatory structure that can focus more energy on the end consumer and less on inter-agency relationship management;
- Consolidated view for regulators of compliance performance across all regulated registrants.

The status quo is not optimal. With multiple regulators, those providing financial consumer products and services must generally fit themselves into the right regulatory box – sometimes at the expense of the customer experience. For example, not long ago, advisers registered with the MFDA were unable to sell ETFs to their clients notwithstanding that they were simply mutual funds with a different investment mandate and with lower fees. The barrier existed because MFDA registered advisers did not have access to a securities exchange to purchase the ETFs, nor did they have the required product training.

It has taken too many years for the regulators to resolve these issues and build the appropriate infrastructure, and even now the process is not as smooth as it should be. Such operational blockades can be identified and eliminated more efficiently with one regulatory agency, and will no longer artificially obstruct movement and progression into next-stage business development positions or limit consumer access to suitable products.

The ultimate beneficiary of a merged Agency will be the investor who will be able to look to a single regulator who will have a laser focus on all issues related to the distribution of investment products and services and ensure the public interest is served. A single regulator will free up a lot of effort that the dealer and adviser must now dedicate to respond to the requirements of their multiple regulators.

Summary – Why It Matters

The regulatory framework that governs the distribution of wealth management products is very robust, as it should be, given the asymmetrical relationship between an adviser who holds all the information and mostly unsophisticated investors who are deeply reliant on the information given to them by the adviser for their daily and longer-term financial needs. That reliance starts with opening a first savings account and moves through the life-stages of education, marriage, having children, divorce, beginning a business, launching a career, losing a job, planning for and living in retirement, critical illness, and estate planning. While dealers are consolidating, the number of advisers continues to grow which suggests that demand for investment advisory services will also continue to grow.

This high level of reliance requires access to affordable financial tools and services. A regulatory structure that creates separate advisory organizations based on the sale of a specific product can keep an individual from investing in products that may be more suitable for her needs.

Particularly where an industry is highly regulated, and cannot operate outside that regulatory framework, as is the case with investment advice, there is an extra onus on the industry and its regulators to create a regulatory structure that is efficient as possible. One that will foster increased productivity, support and stimulate innovation, enhance investor service levels, and deliver value for money.

The dealer structure of today cannot be regulated in the same way it was in the 1990s when public participation was low and offerings were narrower. Dealers have consolidated a range of activities and functions to meet the demand for more holistic financial planning advice, but must still register with separate regulatory organizations who have narrower oversight roles.

The growing costs of regulation is the argument usually put forward for the need for reform. A better measure is to evaluate whether the regulatory framework, which was designed to oversee discreet, individual, transactional, order-execution activities, is structured appropriately to efficiently regulate an industry that has evolved into a mass-market, wealth management advisory business not willing, or needing, to be constrained to selling discreet individual products. And where the consuming public has expanded into a broader demographic and socio-economic group that is looking for a range of financial advice and products that will fully meet their growing and evolving life needs.

When measured against that test, it is clear there are too many regulatory cooks in the kitchen. The organizations that oversee investment advice have become overly structured and complex with overlapping roles applying differing standards when enforcing compliance. To keep everyone's roles straight, related regulators have to create cooperative agreements and memoranda of understanding. Registrants are feeling constrained in the services they can deliver to their clients and are seeking relief from some of the narrow permissions they operate under. Furthermore, consumers are being held to purchasing the specific products and services that their adviser is licensed to provide. Many dealers and advisors grumble that the complexity of regulatory requirements and the number of regulators demanding attention are drawing them away from spending more of their time and efforts on their customers.

These conditions all point to the need for reform. The case for collapsing IIROC and the MFDA into a new Agency is particularly compelling. Identifying related provisions in rules applied by the securities commissions and transferring them to this Agency is also a desirable outcome. These moves will be a clear win for all parties, most particularly for consumers who will benefit from a single regulatory organization focused on ensuring those dealers and advisers are being held to consistent standards requiring them to deliver the products and services that fit the needs of their customers.

In fact, a longer-term assessment of regulatory effectiveness could measure how accessible and affordable regulated advisory services are for the individual consumer and how successful those services are in getting consumers to develop good financial habits and build wealth.

Regulators have been actively responding to the changing environment but not with a full-throttle effort of identifying and clearing out the sludge that has accumulated over the decades. The combination of new technology and a broad consumer base hungry for good financial products and services should provide the impetus to fire up the process.

This paper does not provide an exhaustive assessment of all the changes that would lead to a thoroughly modernized framework. A full effort can only be mounted with resources from all of the regulatory bodies concerned and all of its industry players, which must manage the multiple regulatory relationships. It also requires the full political support of the government ministers to whom these bodies report and who have a strong interest in improving the efficiency and productivity of the agencies they regulate. It is hoped that the facts presented in this paper provide a solid push.

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