

November 9, 2012

Mr. Robert Keller  
Policy Counsel  
Investment Industry Regulatory Organization of Canada  
121 King Street West, Suite 2000  
Toronto, Ontario M5H 3T9

Dear Sirs/Mesdames:

**Re: IIROC Request for Comments – Draft Guidance Regarding Compensation Structures for Retail Investment Accounts**

The Canadian Advocacy Council<sup>1</sup> for Canadian CFA Institute<sup>2</sup> Societies (the CAC) appreciates the opportunity to comment on IIROC's draft guidance note regarding compensation structures for retail investment accounts as set out in IIROC Notice #12-0253.

Members of the CAC have had extensive experience dealing directly with retail clients with both commission-based and fee-based advisory accounts. The CAC agrees with IIROC that Dealer Members and persons who transact directly with retail clients must (i) consider how an account's specific compensation arrangements affect their obligations under IIROC rules, including with respect to potential conflicts of interest, and (ii) ensure that adequate disclosure is made to such clients of all aspects of the compensation arrangements affecting their accounts.

The CAC does not believe at this time that banning third party commissions, as is the case in certain international jurisdictions, is necessary. However, the CAC wishes to stress that regardless of the account type that is ultimately deemed suitable for a particular client, the advice given by a registered representative to meet a client's goals should be the same. We believe that the draft guidance note should emphasize that registered representatives should act in a manner consistent with a fiduciary obligation to act in the best interests of their clients.

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<sup>1</sup> The CAC represents the 13,000 Canadian members of CFA Institute and its 12 Member Societies across Canada. The CAC membership includes portfolio managers, analysts and other investment professionals in Canada who review regulatory, legislative, and standard setting developments affecting investors, investment professionals, and the capital markets in Canada. See the CAC's website at <http://www.cfaadvocacy.ca/>. Our Code of Ethics and Standards of Professional Conduct can be found at <http://www.cfainstitute.org/ethics/codes/ethics/Pages/index.aspx>.

<sup>2</sup> CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. CFA Institute has more than 113,000 members in 140 countries and territories, including 102,000 CFA charterholders, and 137 member societies. For more information, visit <http://www.cfainstitute.org/>.

### *Assessing Suitability at Account Opening*

With respect to assessing the overall suitability of an account type, the CAC agrees that both at the account opening stage and during ongoing supervision, an account's compensation structure is of great importance.

As a general matter, the CAC believes that, in either a commission-based or a fee-based account, a long term hold, or a "no activity recommendation", can be a valid investment strategy; therefore, the suitability of a fee structure should not be determined solely based on a comparison of commissions paid in prior years and the proposed fee. The CAC agrees with the statement in the draft note to the effect that, for a variety of reasons (including the level of service requested by a client), the account offering the lowest cost is not necessarily the only suitable account type for a client.

### *Disclosure*

The CAC recognizes that while the CRM disclosure obligations are not yet effective, we would encourage IROC to send a strong message that clients should be fully informed of the various types of accounts available, and the differences between those accounts. To that end and in advance of the effectiveness of the rules, the CAC believes that such disclosure of account charges should be required of Dealer Members at this time, and not simply be a "best practice".

We also believe strongly that all forms of compensation, including but not limited to trailer fees, new issue fees, front load charges, back load charges, and all similar charges that impact the value of a client portfolio, should be described to retail clients in a plain language format. In addition, any other "hidden" revenue sources, such as soft dollars, dealer dollars (co-operative marketing expenses) and referral fees, which may not necessarily impact any particular client account but which represents compensation paid to dealers, should be disclosed to clients.

In order to help ensure that clients are made aware of and understand the compensation structure that will apply to their account, to the extent disclosure is made in a separate document and is not a part of the account application form itself, a client should be required to acknowledge that the registered representative has provided the requisite information and explanation by signing a separate disclosure document. Once again, such activity should be a requirement and not a "best practice".

However, the CAC notes that while disclosure to clients of account charge options is of paramount importance, during a suitability review, it may not be possible to determine the exact amount of charges that would have been payable had an account been opened with a different commission structure.

### *Account Supervision*

The CAC agrees that, as specified in the current IROC Dealer Member Rules, a review of fee-based accounts should be triggered by factors which differ from those used for commission-based accounts. While the list contained in the draft guidance note is helpful and non-exhaustive, we note that in some cases it may be difficult to monitor every account on each of the listed factors. As stated in the draft, Dealer Members may apply the unique facts and circumstances of their businesses to design appropriate supervisory structures, provided the desired outcome is achieved for their clients.

### *Ongoing Review of Suitability*

The CAC agrees that the suitability of the compensation structure should be reviewed from time to time, and at least on an annual basis.

With respect to fee-based accounts, we understand that some Dealer Members have a policy that the “ticket charge” that would otherwise be included in a commission-based fee is usually charged instead to the Dealer Member. We believe that for full transparency, any such charge should be disclosed to clients, and Dealer Members should be discouraged from recommending that commission-based accounts be used solely to avoid such fees.

### *Double Charging*

The CAC believes that registered representatives and supervisory personnel should be vigilant in ensuring that fee-based accounts are not subject to double charging. The problem is particularly acute with respect to new issue securities. Some members have indicated that they do not participate in new issues for fee-based accounts as a result of concerns related to double-charging, and query whether registered representatives should be restricted from investing in new issues for fee-based accounts. In other cases where such fees are incurred, they are reduced by the amount of the commission to the applicable account. We also understand that some Dealer Members are prohibited from purchasing new issues for managed accounts but are permitted to do so for other types of accounts, resulting in less investment choices for clients with managed accounts.

The draft guidance note also specifically mentions mutual fund securities. We believe it should be best practice for those purchasing mutual fund securities for fee-based accounts to exclude such assets in the determination of the assets under management used to calculate the advisory fee. Alternatively, such securities could be switched to a no-fee “F” class of units, where available.

The draft guidance note states that depending on the circumstances, a failure to observe one of the practices described in the note to avoid double charging could be considered a violation of the specified Dealer Member Rules. We believe that the guidance note should provide that only in

exceptional circumstances should embedded fees be permitted in fee-based accounts without resulting in a violation of the rules.

In all cases, the CAC would like to see well-documented disclosure of all embedded fees in both commission-based and fee-based accounts, with a clear delineation of fees that have been included, fees that are excluded, and any adjustments that have been made.

### **Concluding Remarks**

We thank you for the opportunity to provide these comments. We would be happy to address any questions you may have and appreciate the time you are taking to consider our points of view. Please feel free to contact us at [chair@cfaadvocacy.ca](mailto:chair@cfaadvocacy.ca) on this or any other issue in future.

(Signed) *Ada Litvinov*

**Ada Litvinov, CFA**  
**Chair, Canadian Advocacy Council**