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Via email October 13 2020

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Consultation Paper - Competency Profiles for Registered Representatives and Investment Representatives, Retail and Institutional
https://www.iiroc.ca/documents/2020/00155455-1cf6-487c-be85-70c563ce922f_en.pdf

Kenmar Associates appreciate the opportunity to provide input into this consultation.

Kenmar Associates is an Ontario-based privately-funded organization focused on investment fund investor education via on-line research papers hosted at www.canadianfundwatch.com .Kenmar also publishes ***the Fund OBSERVER*** on a monthly basis discussing investor protection issues primarily for investment fund investors. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused investors and/or their counsel in filing investor complaints and restitution claims.

Consultation is timely

The CSA Summary Report *2016-2019 Investor Research Findings on the Impact of CRM2 and POS on Investor Knowledge, Attitudes, and Behaviour* https://www.securities-administrators.ca/aboutcsa.aspx?id=1954 released August 27, 2020 contained some disturbing facts. The Tracking Study shows that a statistically significant increase in the percentage of investors advised under the discretionary authority (PM model) recently changed, or were likely to change, their investment firm (13% in 2016, versus 24% in 2019). There was no evidence that advisors are more frequently recommending lower-cost options. After two years of increases, 2019 saw a decrease to 44 % – almost to 2016 levels – in the portion of respondents who said their advisor discussed fees with them before buying an investment product in the previous 12 months. Almost half of Canadian investors are not aware of indirect fees (such as payments made by investment funds to dealers). These stats are indicators that RR's need to step up their game.

NASAA recently released results of a Benchmarking Initiative To Help Measure Effectiveness of Regulation Best Interest - The examinations found notable differences between broker-dealers operating under a suitability standard and investment advisers operating under fiduciary duties Among other things, the regulators found that "investment advisers (as opposed to broker-dealers) generally took more conservative investment approaches overall, avoiding higher cost, riskier, and complex products." When complex products were sold, broker-dealers were twice as likely as investment advisers to recommend the purchase of leveraged and inverse ETFs, seven times as likely to recommend private placements, eight times as likely to recommend variable annuities, and nine times as likely to recommend non-traded REITs. These kinds of Firms also had more robust due diligence, disclosure and conflict management practices. "https://www.nasaa.org/55758/nasaa-releases-results-of-benchmarking-initiative-to-help-measure-effectiveness-of-regulation-best-interest/ Hopefully, the IIROC approved training program would help prevent such sales practices taking root in Canada under CFR and IIROC rules.

Innovative technologies are making it easier for retail investors to stay informed about their investments and reshaping their relationships with RR's. Changing demographics and increased longevity will play a role in how RR's engage with their clients in the future and what types of advice they will need to offer at key life stages.

Kenmar believe that the consultation paper does a good job at describing the basic skill set required to provide investment personalized advice to retail clients. We especially like the graphic which ties all the components of competency together.

Incorporation of CFR obligations

While the proposed Profile covers the generics of providing personalized advice to retail clients, it is not obvious that the profile will lead to course designs that will assure compliance with securities laws. In particular, we expect the education will require conduct standards and practices that apply CFR requirements such as:

- An obligation to assess the suitability of client trades and investment recommendations, including that the RR must reasonably determine that any requested or recommended investment action "puts the client's interest first"
- A requirement to disclose and resolve material RR-client conflicts-of interest in the best interests of clients
- Prohibiting misleading or deceptive communications by RR's aimed at clients or potential clients
- A requirement for the RR to disclose when primarily proprietary products are available and whether there will be other limits on the availability of products and services. (IIROC could go further and require RR's to explain the possible adverse consequences of a restrained product shelf)
- RR's must not buy, sell or recommend a security unless they take "reasonable steps" to understand "at a general level" the securities that are available at the Firm and may only recommend a security that has been approved by the Firm.
- A KYC update is triggered when the RR becomes aware of a significant change in client circumstances. Minimum timeframes for KYC : every 12 months for a managed account, within 12 months of recommending a trade for an exempt market dealer and every 36 months in any other case (IIROC may wish to require an annual update for RR's as recommended by investor advocate groups).

Under CFR, suitability determinations must take into account the client's KYC information, the registrant's KYP assessment, the impact of the action on the client's account (including concentration and liquidity considerations), potential and actual impact of costs on the client's return on investment and a consideration of a reasonable range of alternatives. In addition to the above noted points, any specific action must also "put the client's interest first". In this way, "suitability" (as the word has traditionally been understood) is insufficient -the RR must be able to demonstrate how the recommendation puts the client's interest first. CFR provides rules as to when suitability assessments must be carried out on an ongoing basis, including when the registrant becomes aware that a security or the account may no longer be suitable for the client. The bottom line is that CFR expects RR's to be able to demonstrate that a particular action for a client was made in a way that put the client's interest first.

Titles and designations confuse investors

We recommend that a more descriptive nomenclature for registrants. *Registered Representative* conveys very little information as a title. If the person is a Financial Advisor why not use that label?

What confuses investors is dozens of misleading "advisor" tiles and designations, multiple registration categories and the obligations representatives have to deal fairly and honestly with clients. A September 2015 OSC mystery shop observed an extensive variety of business titles approved by SRO Member Firms across all platforms. In all, 48 different titles were used by "advisors" on the four platforms shopped. From the perspective of a retail investor, the number and variety of business titles encountered when shopping for advice makes the process of choosing an "advisor" a confusing and complex one. https://www.osc.gov.on.ca/documents/en/Securities-Category3/20150917-mystery-shopping-for-investment-advice.pdf

Industry has moved beyond investment recommendations

Over the past two decades the financial services industry has rebranded itself from a transaction business to an advice business and more recently to a Wealth management business but remained anchored in a transaction-based regulatory environment. Corporate culture has remained tied to a sales and marketing mindset rather than as a trusted provider of unbiased investment advice. Regulators have allowed this disparity between reality (the suitability standard) and advertising and marketing to persist by permitting dealers and salespeople to hold themselves out to Canadian consumers as trusted advisors despite significant conflicts-of- interest that adversely affect the advice provided. A report *Lack of truth in advertising deceives investors* from the Small Investor Protection Association (SIPA) illustrates the divergence of the advisory services promoted vs. the actual services delivered. http://www.sipa.ca/library/SIPAsubmissions/720_SIPA_Report_Deception_20150505.pdf Kenmar argue that the competency framework must relate to the services promised to be provided when they open an account at an IIROC registered dealer.

As we peruse the proposed profile we are compelled to conclude that the profile remains focussed on products and recommended transactions rather than portfolio construction and holistic financial advice. As regards construction of suitable portfolios, there should be a knowledge of elementary statistics and basic optimization mathematics. Addressing holistic financial advice, the advice promoted and marketed by many IIROC Firms, requires a broader knowledge base than the proposed competency profile.

Anecdotal feedback from a few IIROC registrants suggests (a) there is more emphasis on stock selection than portfolio design in training and (b) there is a message conveyed that hot funds, hot stocks can be found …market timing is legitimate.

If RR's are to become professional advisors, their role must be one of providing advice as a service and not be limited to transactions. Firms and RR's should be held accountable for the services they market (IIROC complaint handling rules can be improved as regards "service" issues).

We encourage IIROC to monitor industry ads, promotions and marketing touting integrated wealth management when in fact, in most cases, this is not truthful. There are still too many "stockbrokers" in the industry masquerading as wealth managers. This is a key reason we have been advocating for mandatory use of Engagement letters.

IPO's create ethical issues

We have been told that IPO's put incredible pressure on advisors to move product. We cannot provide any backup to this assertion except to note that IPO sales commission structures are extraordinarily lucrative inducements. Another related issue is the sale of DSC mutual funds which the OSC has decided not to ban.

What consumers need and want

What retail investors want and need is trustworthy financial advice on issues that range far broader than security choices and selection. They need financial plans for themselves and their families, help with tax and social benefit programs, investments that reflect personal values, discussion of charitable giving and philanthropic goals and help with estate planning

Based on our dealings with retail investors we find the following opportunities for improvement in RR competency:

- Understanding of all applicable laws rules , procedures and policies ; in particular NI81-105, since mutual funds constitute a high percentage of assets in accounts and the soon to be implemented CFR
- Familiarity with the principles of behavioural finance
- Assessing a client's risk profile (need , tolerance, capacity)

- Expertise in converting a client's KYC and risk profile into a personalized investment portfolio
- Knowing when to avoid DSC option mutual funds
- The analytical skills to construct defined risk- reward portfolios
- Providing advice on de- accumulating accounts e.g. RRIF's
- Understanding how to resolve conflict-of-interest in the best interest of clients
- Up to date on ESG investing, Bitcoin
- Prepares Investment Policy Statements as a communication tool with clients
- Has competencies required to prepare holistic financial plans for clients
- Use of the tax Code to optimize client returns over several accounts
- Assists clients implementing RESP, RDSP and other Govt. social benefit programs
- Knows when to use a fee-based account and avoid reverse churning
- Can create portfolios for De-accumulating accounts to meet cash flow needs
- Learning more about insurance and estate planning

We see too many cases involving improper DSC sales, mis-selling inverse ETF's , unsuitable portfolios , mutual fund account churning, undue margin / leveraging, unauthorized trading , reverse churning, unnecessary use of expensive products and off- book transactions. If the courses/curriculum provided help reduce these investor harming practices, the courses would be deemed successful.

IIROC may wish to consider alternate information sources such as OBSI complaint statistics, client complaint database, investor advocate feedback and empirical research on advisors to identify RR training needs.

What do financial consumers expect from a FA?

Based on our continuous contact with financial consumers we can provide some useful information to IIROC. Here's what we see are the expectations of clients:

- Complies with a Code of Conduct
- Has a client -friendly communication process; addresses client questions, dissatisfaction and complaints
- Uses Engagement letters to clarify service offering for clients
- Is readily accessible by electronic and other means
- Interacting and communicating with seniors and other vulnerable investors
- Proactively takes action to ensure KYC is up to date
- Weaves social benefits programs into the financial plan
- Keeps up-to-date on securities regulation and dealer rules, policies and procedures
- Explains the impact of cost/fees on long-term returns.
- Has sufficient analytical skills in order to compute trade-off decisions
- Assists with income tax filing
- Resolves any unavoidable conflicts-of-interest in the best interests of clients
- Ensures that robust disclosure and best interests of clients are applied when dealing in an IPO

- Ensures that fees are disclosed, are appropriate, fair and that there is no double billing
- Discloses any restrictions on his/her providing advice (e.g. enhanced supervision)

Above all, retail investors rank trust as the most important advisor characteristic they seek. The training curriculum should therefore have a robust ethics module.

Risk profiling a systemic issue

A November 2015 report by the OSC IAP found serious Industry-wide issues with the Risk profiling process. Among the main findings:

- There is a confusing and universal lack of existence or consistency of the definitions of risk concepts and a lack of understanding of the factors involved in risk profiling.

- Most of the questionnaires (83.3%) in use by the industry are not fit for purpose - they have too few questions, poorly worded or confusing questions, arbitrary scoring models, merge multiple factors (75%) without clarity or have outright poor scoring models. Fifty five percent had no mechanism to recognize risk-averse clients that should remain only in cash.

- Almost all regulators surveyed are principles-based and provide little guidance on how a firm or advisor should arrive at the determination of a risk profile. No regulator provides clear guidance on how to combine the multiple factors and form a client risk profile. Only 11% of firms could confirm that their questionnaires were 'validated' in some way.

- Almost half of the firms reported that risk questionnaires were developed in-house and another 36% said that advisors could choose their own risk profiling methodology.

A faulty risk profile can lead to unsuitable recommendations to the detriment of investors. Unless the situation has dramatically improved since the report was issued, there is a danger risk profiling could be the weak link in the suitability chain. http://www.osc.gov.on.ca/en/Investors_nr_20151112_iap-releases-research-risk-profiling.htm

Advising seniors and vulnerable investors

There is a need for proficiency training on de-accumulating accounts like RRIF's. The problem is not just around education about withdrawal rates and sequence of returns (and frankly mortality rates) and RR's advisors discussing these concepts, risks and potential outcomes to clients. It is one thing to educate RR's on these matters but it is another thing to train them to explain the issues and risks to clients. We appreciate that it can be a huge task to explain complex ideas to the average person. However, we don't think it should be distilled to "You have to take these risks to generate the return you need" which indicates to us that it is the RR making the decision for the client. The conversation should instead be "Here is what could happen, so are you comfortable with this or not?" so the client is making an informed decision with full knowledge of the potential outcomes.

Robust continuing education

There must be a meaningful continuing education requirement. Firms must ensure appropriate training is provided so RR's remain competent. We recall that back in 2012, Laurentian Bank Securities Inc. admitted that it failed to offer training to give its supervisors sufficient knowledge to adequately supervise the trading of leveraged ETFs in retail client accounts and was fined $140K. IIROC (and Firms) also need to monitor and assess regularly the training's effectiveness to ensure it meets objectives.

One important area involves the CSA initiative (trusted contact/holds) on the protection of seniors and vulnerable investors. We expect this will require RR training once it becomes law.

COVID-19 driving Work-at-home advice giving

There may be some training required to accommodate the work-at-home protocol as it appears this method of working could become a permanent fixture of the advice industry. Use of video conferencing, digital signatures, security, privacy protection, record retention etc. are some of the changes that need to be addressed.

The rise of indexing

From our perspective, there needs to be more training on index funds and ETF's which are fundamentally different than 99% of funds offered. Product competency must include knowledge of this rapidly growing style of investing. Another major shortcoming is the complete lack of sensitivity training regarding the long term impact of costs which, as research shows, consumes 50% of the returns of many mutual funds. We believe this would lead many RR's to move more clients to lower cost products and boost their long term returns.

Regulatory exemptions

Each year, IIROC grant hundreds of regulatory exemptions. In effect, rules are modified or waived to suit particular circumstances. Of particular concern are exemptions related to proficiency. **We recommend that IIROC review the process for granting relief to confirm that such continued granting of exemptive relief protects investors and is in the Public interest.** If all these exemptions are valid, it raises the question whether the basic rulebook is up-to-date or properly written. Reference on IIROC exemption volume https://www.iiroc.ca/Documents/2020/1c8ed9e3-6abc-4996-a0c1-bb15d6e1e400_en.pdf

The impact of technology on RR's

A recent CNBC article [Technology is redefining that client-financial advisor relationship] identified a range changes impacting the required skill set of RR's. It may not be inappropriate for IIROC to require an education module on technology given the changing client-RR relationship.

FSRA liaison

Kenmar recommend that IIROC work closely with the FSRA as they wrestle with the proficiency aspects related to the implementation of the Ontario Financial Professional Title Protection Act. In order to prevent investor confusion, IIROC should ensure that its competency profile is equal to or higher than the FSRA proposal. If this is done it would ensure that IIROC advisors could hold the Financial Advisor (FA) title in Ontario and IIROC recognized as a FSRA approved credentialing body.

Summation

The proposed competency profile is well presented and has no identifiable gaps. We do however believe that consideration of some of the points we have raised might bolster the proposal further.

While technological advances are allowing RR's the freedom to focus on big-picture thinking, it's important to be aware of how these changes will reframe the types of education RR's need. This means looking ahead at what skills are most likely to be valued over the next two decades. When computers are doing more of the actual 'doing' in the economy, what's the thing that's valuable from other people's point of view? The answer in our view, at least for now, is the human element of financial services and the willingness to face those challenges head on. RR's are going to face a lot more of the hard questions and the hard conversation. By focusing on clients' needs and the more human aspects of the practice, RR's can embrace the changes new technologies bring to the field.

Unfortunately, competency requirements won't change the fundamental conflict for those advisors whose compensation is dependent on the products they sell and won't influence ethics.

As an aside, there may be need for a financial registration category for a fee-only advisor working to a fiduciary standard.

Kenmar hope the input is useful to IIROC in its deliberations on this important socio-economic issue.

Approval is granted for public posting of this letter.

We look forward to meeting with the IIROC to discuss this letter in more detail.

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Kenmar Associates

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Earning Investors' Trust: How the Desire for Information, Innovation, and Influence Is Shaping Client Relationships https://trust.cfainstitute.org/wp-content/uploads/2020/05/CFAI_TrustReport2020_FINAL.pdf According to this April 2020 CFA Institute study, advisors and Firms have to improve their trust with clients. In Canada, trust in financial services was unchanged in the latest survey, with just 51% of respondents saying they trust the industry. A decreasing percentage of respondents said their advisors were their most trusted source of advice: 59% of investors compared to 65% in 2018.

The market for financial advice
Higher standards and greater accountability for Title holders should increase investor welfare and support the benefits of confidence in Titles, but only if the Titles are supported by best interest/fiduciary standards. Fiduciary Duty and the Market for Financial Advice
https://www.law.nyu.edu/sites/default/files/Manisha%20Padi%20Fiduciary%20Duty%20and%20the%20Market%20For%20Financial%20Advice.pdf