SIPA
SMALL INVESTOR PROTECTION ASSOCIATION

A Voice for Small Investors
Seeking Truth and Justice

October 24, 2015

Via email to sgreenglass@osc.gov.on.ca

Ms. Susan Greenglass
Manager of Market Regulation
Ontario Securities Commission
20 Queen Street West, 22nd Floor
Toronto, ON M5H 3S8

Dear Ms. Greenglass:

It is our understanding that the Ontario Securities Commission (OSC) has oversight responsibility for the Investment Industry Regulatory Organization of Canada (IIROC). We recently read an IIROC announcement that a former Montreal based advisor will go before an IIROC Hearing Panel for allegedly taking funds from a client's account. The client had been dead for four months, according to IIROC, and worse still, the client was the registered representative's spouse. This incident finally inspired us to publicly speak out against IIROC's proposed rule that would allow registered representatives (RR's) to act as trustees (T) and executors (E).

The Small Investor Protection Association (SIPA) wishes to comment on the proposed amendments to Dealer Member Rule 43 and Dealer Member Rule 18.14 with emphasis on the executor appointment provisions. The amendments expand the conditions under which a RR can act as an Executor or Trustee to administer the estate of a person who was not related to the RR, provided the RR who carries out the role of E/T does not also have control of the testator or settlor's accounts with the Dealer Member ("dealer") in their capacity as an RR.

Our analysis of this proposal suggests that it is seriously flawed - published and unpublished commentary from other investor advocates is consistent with this viewpoint. The OSC IAP has also expressed concerns about such appointments. They stated *"The Panel is concerned that most clients and their beneficiaries will not understand that the responsibility and liability rests solely with the E/T, personally. How will this be effectively communicated and acknowledged? For example, will the E/T be prohibited from referencing the DM on letterhead or using their normal business title?"* This is just one of many issues that need careful reflection before approving these proposed amendments.

One reason why a client might appoint a RR as an executor could be that he/she believes they will be protected by IIROC. So what duty does the IIROC actually have to an investor? NONE. see *Morgis v. Thompson Kernaghan*. The Ontario Court of Appeal ruled that the IDA (now IIROC) has "no private law duty of care to individual investors." It could very well be that if clients understood this they might

not appoint RR's as executors. We expect that dealers would feel duty bound to disclose to the client the true role of IIROC before deciding on an appointment.

In a IIROC brochure *Why IIROC matters to you , the Investor* we observe the following quote *"*Use of the word Advisor – what this means: In this investor brochure, we have used the general term "advisor" to refer to a number of official regulatory approval categories such as Registered Representative and Investment Representative. Please note that "advisor" is not an official IIROC approval category for individuals working at IIROC-regulated firms. "Advisor" is also not being used in this brochure to represent an official registration category."*

It is our firm conviction that the use of the term "advisor" misleads clients into believing they are dealing with a fiduciary. Furthermore, a January 2013 IIROC sweep of titles and designations found titles such as Financial Consultant, Wealth Advisor, Private Client Principal ,Retirement Specialist, Consultant to Seniors, Vice President, Senior Vice President, and Managing Director. It appears to us to be reasonable that an unsuspecting client would assume that such people can be trusted as executors. In fact, we know that most titles are not representative of the skill set of the RR or his/her hierarchical level at the dealer. Again, we would expect the dealer to clarify the meaning of the RR's title as part of the approval process.

SIPA do not believe the stated conflict-of-interest controls are adequate. Even the IIAC stated in its Comment letter *"The IIAC and our members recognize that assignment itself may not be sufficient in all circumstances to appropriately address the conflict of interest…"* and would be required to establish additional controls. Such controls would presumably include a thorough assessment of the situation by senior personnel including an assurance that the client is fully cognizant of the consequences of an appointment and is competent to make such an appointment.

It should be noted that independent research shows that RR's as a general observation are not required to provide advice that is in the best interests of clients. Using unique data on Canadian households, independent researchers assessed the impact of financial advisors on their clients' portfolios. They found that advisors induce their clients to take more risk, thereby raising expected returns. On the other hand, they found limited evidence of customization: advisors direct clients into similar portfolios independent of their clients' risk preferences and stage in the life cycle. An advisor's own portfolio is a good predictor of the client's portfolio even after controlling for the client's characteristics. This one-size-fits-all advice does not come cheap. The average client pays more than 2.7% each year in fees and thus gives up all of the equity premium gained through increased risk-taking. See Retail Financial Advice: Does One Size Fit All? http://www.nber.org/papers/w20712 Given this data, we are surprised that IIROC wishes to extend the reach of RR's into the accumulated savings and assets of Canadians.

Besides the Best Interests issue there is also the issue of dealing with seniors who are the most likely candidates to make such appointments. For good reason, seniors are often placed in the vulnerable investor category. Financial exploitation is the most common form of elder abuse, accounting for about half of cases. Physical and cognitive impairments, such as diminished mental capacity must be assessed. Often there is no sudden onset and RR's and dealers are confronted with the daunting task of determining the point in time where gradual degeneration has become an issue. Dealers would not only have to validate that the appointment is an informed one but also that the client is mentally competent to make such a critical decision. This is a task that would need to be carefully executed and documented by qualified staff other than the RR.

While a RR acting as a trustee or executor would be considered to be engaged in Outside Business Activities and make the necessary disclosures and filings, this offers no protection for the client. SIPA have seen dealers walk away from OBA complaint cases claiming Zero accountability when the approved OBA goes terribly wrong.

The proposed change is based upon the assumption that conflicts-of-interest can be monitored within a dealer. However, that pertains only to the accounts of the testator or settlor that are held with the Dealer Member. There would be no safeguards/oversight if the RR simply transfers the assets elsewhere where they are managed under unknown protocols. In any event, there appear to be many supervisory challenges in the industry as evidenced by IIROC enforcement reports, OBSI findings and our own observations and experiences.

SIPA notes the challenges IIROC dealers currently face in overseeing and managing existing conflicts of interests and sees no good or just reason to expanding the list of hazards. On the cash outflow side, dealers would need to establish controls to prohibit funds going out to anyone other than the "Estate" or the beneficiary of the trust. We assume that dealers have such legal rights under provincial and Federal laws.

Additionally, dealers will need to implement controls that limit the number of clients that any one RR will be allowed to handle as an executor. They will also need to check whether the RR has been named as a beneficiary and has in fact been identified as the sole executor. No doubt many unforeseen control requirements will emerge. . In effect, dealers will be expending time and effort without any economic return. Moreover, dealers are in the midst of implementing CRM2 and other regulatory changes that requires their full attention. Diverting precious resources to this controversial, risky activity makes no sense to us.

The influence that a registered representative has over a client is considerable especially one that is elderly and possibly vulnerable to suggestion. The Ontario Securities Commission has recently pointed out several deficiencies in IIROC

governance and complaint handling processes. SIPA has for a number of years expressed concerns about IIROC's loose connection to the needs of retail investors and this proposed rule further exposes the gap.

For instance, IIROC refuses such investor-friendly gestures as including their logo on confirmation slips and account statements. Their poor processing of client complaints has reached a disturbing level. We have pointed out deficiencies in the complaint handling rule, wrist slap fines and a bias to prosecute RR's rather than dealers. More recently we have observed a lax approach to senior investors and a tepid response to the OSC's mystery shopping report. This proposal is consistent with a complete lack of sensitivity to the investor protection needs of Canadians.

From our viewpoint it appears this proposal gives RR's license under securities law to act as executors to members of the public without reference to necessary proficiencies, professionalism, or experience. In effect, IIROC is creating permission for unregulated activity that is well outside the terms of its Recognition Order and mandate.

We believe this proposed rule change will have the following adverse consequences:

The account would be transferred to another registered representative who will have to start over again with understanding the needs of the client This should be troubling for the OSC as professional advisers regard the final phase of the investor's investment life cycle as the most important. When the account is transferred to a new RR at this late stage many risks seep into the relationship that could have serious consequences for the estate and its beneficiaries.

The existing clients of the registered representative would likely see a decline of service while the registered representative deals with the many time-consuming tasks involved with being an executor. If there are disputes or contestations the time away from work could be very significant.

Most retail investors lack the knowledge to make an informed decision regarding the appointment of an RR as a trustee/executor. For instance they may not be aware that the RR has previously been sanctioned, does not carry executor insurance or is not familiar with estate law, tax rules or accounting. Most vulnerable investors (seniors, widows) are not aware of the risks associated with delegating such duties to individuals who have been providing investment advice under a non-fiduciary advisory regime. Most Canadians are not aware that Financial Advisors are in fact commission driven sales person and as such are not required to look after client's best interests. Thus, their decision to appoint a RR as an executor is likely not to be an informed one.

The estate would be exposed to abuse especially if the deceased has no family or relatives. In July, 2015 FINRA barred former UBS Financial Services and Morgan Stanley broker John Anthony Waszolek of Scottsdale, Arizona for appointing himself

successor trustee and attempting to collect a multi-million dollar inheritance from a deceased elderly client and Alzheimer's patient who had been with Waszolek for over 30 years. Ref http://www.investorclaims.com/documents/John-Anthony-Waszolek-COMPLAINT.pdf

RR's who act as trustees, even with the best of intentions, could also face legal consequences for not acting in the best interests of the trusts or their beneficiaries The RR would be exposed to liabilities and legal action that would further divert his/her attention of providing investment advice to clients. Clients often attempt to keep executors from the risk of personal liability by inserting an exemption clause into a will or trust document. Typically, the clause reads something like this*: "No trustee acting in good faith shall be held liable for any loss, except for loss caused by his or her own dishonesty, gross negligence or a willful breach of trust."* Recent court cases show that this provision can be struck down in civil litigation.

With the dealer in the approval loop, the dealer could be exposed to liabilities in the event the will is improperly administered or is challenged by third parties.

If the rule is implemented regulatory arbitrage will be created between IIROC and MFDA dealers (who are prohibited from allowing such appointments). The MFDA consider the prohibitions fundamental to responsible securities regulation. The penalties for contravening applicable regulations vary greatly according to the severity of the infraction. The MFDA can impose a reprimand, monetary penalties of up to $5 million, and/or suspend someone's involvement in the industry, either temporarily or permanently.

The negative impact such a rule could have on the industry and regulators were something to go off the rails could be significant.

We believe that if the client is unable or unwilling to appoint a family member or friend than the best alternative would be to use a professional estate firm such as a trust company. If there are no family or friends and the client feels they may become incompetent to handle the account they can take steps to have the provincial Public Guardian take over the account. Another choice would be to have the RR act as an advisor to the executor providing the RR received appropriate credentials such as those from the Canadian Institute of Certified Executor Advisors (CICEA).

It is difficult to see any upside for a responsible dealer or RR to be involved in such an arrangement. In fact, this rule would most appeal to RR's with mal-intentions and/or an insatiable greed for fees. Such RR's place the assets of a client in harm's way. We see only downside and considerable risk for all participants if this rule change is approved by the Ontario Securities Commission.

We conclude with this comment from Mark O'Farell, president of the Canadian Institute of Certified Executor Advisors "*I think people who are thinking of taking on an executor might think the advisor is suitable because they have knowledge of the estate's taxes and investments. Personally I think it is a big mistake. I don't think the advisor is suited to act as an executor*."
http://www.wealthprofessional.ca/news/a-sober-second-thought-on-advisor-as-executor-177920.aspx

The proposed change introduces a new and unmanageable conflict-of-interest situation that is contrary to public interest. We urge the Commission to disapprove this proposed rule change.

Sincerely,

Stan I. Buell
President
Small Investor Protection Association