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Rule Consolidation Project –Phase 4
Rule Consolidation Project – Phase 4 | Canadian Investment Regulatory Organization

Given the breadth of this consultation, Kenmar has prioritized issues that we believe are most critical to enhancing retail investor protection and fostering trust in the regulatory framework.

Kenmar Associates is an Ontario-based privately-funded organization focused on investor education via articles hosted at www.canadianfundwatch.com Kenmar also publishes the Fund OBSERVER on a monthly basis discussing consumer protection issues primarily for retail investors. Kenmar is actively engaged with regulatory affairs. An affiliate, Kenmar Portfolio Analytics, assists, on a no-charge basis, abused consumers and/or their counsel in filing investor complaints and restitution claims.

Commentary

2.1 Additional account types and services we are proposing to allow mutual fund dealers to offer

Adding margin to a mutual fund Dealer's services has a number of implications not the least of which is retail investor protection. The MFDA utilized prescriptive requirements for assessing suitability of leverage and CIRO are moving to a principles based regulation. The MFDA requirements proved to be very effective at curbing unsuitable leveraging. Kenmar recommend retention of a prescriptive regulatory framework for this high risk/ high investor impact investing strategy.

2.5.4 Personal financial dealings – Settlement agreements without the Dealer Member's approval

The IDPC Rules specify that entering into a settlement agreement and/or paying for client account losses out of personal funds without the Dealer Member's prior written consent are both prohibited personal financial dealings. Although the MFD Rules do not address these activities, MFD guidance dealing with personal financial dealings specifies that no Approved Person may enter into any settlement agreement with a client without prior written consent of the member. We believe

the IDPC Rule restrictions are reasonable and propose to adopt this provision. (DC Rule clause 3110(2) (ii))

The IDPC restrictions are not reasonable. We believe that since the account Agreement is between the client and the Member, the resolution of the complaint is the sole responsibility of the Member. An AP is a representative of the Member. All complaints about investment services should be resolved in accordance with CSA, CIRO and the Member's complaint handling regulations /rules.

The final agreement must be between the complainant and the Member, regardless of the source of the compensation funds. Under no circumstances should the salesperson sign a complaint settlement agreement with a complainant client.

2.6.1 Know-your-client

We recommend adding **Trusted Contact Person** to core KYC information as fraud is now a major, and growing, investor protection issue.

2.8.1 Retail client suitability determination requirements

We have observed that a number of Dealers have limited their product shelves to proprietary products which could impair portfolio construction. Such restrictions could result in a situation where the Dealer's offering is unsuitable for an investor. As a minimum, in such cases, the Dealer Client Relationship Document should warn clients that the restricted product shelf may unduly constrain suitable portfolio construction in the best interests of clients.

2.8.3 Suitability of leverage strategies

We are concerned about the migration to a principle-based approach to regulation (trade supervision and leverage supervision) .In particular, on leveraging we strongly recommend the prescriptive approach be retained as leveraging is a high risk investing strategy and a principles-based approach could result in muted enforcement. Even if the prescriptive rules were transferred to guidance we feel enforcement would be more challenging.

2.10.1 Advertisements, sales communications and client communications

The updated rules should include all forms of modern ads, sales communications and client communications including in particular, social media. We note that the SEC has sanctioned Dealers for off-channel communications such as text messaging and email. The basis for the penalties were the Firms' failure to properly maintain and preserve such electronic communications, on personal devices used by their employees which impeded the SEC's ability to conduct investigations and enforce compliance with securities regulations.

Question #1 - Definition and application of "investment product"

Will the revised definition, and application of the term "investment product" provide additional clarity to the scope of Dealer Member obligations to clients? What additional investment products we consider obtaining Board approval to include in this definition? Are there different products that should be added for different regulatory purposes?

The definition appears to be very narrow. An "investment product" could include cash, cryptocurrency, a GIC, a PPN and a product necessary to comply with CFR best interests obligations .An "investment product" can involve deliverables like a financial plan, an ESG plan, tax planning, a portfolio strategy and assistance with charitable giving. The real issue is the prevailing practice of financial advising going well beyond securities and transactions. The term stockbroker has long ago given way to the title Financial Advisor. One can argue that an "investment product" is any deliverable provided to a client as part of the investment service agreement. These deliverables are delivered subject to CIRO rules and account Agreements. If these deliverables prove to be unsuitable, clients can file a complaint and if dissatisfied with the response, can escalate the complaint to OBSI.

Kenmar supports a broader definition of "investment product" that encompasses all deliverables provided under an investment service agreement by a CIRO regulated Firm. This approach aligns with evolving advisory practices and ensures comprehensive regulatory oversight.

Question #6 - Prohibition on accepting certain positions of control or authority over client affairs

Does the addition of the prohibition on an Approved Person or employee accepting a position of power of attorney, trustee, executor or otherwise having full or partial control of the affairs of a client have implications in respect of the relationship between the client and the Approved Person or employee? Should there be exceptions to this prohibition, and if so, under what circumstances?

Acting as POA for instance for property is a material conflict of interest. There are tremendous conflicts-of-interest and opportunities for client exploitation. We take no issue if the client is immediate family. In certain situations, a trusting, long-term relationship between a client and an AP may justify an exception. The default should be "NO", except for immediate family members. Otherwise, there should be a clear process to prove to the CCO that this is an appropriate arrangement. **Any exceptions should require rigorous oversight, including disclosure, independent approval, and periodic review.**

The designated Trusted Contact Person might be a permissible candidate. (NOTE: A client-designated POA can be named as a TCP, but clients are encouraged to select an individual who is not involved in making decisions with respect to the client's account).

In some cases, clients should be referred to the Office of the Public Guardian.

If approval is granted to accept Power of Attorney, whether the client is family or not, the best course of action is to have someone else manage those accounts as the designated account advisor.

Acting as an executor can be time consuming and could detract from serving other clients, so it's best to avoid the assignment except for immediate family.

We think it best to keep the client –AP relationship professional.

Question #7 – Prohibition on being named as beneficiary

Is it appropriate to prohibit an employee or Approved Person from accepting the status of a beneficiary of a client's estate or receiving a bequest from a client's estate upon learning of such status unless they are a member of the client's immediate family?

This portion of the comment letter has been prepared by Mr. H. Naglie, a respected individual in the investor protection space.

Arguments in Favor of Prohibition

1. **Preservation of Professional Integrity and Objectivity**
   Allowing employees or APs to accept a beneficiary status or bequests may compromise the impartiality of the professional relationship. The financial incentive could influence the advice provided, prioritizing personal gain over the client's best interest. This would undermine the fiduciary duty owed to the client.
2. **Prevention of Exploitation and Financial Abuse**
   Senior clients, who are often more vulnerable due to cognitive decline or isolation, may be particularly susceptible to undue influence or coercion. A prohibition acts as a safeguard against financial exploitation, a growing concern in the financial services industry.
3. **Maintaining Public Trust in the Industry**
   The financial advice profession relies heavily on public confidence. High-profile cases of exploitation could erode trust in the industry. A blanket prohibition simplifies enforcement and provides a clear standard, promoting consistency and reinforcing the profession's ethical standards.
4. **Administrative Simplicity**
   A clear prohibition eliminates the need for subjective assessments or investigations into whether a particular relationship is "trusting and sincere." This reduces the risk of regulatory breaches and simplifies compliance monitoring.

Arguments Against Prohibition

1. **Potential Violation of Individual Rights**
   A blanket prohibition could infringe upon the employee's or AP's personal freedoms and rights, including the right to inherit or accept gifts in legitimate, non-exploitative relationships. This could raise human rights concerns, particularly if the relationship predates the professional one or is demonstrably genuine.

2. **Discrimination Against Non-Family Relationships**
   Limiting exceptions to immediate family members may unfairly disadvantage other meaningful relationships, such as long-standing friendships or de facto familial bonds. This rigid approach may fail to reflect the diversity of personal relationships.
3. **Risk of Unintended Consequences**
   Clients may feel disempowered or restricted in their autonomy to decide how to distribute their estate. This could lead to dissatisfaction or the termination of the professional relationship, potentially leaving clients without adequate financial guidance.
4. **Case-by-Case Considerations**
   In certain situations, a trusting, long-term relationship between a client and an AP may justify an exception. Allowing some discretion, subject to robust disclosure and oversight mechanisms, could strike a balance between preventing abuse and respecting individual circumstances.

On balance, a prohibition on employees or APs accepting beneficiary status or bequests from clients, with an exception for immediate family members, appears to be the most prudent course. The risks of exploitation, particularly concerning vulnerable seniors, outweigh the potential benefits of a more flexible approach. However, the policy should be accompanied by a robust mechanism to address exceptional cases that align with human rights and ethical considerations. For instance, Firms could require disclosure, written client consent, and third-party review in rare circumstances where an exception might be warranted. This approach seeks to protect clients while acknowledging the complexities of individual relationships.

Conclusion

These measures align with international best practices, including the G20/OECD Principles on Financial Consumer Protection, which advocate for robust safeguards against conflicts-of-interest.

Kenmar believes the proposed prohibitions and definitions, with minor enhancements, will significantly advance investor protection. We urge CIRO to adopt these measures promptly and remain committed to supporting this important initiative.

A rule of prime importance to us is the rule regarding client complaint handling. It is not part of this consultation. In our view, both the MFDA and IIROC rules need to be modernized so as to better protect retail investors.

We hope the information provided proves useful to CIRO decision making.

Please feel free to contact us if there are any questions regarding our commentary.

K. Kivenko, President