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Disgorgement – Proposed Amendments to the Mutual Fund Dealer Rules

<https://www.ciro.ca/newsroom/publications/disgorgement-proposed-amendments-mutual-fund-dealer-rules>

I welcome the opportunity to comment on the proposal to bring mutual fund Dealers into the disgorgement rebate regime. The proposal makes it clear that mutual fund Dealer Hearings will now make disgorgement sanctions visible consistent with Investment Dealers. This will enable the system to disgorge ill- gotten gains from mutual fund Dealers and their representatives, and provide cash-received-back..... to harmed investors.

Disgorgement is a positive step forward in investor protection which I fully support.

However, there is a design flaw in the Hearing Process - as it only involves the sales representatives - and the process only permits disgorgement from the Dealer's Representative, the subject of the Hearing. The Dealer is immunized from disgorgement. So

this means and includes - that although supervision failed to impede the harm to investors, it can retain the fees it received from a rule breaking transaction effected by those it was supposed to have supervised. The investor - paid the fees directly to the Dealer.

As a fundamental principle, management and supervision are accountable for the activities of the representatives which they have recruited. Representatives are the public face of the Dealer. Empirical research has demonstrated that supervision can be conflicted when it receives compensation based on the sales performance of the persons who are supervised.

In a April 2017 Guidance note([IIROC Publishes New Guidance to Address Findings of Compensation-related Conflicts of Interest Review](#)) - IIROC reported a lack of comprehensive oversight of compensation programs - and their associated conflicts of interest by investment firms. The result of course is misconduct by representatives in pursuit of enriched compensation- which is also a supervisory management controllable issue.

IIROC Publishes New Guidance to Address Findings of Compensation-related...

Next steps include enhanced examination program

An August 2023 CSA-CIRO review (<https://www.ciro.ca/newsroom/publications/joint-canadian-securities-administrators-canadian-investment-regulatory-organization-staff-notice-31>) found that 28% of Firms had inadequate controls to address certain material conflicts of interest - which are not in the best interests of clients who are not property informed - as a sales apparatchik.

A Ontario Securities Commission (OSC) and the Canadian Investment Regulatory Organization (CIRO) Report [Sales Culture Concerns at Five of Canada's Bank-Affiliated Dealers](#) - concluded it's clear that sales pressures and incentivization may be driving concerning behaviours. In their survey responses, representatives more often identified sales-related targets as the primary means to increase compensation, as compared with other factors, such as client feedback or referrals. And: who sets the sales targets supervision? **The bottom line** is that Dealer Management creates the conditions for Rep misconduct, and let their representatives take the heat when things go awry. This has to stop.

Accordingly, I recommend that CIRO restructure its rules regarding Hearings - such that when a Dealer representative has caused investor harm - "that any ill-gotten gains" be disgorged from the Dealer representative recruited by the Dealer(s) to produce the referenced unconscionable sales - as well as the Dealer(s) responsible for supervising that same representative.

This basic change will put much more money into the pockets of harmed investors, because disgorgement will be collected from the Dealer(s) even if CIRO fails to collect from the representative. It can also be expected to cause Dealers to alter their compensation practices, and other advice skewing incentives. The result will be enhanced supervisory practices in conformance with the Client Focused Reforms. It will also increase public confidence and trust in capital markets and CIRO.

In addition, I recommend that CIRO up its game on Disgorgement Order collections. The prevailing collection rates are nothing to be proud of.

Prompt public posting of this letter would be appreciated.

Respectfully,

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