



SOCIAL INVESTMENT ORGANIZATION

The Canadian Association for Socially Responsible Investment

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Sherry Tabesh-Ndreka, Policy Counsel
Investment Industry Regulatory Organization of Canada
121 King St. West, Suite 1600
Toronto ON
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Dear Ms. Tabesh-Ndreka:

Re: IIROC NOTICE – KNOW YOUR CLIENT AND SUITABILITY GUIDELINES

I am writing on behalf of the members of the Social Investment Organization, the national association for socially responsible investment (SRI). Our sustaining and associate members include 38 financial institutions, asset management firms, fund companies, investment consulting firms and credit unions. As well, our membership includes advisors, consultants, lawyers and non-profits from across Canada. Our members are committed to the development of socially responsible investment, which is the integration of social and environmental considerations into the selection and management of investments. Our members serve more than a million Canadian depositors and investors.

With this letter, we are responding to the recent request for comment on the guidance note, entitled *Know your Client and Suitability Guidelines*.

Let me take this opportunity to commend IIROC on this initiative. The events of the last 18 months demonstrate strongly that advisors need to take care in assessing client suitability, and to obtain sufficient knowledge of recommended products to ensure that clients are appropriately matched with products.

However, we want to raise a matter that we feel is a major deficiency in your guidelines; namely, the lack of guidance on the assessment of client suitability on environmental, social and governance (ESG) issues. There is significant client demand for investments that reflect personal values on ESG issues. There is strong evidence that the majority of Canadians are demanding investments that take into consideration non-financial impacts, as well as traditional parameters of risk and return. Yet current know your client and know your product practices fail to take account of these client preferences, with the potential result that there could be a mismatch between client preferences and investment product recommendations.

We believe your guidelines should include guidance on assessing the ESG preferences of clients, as well as matching these preferences with appropriate products.

Background

Investors in Canada and around the world are becoming increasingly interested in environmental, social and governance (ESG) considerations in securities selection and portfolio management.

This has been prompted by recent concerns with climate change, as well as long-standing awareness of issues such as sweatshop labour, product safety, employee relations, and a host of other social and environmental concerns. It is clear that Canadians want investments that reflect their concerns not just as investors, but as members of families and communities, and their values as citizens and consumers in the world.

This has been borne out by many studies on investor attitudes during the last few years. For instance, in Canada, GlobeScan has conducted a number of investor attitude studies on a host of topics, including the views of retail investors on the social responsibility aspects of their portfolios. (For a summary of this research visit http://www.socialinvestment.ca/SIO_pres_GlobeScan_.pdf) This research reveals:

- Nearly nine out of ten investors believe the financial community should pay more attention to social and environmental performance when valuing companies
- More than nine out of ten investors agree that corporate CEOs and Boards should monitor the performance of their companies on corporate social responsibility
- More than three-quarters of investors are interested in learning more about the social performance of companies in their portfolio
- More than three-quarters of investors believe that corporate social responsibility reporting is an important factor when making an investment decision

Yet, in spite of this overwhelming desire for more information on the social and environmental performance of investments in their portfolios, most Canadian advisors fail to incorporate non-financial considerations into their clients' suitability assessments. Research shows that they fail to take even the first step – which includes an inquiry into their clients' ESG concerns. This is illustrated by GlobeScan research showing:

- Sixty-six per cent of investors have not considered or had a discussion with their financial advisor about the corporate social responsibility performance of companies in their portfolio
- A further 11 per cent have considered the issue, but not brought it up with their advisor
- Thirteen per cent have brought the issue up with their advisor, and one per cent said that both they and their advisor have brought it up
- Only eight per cent of advisors have brought it up with their clients.

We believe that this lack of advisor inquiry into social and environmental concerns by their clients represents an important gap in the client suitability assessment process. Just as it is absolutely essential to assess client suitability on issues such risk tolerance and investment horizon, it is also critical that advisors determine client preferences on ESG issues.

The failure to inquire about a client's preferences on ESG considerations raises the very real possibility that advisors are executing investment plans without knowledge of client concerns on ESG matters. In the draft guidance document, you state clearly that "suitability needs to be considered in light of other investments within the client's account or portfolio, and in relation to his/her financial condition, investment knowledge, investment objectives and risk tolerance."

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We believe that ESG preferences are an important component of a client's investment objectives, and need to be clearly articulated by the client to the advisor so that the advisor can recommend appropriate investment products based on these ESG preferences.

This is not to assume that all clients will want to incorporate ESG considerations into their portfolio. Many will declare disinterest in the concept. In this case, the assessment by the advisor should be that ESG considerations are not important to client suitability, or that other issues are clearly more important.

However, for clients who does express an interest in ESG considerations, it is important for advisors to identify this in their Know Your Client assessment, and to keep this in mind in terms of recommending appropriate products.

Model of best policy – Australia

In terms of best guidance on this matter, we commend to you the model in place in Australia, as set out in Regulatory Guide 175, Financial Product Advisors – Conduct and Disclosure, established by the Australian Securities and Investments Commission (ASIC) ([http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg175.pdf/\\$file/rg175.pdf#4](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/rg175.pdf/$file/rg175.pdf#4))

Reg. 175.124

What inquiries about environmental, social or ethical considerations should be made?

Providing entities must form their own view about how far s945A requires inquiries to be made into the client's attitude to environmental, social or ethical considerations. However, as a matter of good practice (and irrespective of any current legal requirement), providing entities should seek to ascertain whether environmental, social or ethical considerations are important to the client and, if they are, conduct reasonable inquiries about them.

From: Regulation 175.124, Australian Securities and Investments Commission, Regulatory Guide 175, Licensing: Financial product advisers—Conduct and disclosure

The regulatory environment on socially responsible investment in Australia is the best in the world, supported by a broad consensus among industry associations, ASIC and legislators from different political parties that disclosure on environmental, social and governance considerations should be mandated. As a result, ASIC has instituted guidelines for such disclosure not only for advisors in their relationship with clients, but in the product disclosure statements of investment funds under ASIC jurisdiction.

We believe the Australian approach has a lot of value and wisdom. It mandates that inquiries should be made, but does not specify a checkbox approach. It also suggests that the general client suitability rule does pertain here, but leaves it to the advisor to determine the importance of social, environmental and ethical considerations for any given client. This encourages advisors to become engaged with their clients on social and environmental issues, not just to regard this matter as an isolated compliance requirement.

In the following, we recommend a similar approach to IIROC to include in your suitability guidance.

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Recommendation

We recommend the following:

- That you add a statement in your guidance document to note the importance of determining client preferences on environmental, social and governance considerations. The wording could be similar to the ASIC reg. 175.124, except that we would recommend the use of the term “environmental, social and governance considerations” rather than “environmental, social and ethical considerations,” as stated in the ASIC guideline. The term ESG has much broader current usage than environmental, social and ethical considerations.
- That you add a reference to environmental, social and governance considerations in Form 2, under IROC Dealer Member Rules. This will clarify that advisors must make inquiries on ESG preferences on the New Account Application Form, whether it is done on paper, or electronically.
- You should also give consideration to drafting a Guidance Note specifically on ESG investments that would clarify advisor obligations to match appropriate investments with client ESG preferences.

Conclusion

Clients are increasingly asking for ESG information, and the investment industry is responding. Yet, evidence shows that the majority of advisors are not making inquiries into their client’s views on these topics, which prevents them from fully assessing client suitability.

We believe that this is an important gap in the client relationship model. Increasingly, the relationship between advisors and their clients is based on more than just financial considerations; there are growing demands on advisors to take a holistic approach to their clients’ needs and to know their clients in depth.

We urge you to implement these recommendations. Advisors, clients and the general public will benefit from them.

Sincerely,



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