November 25, 2005

VIA COURIER

Task Force to Modernize Securities
Legislation in Canada
Suite 1600, 121 King Street West,
Toronto, Ontario M5H 3T9

Attention: **Thomas Allen, Q.C.**
Task Force Chairman

Dear Sirs:

Re: Task Force to Modernize Securities Legislation in Canada; Comment Letter

I am writing this letter in response to your October 5, 2005 invitation for comments on securities regulations which need to be either modernized or enhanced. It is my opinion that one such regulation, the "suitability" rule, should be considered by the Task Force for the foregoing reasons. The suitability provisions are a key area of securities legislation, and as such the precise meaning and application of the rule should be considered in any event, given Task Force's Mandate.

Suitability provisions are contained in IDA regulations (see IDA Regulation 1300.1 (q)) as well as in provincial securities legislation (the statutory provision in British Columbia is set out in subsection 48(1)(b) of the B.C. *Securities Rules*). The essence of the obligation imposed under these regulations, ignoring some significant wording differences, is that a salesperson and a full-service dealer must only recommend "suitable" (or "appropriate") securities to each client, and only transact trades in "suitable" ("or appropriate") securities on behalf of each client.

In my opinion, there are several reasons why it is both timely and important for the Task Force to consider the suitability rule. First, a significant proportion of all complaints made to the IDA involve suitability issues. Given this recurring statistic, there must be a significant problem associated with the provision. Second, it is my observation that quite often, the word "suitable" means different things to different salespersons. Salespersons thus apply the requirement in different ways. A related observation is that compliance

11th Floor, Three Bentall Centre, 595 Burrard Street, P.O. Box 49049, Vancouver, B.C. V7X 1C4
Tel (604) 443-5400 Fax (604) 443-5401

personnel often differ in their interpretation of the word, and therefore apply varying standards in their supervisory reviews. Third, there is with the current construct of the rule, a significant "hindsight" element for the simple reason that suitability invariably only becomes an issue after a particular trade has been made, and then only under circumstances if the value of the security in question has decreased in the intervening time period.

So far as I can tell, the suitability rule was first promulgated by the NASD in 1939. According to one US legal commentator, the origin of the suitability concept is "somewhat unclear" (see Cohen, "The Suitability Doctrine", *The Journal of Commerce* (Summer 1978) page 533 at 540). One would have thought that the origin of such a significant concept would have been tolerably plain. Perhaps this is one reason why in my opinion the concept, and therefore the current requirement, is so confounding.

The words "suitable" and "appropriate" are not defined in the applicable Canadian securities regulations, nor have any Canadian legal journal articles analyzed the concept. The concept of suitability has however been discussed in several recent US legal journal articles. It is described as "somewhat nebulous and amorphous with respect to its content and parameters" (see Lowenfels and Bromberg, "Suitability in Securities Transactions", *The Business Lawyer* (August 1999) page 1557 at 1557). Cohen (referred to above) says at page 534: "There is no accepted definition of the broker's duties under suitability rules...[and] *suitability remains an amorphous concept*" (emphasis added). Another US author is more blunt (see Rapp, "Rethinking Risky Investments for the Little Old Lady" 24 *Ohio Northern University Law Review* (1998) page 189 at 212): "The legal concept underlying a broker's suitability obligation has never been neatly articulated. [There is] no accepted definition...*the scope of a broker's suitability responsibility is entirely unclear.*" (emphasis added).

The British Columbia Supreme Court recently considered the statutory provision. In *Quantum Financial Services (Canada) Ltd. v. Yip* (1998) D.L.R. (4th) 155, the court (at paragraphs 102 and 103) said: "Rule 48 of the Securities Act requires the broker to have reasonable, not perfect knowledge of the client's financial situation, investment goals and *overall* suitability for trading. The authorities in British Columbia indicate that a broker is *not obliged* to "put his nose into his client's business..." (emphasis added) Quoting *Varcoe v. Sterling* 10 O.R. (3d) 574, the court (at paragraph 90) noted that "suitability is governed by the amount that the client can afford to lose in a risky business without doing significant harm to financial obligations or lifestyle." These judicial determinations vary significantly from the manner in which the securities regulators, noteably the IDA, interpret and apply the subject provisions.

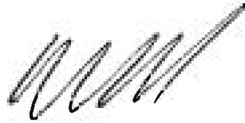
In the result it seems reasonably apparent that the general purpose of the concept has not been formulated to any significant degree. This is likely one of the reasons why the meaning of the rule varies and why its application seems so confounding. In addition to these issues, an inherent issue is the one set out in the Task Force's Mandate, namely who should be responsible for deciding a client's "risk appetite" – the investment advisor or the client? In other words, should an investment advisor be responsible for

recommending and trading only “suitable” securities or should the advisor be responsible for only ensuring the client understands what are “suitable” securities?

For me to proceed further at this point would be presumptuous, since it will be up to the Task Force to determine whether it will consider the issue. To the extent it does, I would be pleased to provide further input into the topic.

Yours very truly,

GLOBAL SECURITIES CORPORATION



Douglas R. Garrod
President