IIACACCVM
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Via Email

October 5, 2016

British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission (New Brunswick)
Registrar of Securities, Prince Edward Island
Nova Scotia Securities Commission
Superintendent of Securities, Newfoundland and Labrador
Registrar of Securities, Yukon Territory
Registrar of Securities, Nunavut

Attention: Robert Blair, Secretary (Acting)
Ontario Securities Commission
Suite 2200 -20 Queen Street West
Toronto, Ontario M5H 3S8
comments@osc.gov.on.ca

Me Anne-Marie Beaudoin, Corporate Secretary
Autorité des marchés financiers
800, rue du Square-Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal, Québec, H4Z 1G3
consultation-en-cours@lautorite.qc.ca

Dear Sirs / Mesdames:

Re: Proposed Amendments to NI 31-103 and its Policy – Re. Client Relationship Model Phase 2 (CRM2) Amendments

The Investment Industry Association of Canada ("IIAC")[1] appreciates the opportunity to comment on the proposed CRM2 Amendments to NI 31-103. Further to the reference in the consultation paper to

[1] The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 132 investment dealer member firms that are regulated by the Investment Industry Regulatory Organization of Canada ("IIROC"). These dealer firms are the key intermediaries

proposed amendments which range from "technical adjustments to more substantive matters", we have identified what appear to be substantive changes introduced with the CRM2 Amendments that have been included as "additional guidance" in the Companion Policy to NI 31-103 (the "CP"). We wish to highlight that there does not appear to have been corresponding rule amendments to substantiate the proposed new CRM2-related requirements and that the proposed disclosures may be unnecessary. The CRM2 regime was structured to provide the appropriate disclosures at the appropriate times, however we are concerned that that these changes do not clearly align with that objective. We appreciate that our members would be exempt from the requirements, however we are concerned that there would be follow-on changes to the rules of self-regulatory organizations (SROs).

CP Section 14.2 - Relationship Disclosure (RD) Information and Disclosure of charges and other compensation

The first paragraph of CP section 14.2 indicates that there must be disclosure in the RD document of whether a firm "exclusively or primarily invests its clients' money in securities issued by a related party". This appears to be related to the requirement to provide "a general description of the products and services the registered firm offers to the client". In this regard, however, we request clarification of the new language added to the section by specifying which definition of "related party" applies. We suggest that it may be more appropriate to change the reference to "related issuer or connected issuer".

In addition, a new reference is made in the guidance to including information in the RD document about "commissions paid by issuers", "bonuses from affiliated companies", and "amounts a client might pay when holding an investment including management fees associated with mutual funds". The requirements regarding relationship disclosure[2] focus on disclosure of amounts the client will pay for their investments. Affiliate bonuses, new issue commissions and management fees associated with mutual funds are not amounts paid directly by the client for their investments. As such, this proposal would expand the scope of the current relationship disclosure requirements and necessitate change to the relationship information already provided to clients, although in our view, it would not be useful.

We believe that the current structure of relationship disclosure is suitable and disclosure of the subject items is already effectively delivered to clients by appropriate means and at the appropriate times. In particular, the disclosure of referral arrangements as part of general conflicts disclosure in the RD information or other associated account documents, would appear to already capture "affiliate bonuses" as a form of compensation related to referral arrangements. We believe that the conflicts of interest information provided by firms in this regard is comprehensive and effective. Further, the commission paid

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in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations that is fundamental to economic growth.

[2] See IIROC Dealer Member Rule 3500.5.

by issuers, is, in the case of new issues specifically, already to be disclosed in the annual fee/charge report provided to clients, as third-party compensation, together with all fees the firm receives from third-parties. Non-securities products that have associated commissions paid by issuers would be outside the scope of the CRM2 requirements. Finally, fees that impact the profitability of a client's investments such as the management expense ratio (MER), are required to be disclosed in the context of pre-trade disclosure of charges before a dealer accepts an instruction from a client to purchase or sell a security. We believe the most effective and appropriate manner for this disclosure to be delivered is through the advisor prior to a transaction, rather than to include in the RD document which the client may not in any event link to a specific transaction. Moreover, the client will receive disclosure of the trailing commission portion of the mutual fund management fees that the dealer receives, in the annual fee/charge report.

CP Section 14.17 - Report on Charges and Other Compensation

i) *Disclosure of employee bonuses in annual report* - The guidance indicates that the disclosure requirement includes any form of payment to the firm or representative of the firm linked to registrable services, including "employee bonuses". We submit that it is extremely challenging, if not impossible, to identify the quantum of the employee bonus on a "per-client" basis for the purpose of reporting as a line item in the annual report. We also do not believe it would be appropriate to disclose an employee's entire bonus on the annual report as this would be not specifically linked to any client transaction and would be misleading to clients. It also isolates private employee-specific compensation information which would raise a privacy issue, and goes beyond the CRM2 requirement to disclose compensation the firm receives. This type of "incentive" compensation is already appropriately disclosed as a potential conflict in the RD information or other associated account documents at the outset of the relationship and should not also be included in the annual fee/charge report which would be a new substantive requirement. Firms have also finalized their implementation of CRM2 requirements and would not have collected the necessary data nor would vendors have developed programs to process it.

ii) *Disclosure of non-cash incentives in annual report* - In respect to the consultation question on including in the annual fee/charge report a note disclosure concerning non-cash incentives such as promotions or other employment benefits as "potentially influencing representatives to recommend one investment over another", we similarly note that disclosure of this type of "incentive" is already captured in the RD information or other associated account documents. We do not believe it would be useful to add note disclosure in the annual report after the fact of client having transacted in the investments and as it may not even be linked to any specific client transaction and be misleading to clients. We believe the appropriate delivery of the disclosure is at the outset of the relationship in the description of potential conflicts of interest.

iii) *Disclosure of embedded fees paid to issuers in annual report:* In respect to the consultation question regarding adding note disclosure concerning embedded fees paid to issuers such as mutual fund management fees in the annual fee/charge report, we note again that this is already required in the

context of pre-trade disclosure of charges before a dealer accepts an instruction from a client to purchase or sell the security. We believe that is the most effective and appropriate means to deliver the disclosure to the client, rather than disassociated from the transaction in a long or complex document, as noted in respect of the proposed change to RD information in CP section 14.2. We also request clarification as to whether the disclosure proposed would have to be provided for mutual fund series designed to be held in in fee-based accounts, i.e. F-class funds.

CP Section 14.19 – Investment Performance Report – Opening market value, deposits and withdrawals

In regard to new guidance relating to the "inception" date that firms may choose if it is an earlier date than July 15, 2015 or January 1, 2016, we note that apart from the date having to be reasonable based on the availability and accuracy of recorded historical market value information, it is further indicated that as with position cost information, it would be considered reasonable when the firm uses the same earlier date for:

i) All client accounts or security positions that were transferred to the firm at the same time; or

ii) All clients that are on the same reporting system of the registered firm, if the firm has more than one reporting system.

We request clarification as to whether firms will be subject on review to an additional standard beyond accuracy of the data, to have to have the same inception date for transfers-in and the same reporting systems in order to justify that the inception date is reasonable.

CP Section 14.19 - Investment Performance Report – Percentage Return Calculation Method

The guidance on this subject indicates that the client's actual personal rate of return must be compared to the client's "target rate of return". We note that providing a comparative target rate of return is not mandated under any rule currently and we in any event would oppose such a requirement which may go beyond advisor's current proficiency and offerings, to require what is provided by a financial planner or Certified Financial Analyst. IIAC member firms indicate that advisors without these qualifications do not perform target rate of return calculations. As a result, we do not agree with the imposition of a requirement to provide a target rate of return analysis and comparison to the client's personal rate of return.

In order to calculate a risk-adjusted rate of return, the preparation of a financial plan would be necessary as it would include a cash flow analysis. If the CSA expects advisors to provide a target rate of return, then clients would be required to pay for the preparation of a financial plan, thereby increasing the cost to clients. This may not be appropriate and may be cost prohibitive for many clients.

We are also concerned about the underlying assumption with this new requirement that if an advisor identifies a target rate of return that clients need to meet their investment needs and objectives, such a rate of return is achievable. Advisors would be put in a position where they will likely be offside the target rate of return requirement where it clashes with the client's suitability requirements, for example, a senior requiring a high rate of return but suitability requirements would dictate low risk investments. We do not believe this comparison will be productive and it risks unnecessarily increasing potential complaints and confusion by clients, contrary to the objectives of CRM2 which are to bring enhanced communication and harmony to the advisor-client relationship.

NI 31-103 Section 14.5.2 – Restriction on Self-Custody and Qualified Custodian Requirement

We have identified an inconsistency in the requirement for a functionally independent custodian. Subsection 14.5.2(6) states that a Canadian financial institution that is the custodian of cash of the client or investment fund must be functionally independent of the registered firm. However, subsection 14.5.2(5) exempts a qualified custodian of securities and cash from the functional independence requirement if the custodian is a bank or trust company that has the requisite system of controls and supervision. This means that a bank or trust company that is not functionally independent of a registered firm is qualified to hold securities, but not cash, for a client or investment fund. We request that an exception be made in subsection 14.5.2(6) similar to the exception in subsection 14.5.2(5).

Implementation Concerns

To the extent that there are new requirements that are not connected to new rules and which appear to be on a fast track to be made final, it is unclear what the expectation of the regulator is concerning implementation. We note that firms' requirements have been set for final implementation of CRM2 in accordance with their SRO rules. It is not contemplated to integrate these new and complicated requirements that firms and their vendors have not planned for, which may not be clearly related to specific rules, and that cover areas for which SROs would be exempted now but may lead to new changes for our members. Our members expect to comply with their SRO's rules which have already been finalized.

We appreciate your consideration of our comments concerning the CRM2 Amendments and would be pleased to discuss this further should there be any questions.

Yours sincerely,

"Naomi Solomon"