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Submitted via email

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 of New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Northwest Territories
Registrar of Securities, Yukon Territory
Superintendent of Securities, Nunavut

Attention:

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Me Anne-Marie Beaudoin
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Dear Sirs and Mesdames:

Re: Client Focused Reforms - Proposed Amendments to National Instrument 31-103 and Companion Policy 31-103CP

The Investment Industry Association of Canada (the “IIAC” or “we”) appreciate the opportunity to provide comments to the Canadian Securities Administrators (the “CSA”) with respect to the Proposed Amendments to National Instrument 31-103 (“NI 31-103”) and Companion Policy 31-103CP (“31-103CP” or "Companion Policy") (together, the "Client Focused Reforms"). The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 122 IIROC-regulated investment dealer members in the Canadian securities industry[1]. These dealer firms are the key intermediaries in the Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in the public and private markets for government and corporations.

An Executive Summary of the IIAC's comments on the Client Focused Reforms is set out in Appendix A, while our detailed response is contained in Appendix B. Appendix C outlines the potential impact the Client Focused Reforms will have on the Québec Immigrant Investor Program ("QIIP"), and the need for an exemption to ensure the QIIP continues unimpaired.

Overview

The IIAC appreciates the ongoing engagement that the CSA has undertaken in respect of these important amendments to the Canadian registrant regulatory framework. It is clear that the CSA carefully considered previous comments and made several key changes to help achieve an improved regulatory framework.

Our industry remains supportive of measures that enhance the client-advisor relationship. We are committed to working with the CSA and the self-regulatory organizations such as the Investment Industry Regulatory Organization of Canada ("IIROC") and the Mutual Fund Dealers Association ("MFDA") (together, "SROs") to implement the Client Focused Reforms that better align the interests of securities registrants with the interests of their clients.

From an industry perspective, one of the key benefits for all market participants is the harmonized approach to the reforms. The CSA jurisdictions agreed on a model that embeds a detailed and obligatory best interest and client-first conduct within the specific reforms, rather than the alternative of an overarching best interest standard. The CSA deserves much credit for bridging the differences in regulatory approaches, to create a uniform set of regulations across all Canadian securities jurisdictions.

The reforms set out in NI 31-103 are detailed and far-reaching, covering all major aspects of the wealth business. In certain cases, such as in respect of conflicts of interest and referrals, regulators have attempted to address a specific issue with a general policy that has effects beyond the intended issue. Careful wording in the Companion Policy is critical to ensure the industry and regulators have clear guidelines and examples of how to meet and monitor compliance with these new conduct rules. This is particularly important as new rules depart significantly from the existing stringent SRO rules. It is important to recognize that these uniform rules will also apply to other registrants not subject to similar standards of rigorous conduct compliance.

The regulators deserve credit for the deliberate and positive effort to establish a level playing field in the wealth business. However, in order to ensure that all relevant financial industry participants and their

[1] For more information visit, http://www.iiac.ca

clients are similarly regulated and protected, this approach should extend to the insurance industry, under the anticipated rule-making effort of the Financial Services Regulatory Authority (“FSRA”) in Ontario.

Outlined below are some observations regarding important considerations in moving the Client Focused Reforms forward in respect of the rule development process, both at the CSA and SRO level.

Cost-Benefit Analysis

As part of the 2016 consultation process, the IIAC submitted a detailed and independent analysis of the expected costs of implementing the targeted reforms. We hoped this would help to advance a further review of the anticipated costs and benefits in the next iteration, and we had extended our offer to work with the CSA in developing a detailed assessment. We are disappointed that the description of the anticipated costs and benefits of the proposed amendments set out by the Ontario Securities Commission (the “OSC”) in Annex E[2], does not appear to reflect this analysis.

There are some useful observations contained in Annex E; however, the analysis of costs is very general. Throughout the Regulatory Impact Analysis, the language frequently contains statements that OSC “anticipates” that one-time costs will be significant but on-going costs are likely be to less significant. There is little information outlining the basis for these comments, and it is evident that there were no industry consultations surrounding this Regulatory Impact Analysis. It is unclear how the OSC could ascertain the impact of the proposed regulation on the industry without consulting the industry. We also note that Regulatory Impact Analysis does not contain estimated dollar amounts, which would have been helpful.

Role and Application of the Companion Policy

The IIAC is concerned that some of the language contained in 31-103CP is prescriptive in nature, suggesting it has the force of law. As a result of the Ainsley decision,[3] the OSC must ensure that they do not engage in the practice of issuing policy statements as if they were binding. In many instances, the provisions in 31-103CP go beyond a mere guide for appropriate business practices, and how the CSA interprets the provisions of NI 31-103, but appears to impose substantive requirements. It appears as if, in some instances, the CSA is establishing a standard of conduct through 31-103CP, rather than in NI 31-103.

For example, in the section related to Know Your Product (“KYP”), 31-103CP goes into far more detail than what is set out in NI 31-103 and appears to extend the requirements beyond the actual requirements in NI 31-103. Furthermore, the language in the Companion Policy refers in many places to what the CSA “expects” or that firms “are expected to” undertake certain actions/steps.

Without language clarifying that these are suggestions, or that alternatives are acceptable, firms will interpret the language as mandatory and develop policies, procedures, systems, training and operations

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[2] (2018), 41 OSCB (Supp-1) at 251.
[3] See **Ainsley Financial Corp. v. Ontario (Securities Commission), 1994 CanLII 2621 (ON CA)**

that comply with the language in the Companion Policy. There is also concern that SROs will base their examination modules upon the details of the Companion Policy. It is unclear how regulators plan to test for compliance.

Scalability

We appreciate that the CSA has taken into account comments the IIAC raised in Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Toward their Clients* ("CP 33-404") where we raised the importance of addressing the diversity of business models and products offered by our members, and the importance of remaining technology-neutral. The CSA has now included commentary that the Client Focused Reforms have been made scalable to fit registrants' different operating models. While this statement from the notice is also mentioned in the proposals related to KYC (see page 179 of 31-103CP) and touched on briefly in the Suitability section (see page 191 of 31-103CP), we believe further emphasis is required throughout the Companion Policy regarding the ability for firms to tailor the Client Focused Reforms to fit their specific business models, products and services offered and types of clients served.

Focus on Costs

Throughout the Companion Policy, there appears to be an overemphasis on costs, for example, when determining if a security is suitable for a client.

This is highlighted in 31-103CP which states that:

> Unless a registrant has a reasonable basis for determining that a higher cost security will be better for a client, we expect the registrant to trade, or recommend, the lowest cost security available to the client in the circumstances that meets the requirements of subsection 13.3(1).[4]

While we certainly recognize the significant impact that costs can have on performance, and agree it should be a consideration when determining the suitability of the products available on a firm's shelf or for a client, it should not be the determinative factor. Cost considerations must be weighted equally against other factors such as the consistency of returns over time, the diversity of holdings, the stability of the management of the fund, and benefits of a managed program even when it may be more expensive.

We suggest that wording referencing costs throughout 31-103CP be revised to better reflect the various considerations in addition to cost, that are factored into advisor recommendations.

Best Interest Standard

As mentioned above, the IIAC is pleased that the CSA has developed a harmonized approach that introduces a client's best interest standard in the conflict of interest reforms, and a putting client's first approach in the suitability reforms, rather than proceeding with an overarching regulatory best interest

[4] (2018), 41 OSCB (Supp-1) at 191.

standard as proposed by the OSC and the Financial and Consumer Services Commission of New Brunswick in CP 33-404.

However, the terms "best interest" and "putting the client's interest first" are not clearly differentiated in NI 31-103 or 31-103CP. It is not evident if these are meant to be different standards, as neither is clearly articulated or defined in 31-103CP. There is also concern that these terms may be interpreted to be synonymous with a fiduciary standard by the courts. We recommend that NI 31-103 clearly state that a best interest standard (and putting a client's interest first) is not equivalent to a fiduciary standard. This will provide clarity to registrants and guidance with respect to litigation.

Implementation Committee

Given the magnitude of the proposed changes, and to ensure meaningful consultation with the SROs and CSA beyond the comment period, we recommend a joint CSA/SRO Implementation Committee be struck. We also suggest that service providers be included in this Committee to ensure they are aware of operational and systems issues. Such a Committee will help ensure that all relevant regulators and other industry stakeholders remain involved as questions and issues arise from members as they begin to re-engineer their systems and processes. It is not possible to foresee all potential issues at this stage, and as such, it is critical to create a central resource for firms to receive feedback and guidance. This will also help both the regulators and the industry to effectively implement the rules.

The ability to escalate issues when practical considerations arise is imperative in this process. This was illustrated clearly by the experiences during the CRM2 implementation period. That process was marked by unnecessary delays, confusion and a cumbersome process when members individually, or as group, identified areas where the rules lacked clarity.

It is also important to consider that not only will the Client Focused Reforms result in the industry implementing significant changes, but that other regulators are also initiating substantive regulatory changes that will impact the investment industry such as proposed new anti-money laundering and terrorist financing regulations, IIROC's Plain Language Rule Book Amendments, and potential changes to CRM2 reports. A proper implementation timeframe must consider these other pressing initiatives that impact all IIAC members.

Québec Immigrant Investor Program

We believe that if the Client Focused Reforms are applied to the QIIP, it will effectively end this government program that is meant to help stimulate economic growth and contribute to the Québec economy. We have set out our concerns in Appendix C and our request that this program be exempt from certain provisions contained within the Client Focused Reforms.

The IIAC would greatly appreciate the opportunity to discuss our submission with you further and provide additional input as requested.

Your sincerely,

M. Alexander

APPENDIX A: EXECUTIVE SUMMARY

GENERAL COMMENTS

Scope:

The Client Focused Reforms, in general, represent a positive and necessary effort to create a level playing field in the wealth business, where firms are similarly regulated, and clients protected regardless of the channel by which they enter the industry. We note, however, that there remains a significant gap in investor protection relating to the insurance industry. In order to ensure that all industry participants providing similar products and services to their clients have consistent obligations, and that clients are uniformly protected, it is important that the Client Focused Reforms be adopted by insurance regulators.

Cost/Benefit Analysis:

Prior to enacting a regulatory initiative of this magnitude, it is critical to understand the costs that will be imposed on the industry in general, and the various categories of industry participants in particular. Only then can a reasoned analysis of whether the benefits of the initiative are justified in light of the costs incurred. We are concerned that the description of the costs and benefits of the Client Focused Reforms is very general and does not provide any detailed analysis of the basis for the estimates, quantitative estimates of costs, or evidence of industry consultation in developing the prediction of the regulatory impact.

General Issues / Concerns:

There are a number of common issues that run throughout the various sections of the Client Focused Reforms that should be addressed. These include the following:

- Throughout the Client Focused Reforms, the concept of the “cost” appears to be paramount in determining how advisors determine suitability, and in respect of conflict of interest issues. While cost is important in respect of account performance, other factors such as consistency of returns, diversity of holdings, management stability and the benefits of a managed program must also be recognized as elements to be considered in building a client portfolio.
- The terms “best interest” and “putting the client’s interest first” are not clearly defined or differentiated. We are concerned that they may be interpreted by courts as being equivalent to a fiduciary standard unless the intention is otherwise clearly articulated. The National Instrument should clearly state that these terms do not impose a fiduciary standard.
- Although the Companion Policy is intended only to provide guidance, the language it employs appears to transform suggested actions into new regulatory requirements. It should be made clear that the provisions in the Companion Policy are not mandatory.
- Given the far-reaching nature of the proposed changes, the number of unforeseen consequences and practical implementation questions, we recommend that a joint CSA/SRO Implementation Committee be struck to address operational and process issues.

KEY ELEMENTS OF THE CLIENT FOCUSED REFORMS

1. Know Your Client

The IIAC acknowledges the importance of a comprehensive Know Your Client (“KYC”) process as a critical element in ensuring clients receive the best advice possible. While we support many of the provisions contained in the KYC Client Focused Reforms, we have concerns with some of the prescriptive and extensive KYC requirements.

Establishing the identity and reputation of the client

The Companion Policy contains a provision that overlaps obligations contained in the Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations (PCMLTFR). The Department of Finance is currently in the process of a significant review and revision of these regulations. As such, in order to avoid potential confusion and regulatory inconsistency, we caution against adopting language that may become inconsistent with the regulations, and recommend removing the specific provision related to confirmation of certain information relating to individual clients.

2. Know Your Product

We agree that understanding the features of a security for suitability purposes is central to the advisory process. We are concerned, however, that certain elements of the proposed KYP requirements will present significant challenges for the industry.

The language in several sections in the Companion Policy appears to significantly limit firms’ discretion in how they evaluate securities on their shelves. The extensive, prescriptive list of factors to consider, combined with language that appears to require a security-by-security analysis would make it impractical, if not impossible for many firms to maintain open shelves with sufficient product choice to serve a variety of clients.

The onerous KYP requirements, which do not appear to contemplate a risk-based analysis, the use of third-party product research, or bundling of similar securities, will likely result in a significant reduction in the number and variety of products that firms are able to make available to clients. This would negatively impact clients’ portfolios, access to advice, product innovation and the capital-raising ability of Canadian firms.

In addition, the obligations of individual advisors to have a high-level of understanding of all the products on a firm’s shelf is unrealistic and unnecessary, particularly when such products may be outside the advisor’s proficiency or ability to sell. We also note that the existing suitability requirement would ensure that the advisor understands any specific product recommended to a client.

The IIAC also seeks clarity regarding provisions relating to removal of products from a shelf when they are held by clients, and transfers-in of products not contained on a firm’s shelf.

3. Suitability

While we agree with the CSA that the suitability obligation is a fundamental obligation that firms owe to their clients, we have some concerns with the lack of clarity surrounding the requirement to put the client's interests first.

The Companion Policy fails to clearly explain the CSA's intention in putting the client's interests first, and how it should be interpreted. The Client Focused Reforms also do not articulate how, or if a requirement to put the client's interests first differs from the best interest standard outlined in the conflicts of interest requirements. We request further guidance and clarification surrounding the term "put the client's interest first" and additional examples beyond the one included in 31-103CP. To avoid future legal uncertainty, the IIAC also recommends that NI 31-103 explicitly state that a best interest standard and putting a client's interests first standard is not a fiduciary standard.

With respect to the factors for determining suitability, the general catch-all provision of "any other factor that is relevant under the circumstances" is too general to operationalize and supervise. We also have concerns that the Ombudsman for Banking Services and Investments ("OBSI") may interpret such a provision more broadly than intended by the regulators, leaving firms exposed to claims that are unsupported under the regulatory regime. Given the vagueness of this provision and the fact that a suitability determination must also include putting the client's interests first, we would suggest this provision be removed. In the alternative, the IIAC suggests that further clarity and examples be provided in 31-103CP.

We strongly support the statements that the CSA has made indicating that the litmus test for suitability is what a reasonable registrant would have done under the same circumstances at the time of the suitability determination.

4. Conflicts of interest

The IIAC acknowledges that appropriate requirements are necessary to govern elements of the client-registrant relationships that raise conflict of interest concerns.

Materiality

The IIAC objects to the CSA's decision to remove the materiality standard in the requirement for firms to identify and manage existing and potential conflicts of interest. This decision is inconsistent with existing IIROC and MFDA regulation in Canada, as well as the *Regulation Best Interest* proposal published by the US Securities and Exchange Commission in April 2018.

Given the number of clients, accounts and transactions undertaken by firms and advisors, identifying and addressing all potential non-material conflicts represents a significant expenditure of time and effort that may prejudice clients by delaying time-sensitive transactions, without providing corresponding investor protections. We strongly recommend that the materiality standard be applied to the conflict of interest requirements.

Conflicts disclosure

The IIAC recommends that the subjective and unclear language in the Companion Policy indicating firms have a “system for confirming that *effective* conflicts disclosure” is provided to clients, be replaced with a reference to the section in the Companion Policy entitled “*Conflicts Disclosure*”, which clearly articulates key elements of such disclosure.

Conflicts arising from proprietary products

The IIAC recognizes that there are steps that firms should take to ensure they do not favour proprietary products over non-proprietary products on their shelf, where the non-proprietary product may be more appropriate for their clients. It is, however, important to ensure that the additional controls do not represent an unnecessary burden on firms resulting in firms potentially only offering proprietary products. Instead, the requirements should assist firms in providing clients with a wider choice that includes non-proprietary products.

Given the extensive KYP and KYC processes that firms must undertake, we recommend that additional controls, such as monitoring the level of proprietary products in client accounts and obtaining independent advice on firms’ efforts to address such conflicts be removed.

Conflicts arising from third-party compensation

The Companion Policy should be interpreted to accommodate products with third party compensation in situations where the advisor’s suitability analysis indicates that they are the better choice, vis-a-vis lower cost alternatives.

Conflicts of interest disclosure

The IIAC seeks clarification on the expected scope and detail of new required written disclosure regarding the impact and risk of a conflict, and how it will be addressed. There appears to be inconsistency in the Companion Policy as to whether disclosure relating to pre-trade disclosure in relation to charges can be undertaken orally rather than in writing. Given that there are requirements for disclosure of the impacts and procedures for commission-based conflicts at the account opening, and that advisors are obligated to resolve such conflict in the best interest of the client, we recommend that oral disclosure be permitted in such cases to allow for timely trade execution.

5. <u>Referral Arrangements</u>

We are concerned with the broad scope of the definition of referral arrangement, in that it could potentially capture *de minimis* and informal consideration, such as a thank-you dinner, bottle of wine or other expression of gratitude for a referral that would not represent a material incentive to the recipient. We recommend that a materiality standard be included in the definition.

The new requirement in paragraph 13.8(1)(a) that the person or company receiving a referral fee must be a registered individual or registered firm, has minimal investor protection benefit, and will create unintended negative consequences.

Firms and registrants are required to manage their client relationships in the context of their regulatory requirements, regardless of the way in which a client is introduced to the firm, whether that be through referral for a fee, referral with no fee or through firm prospecting. As such, for IIROC registered firms, clients are protected equally, through the extensive and robust regulatory requirements and oversight to which their advisors are subject.

A referral fee paid to a non-registrant can be regarded as a marketing expense, as it is a form of prospecting through third parties. Provided that the referral fee does not increase the amount of fees or commissions to the client pursuant to paragraph 13.8.1(c), it is not clear why such a fee would be prohibited.

As such, we recommend that the restriction on firms and registrants paying for referrals from non-registrants be removed, at a minimum, for IIROC registered firms. If the CSA continues to be concerned about these arrangements, we recommend that paid referrals continue to be permitted where the referring firm or individual is a member of a self-regulatory or self-governing body, or a member of an industry where the activity is subject to regulation, conduct and ethical requirements.

6. Duty to Provide Public Information

IIAC members question how the information required in section 14.1.2 can be provided in a meaningful way. IIROC dealers' account sizes, services, fees and product offerings are highly specific to individual advisors, the client and/or the line of business within the IIROC dealer. Consequently, the concern is that investors will either be provided with information that is too general to be useful (i.e. large ranges of what is available) or it will more closely resemble the relationship disclosure information ("RDI") which may be overwhelming for potential clients. We also recommend that paragraph 14.1.2(c) be revised to remove the requirement to provide a current fee schedule, as it is too specific a requirement and may be problematic from a competitive perspective.

7. Transition

The Client Focused Reforms currently contemplate a two-year transition for certain requirements such as the KYP, KYC, suitability, conflicts and RDI requirements and one-year for the new publicly available information disclosure.

Given the time required to update all policies and procedures, install new systems to monitor and track securities, as well as implement new systems for compliance related to other rules, strike new committees, review all the thousands of products the firm already has on their shelf, train employees, and communicate with clients, we recommend that a uniform three-year implementation period be instituted for all requirements.

With respect to KYC, we also recommend that current client accounts be grandfathered until the new requirements relating to the proposed updating requirements apply, and the accounts be updated either as a result of a significant change, or at the relevant minimum review time period.

8. Order-Execution-Only Exemption Requests

The IIAC recommends the following exemptions related to order-execution-only ("OEO"):

- The information-gathering requirements relating to the factors set out in paragraph 13.2(2)(c) such as investment needs and objectives, financial circumstances, time horizon, etc. are not applicable to the OEO model, and thus specific carve-outs from section 13.2 of NI 31-103 should be provided to OEO firms.
- An exemption for OEO firms from section 13.3 suitability determination requirements should be clearly provided. Although paragraph 9.3(1)(j) indicates IIROC members are exempt from the suitability determination requirement, a more specific exemption would provide certainty.

9. Permitted Clients

IIROC members are concerned that the CSA definition of permitted client in Part 1 of NI 31-103 does not align with the IIROC definition of institutional customer in IIROC's Rule 1 Interpretation and Effect. IIROC's definition includes a "non-individual with total securities under administration or management exceeding $10 million", while the CSA's definition has a higher dollar threshold of $25 million. There are a number of clients who should be considered permitted/institutional that are currently exempt from suitability and KYC rules under the IIROC rules that could now be subject to the Client Focused Reforms which are designed to provide protections to retail investors. These are sophisticated, non-individual clients that do not need or want these levels of protection and intrusion. The cost of complying with the additional requirements under the Client Focused Reforms may result in some dealers unable to provide for these institutional customers that do not qualify as permitted clients. It would be a negative client outcome if these clients cannot receive the same level of services or access as a result of the variation in definitions. We recommend that the definition of permitted client be amended and that item (q) is revised to include "a person or company, other than an individual or investment fund, that has net assets of at least $10 million as shown on its most recently prepared financial statements".

In addition, firms and advisors should be exempt from the KYP requirements in section 13.2.1 of NI 31-103 with respect to permitted clients. Permitted clients are sophisticated and do not require the same level of regulatory protection.

10. Quebec Immigrant Investor Program

In addition to the above exemptions, the IIAC is concerned about the application of the Client Focused Reforms to the QIIP. Its application to the QIIP could impact the survival of the program. We request that the program be exempt from certain provisions that are inconsistent with key provisions of the program. Please see Appendix C for details of the specific exemption request.

APPENDIX B: THE IIAC'S DETAILED RESPONSE TO THE CLIENT FOCUSED REFORMS

The IIAC is supportive of measures that enhance the client-advisor relationship. We are committed to working with the CSA and SROs to better align the interests of the securities registrants with the interests of their clients.

In our comments set out below, we have provided recommendations and alternatives where possible, and identified issues and concerns regarding the interpretation and application with respect to some of the Client Focused Reform proposals.

FIRM'S OBLIGATION TO PROVIDE TRAINING – SECTION 3.4.1

The IIAC recognizes the importance of firm training to ensure registrants have sufficient understanding of their compliance obligations. SRO members are currently subject to rigorous continuing education and training requirements tailored to their registration category. As such, we believe that SRO members should be exempt from the CSA requirements and any additional proficiency rules should be developed by the SROs.

The statement in the Companion Policy that training can be outsourced is appropriate and recognizes the limited resources some firms may have to conduct in-house training.

KNOW YOUR CLIENT - SECTION 13.2

The IIAC acknowledges the importance of a comprehensive KYC process where the collection of detailed and complete KYC information is critical in ensuring clients receive the best advice possible.

The IIAC appreciates that certain of the concerns raised in our submission responding to CP 33-404 have been addressed in the Client Focused Reforms. These include a shift away from some of the more prescriptive proposals; for example, a prescribed KYC "form", the requirement for a client signature on the KYC and any updates, the frequency of updates, and the collection of basic tax information.

The IIAC notes that many of the KYC requirements contained in section 13.2 are substantially similar to IIROC's KYC requirements under Rule 1300 and Rule 2500, and thus will not impose additional burdens on our members. However, many details contained in the Companion Policy create new expectations, and arguably, some of the language suggests that these expectations are in fact viewed by the regulators as requirements.

While we support many of the provisions contained in the KYC Client Focused Reforms, such as the shift to consideration of a client's risk profile, rather than his or her risk tolerance, we do have concerns with some of the prescriptive and extensive KYC requirements, as outlined below.

Establishing the identity and reputation of the client

Under section 13.2 of the Companion Policy, in the section entitled "*Clients that are individuals"*, it states that registrants must "take reasonable steps to confirm the accuracy of the information collected, in order to form a reasonable belief that they know the identity of the individual." This is similar to language that is currently contained in federal anti-money laundering and anti-terrorist financing regulations[5]. A critical component of that regime focuses on client identification and verification, including detailed requirements and steps that must be undertaken in furtherance of those objectives. We caution against adopting language that may or may not align with the AML/ATF regime, especially given the fact that the Department of Finance has recently released an extensive package of regulatory amendments that will radically amend requirements in this area. Further, it is unclear what steps the regulators expect firms to undertake to form a reasonable belief they know the identity of an individual. We suggest that the CSA remove this language from the Companion Policy to avoid potential confusion and regulatory inconsistency applicable to client identification requirements.

Tailoring the KYC process

We are pleased that the CSA has addressed a concern the IIAC reiterated throughout its response to the CP 33-404 proposal, that a "one size fits all" regulatory model is not appropriate, and that scalability is critical to address different business models, and advisor-client relationships.

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[5] *The Proceeds of Crime (Money Laundering) and Terrorist Financing Regulations* (PCMLTFR).

The CSA has acknowledged this through its comments in the Companion Policy related to KYC by stating that the KYC process can be tailored to reflect a firm's business model and nature of relationships with clients. This is important given the variation in business models among IIROC dealers, including the use of robo-advisory models.

Client's financial circumstances

The IIAC does not have concerns with respect to the specific requirements in subparagraph 13.2(2)(c)(ii) regarding the collection of information relating to a client's financial circumstances. However, the Companion Policy relating to this section suggests there is a more onerous requirement for advisors to obtain a breakdown of *all* types of the client's assets and liabilities (savings, RSP, etc.). This information provides a point in time value and it appears that the expectation is that it should be updated when other KYC elements are updated. This requirement raises practical concerns, as many of these accounts are likely to be held in different institutions, leaving firms unable to monitor changes, and rely on such data on an ongoing basis.

Client's investment objectives

Subparagraph 13.2(c)(iii) requires that a registrant take reasonable steps to ensure they have sufficient information about a client's investment needs and objectives. The Companion Policy further states that the KYC process should enable the client to express their financial goals in meaningful terms. Currently, some firms use questionnaires or tools to assist advisors with their KYC collection. We seek confirmation that firms could comply with the above requirements by setting out a number of more specific client objective options that a client can select from. For example, options could include: retire in X number of years, pay for a child's education, or save for a house.

It is also important to make it clear to the client that the stated objectives do not constitute a guarantee of those outcomes. We are concerned that there is a possibility for this misunderstanding when the objectives are included as part of the KYC documents. Consequently, firms must be able to qualify that the objectives may not be attainable.

We appreciate that the Client Focused Reforms removed certain KYC proposals that were included as part of CP 33-404 with respect to non-securities evaluations. The Companion Policy, however, reintroduces the language that an advisor should potentially make an assessment beyond investments, to determine if those options are more likely to assist the client meeting their goals. While the Companion Policy now states that it is dependent on the nature of the relationship with the client, and the securities and services offered by the registrant, the language does continue to raise concerns for our members, especially since the Companion Policy states that registrants "should take into account whether there are other priorities." We would suggest amending this language to ensure registrants understand that not only is this not a KYC requirement, but it is also based on factors in addition to the relationship with the client, such as the registrant's proficiency. Thus, it may not be appropriate to expand the scope of the advisor's responsibilities beyond advising on securities. It is also not clear how an advisor would be able to make this determination in many circumstances. For example, comparing an investment in securities to making additional mortgage payments would require a comparison of current and projected mortgage rates to potential investment returns, and would likely introduce other elements of discretion to the decisions based on intangibles, such as client preference for compounding returns. Imposing additional planning-type assessments beyond investment advice may result in advisors providing advice beyond what their licensing proficiency requirements supports, to the detriment of the client.

Client's confirmation

The IIAC is pleased that the CSA has revised the confirmation of accuracy requirements in subsection 13.2(3.1) of NI 31-103 to include confirmation options such as a handwritten, electronic or digital signature, or by maintaining notes in the client file with detailed client instructions. The inclusion of advisor notes recognizes the impracticalities that may arise when seeking a client signature.

Members seek clarity if the client's information may be updated or maintained by persons other than the advisor if that person is an IIROC-registered individual (i.e. sales assistants, associates). This can assist with ensuring the client's information is current. The registrant would remain responsible for the KYC obligations.

Keeping KYC information current

Subsection 13.2(4) of NI 31-103 outlines the requirement to keep a client's KYC information current and subsection 13.2(4.1) of NI 31-103 details the minimum frequency for reviewing and updating this information. We support many of these provisions, in particular the 12-month review for managed accounts and 36-month timeline for other accounts. We do, however, have concerns with the language contained in paragraph 13.2(4.1) (a)(i) of NI 31-103 which requires a review when a registrant knows or "reasonably ought to know" of a significant change in the client's information. This standard introduces considerable uncertainty and is potentially very onerous. If an advisor does not have actual knowledge of a significant change, it is unclear when it would it be reasonable that they should have known of the change in information. Further, supervising such a standard as to when an advisor "ought" to have known some information regarding the client would be extremely challenging to operationalize. The standard for review and update of the KYC should be when the advisor has actual knowledge of a significant change.

The Companion Policy should also expand upon what is required with respect to refreshing KYC information. It is noted that the advisors are not expected to re-collect all KYC information, but that a meaningful and documented interaction take place. The IIAC requests additional language in the Companion Policy that would assist registrants in understanding the expectations around the term "meaningful". As currently drafted, it is not clear what would be considered satisfactory. Although the Companion Policy does acknowledge that a registrant does not need to re-collect of the information, we question whether a meaningful interaction would require a discussion of every component of the KYC.

Exemptions

In respect to OEO firms, it is not clear that they are exempt from certain of the KYC requirements in section 13.2 of NI 31-103. The CSA Notice and provisions contained in NI 31-103 clearly outline that OEO firms are exempt from the suitability and KYP rules, yet there is not a similar explicit carve-out from certain KYC provisions. The proposed information requirements for KYC are to facilitate suitability determinations, which OEO firms are prohibited from making. The information gathering requirements relating to the factors set out in paragraph 13.2(2)(c) such as investment needs and objectives, financial circumstances, time horizon, etc. are not applicable to the OEO model, and thus specific carve-outs from section 13.2 of NI 31-103 should be provided to OEO firms.

Know Your Product - Section 13.2.1

Given the importance of understanding a security for suitability purposes, the IIAC appreciates the CSA's objective to articulate an explicit set of KYP rules for both firms and advisors. We are pleased that the CSA revised aspects of the CP 43-404's KYP proposed requirements, to ensure the proposed rules in the Client Focused Reforms are more practical. In particular, removing the requirement for firms to conduct annual market investigations will reduce the burden on firms, without compromising investor protections.

While there have been improvements to the proposed KYP requirements, some of the new rules and guidance may still present significant challenges for industry.

Firm KYP process

Section 13.2.1 of NI 31-103 states that before a firm makes a security available to a client, it must take reasonable steps to understand that security. The IIAC agrees that this requirement is important and appreciates the rule does not prescribe how a firm must satisfy that obligation.

The proposed Companion Policy appears to provide flexibility in the KYP process in the statement that:

> The extent of the KYP process required for a security will depend on the structure and features of that security and a firm's policies and procedures should set out the different levels of review for different types of securities as appropriate.[6]

However, the Companion Policy also has language in several sections, including under the section entitled "*Understanding the securities made available to clients*" and "*Due diligence process*" that could effectively negate firm discretion in determining the appropriate processes for evaluating securities on its shelf. The Companion Policy continually references requirements in respect of "a" or "the" security, suggesting that the analysis is on a security-by-security basis. In addition, the extensive prescriptive list of factors relating to *the* security that regulators expect firms to analyze does not suggest there is flexibility or that it may be appropriate for these features to be compared within bundles of securities. In addition, under the "*Due diligence process*" guidance, it states that firms cannot solely approve "a" security based solely on its similarities to others. We suggest that the "*Due diligence process*" language be revised to reflect the reasonableness of bundling certain securities when reviewing and understanding them.

It is critical that firms be provided with flexibility in determining how they comply with KYP requirements in order to ensure that product shelves remain vibrant. It would be extremely onerous, and for some firms, impossible to require every security to go through level of analysis as prescribed in the Companion Policy, and still maintain open shelves. IIROC dealer members can have product shelves with over 100,000 different securities when considering securities on various exchanges and product types like investment funds, GICs, bonds, and individual securities. Without flexibility in how firms evaluate securities, such as allowing a risk-based approach to evaluating securities, the rules would create a barrier to entry,

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[6] (2018), 41 OSCB (Supp-1) at 184.

disadvantaging smaller firms with fewer resources, in particular, and resulting in the narrowing of product shelves in general.

Increasing the burden on firms that currently offer a robust product shelf to clients would have significant detrimental consequences, including:

- Reduced diversification in client portfolios that reflect the diversity of client sophistication, risk appetite, etc.;
- Reduced portfolio options to clients, which may be particularly important in low yield market environments;
- A widening of the advice gap for clients, as firms may impose an increased minimum account size due to increased compliance costs;
- Firms minimizing their risk by only offering low risk/low cost products, leading to firms only accepting “low risk” clients;
- Diminished access to products that benefit small and medium size investors, a trend which has already begun with CRM2 and POS3, as the mutual fund category has been abandoned by some representatives all together;
- A reduced reaction time for advisors in changing market conditions as product innovation and approval time may lag;
- Removal of competitive products from firm shelves so that fewer products may be available for a particular client / risk profile;
- Creation of non-competitive marketplace in products, impacting many smaller firms and manufacturers’;
- Hindered idea generation in investor products in Canada; and
- Diminished capital raising ability in the Canadian marketplace.

In addition to our suggested revisions above, we recommend that the Companion Policy language be modified to more clearly recognize the need for scalability in how various firms satisfy their obligations according to their size and structure. IIROC Notice 09-0087 *Best practices for product due diligence* noted that:

> While dealer members must adopt procedures and controls that are effective given their size, structure, and operations, a firm may not fail to have relevant policies and procedures because of limitations related to its size, structure, or operations.

A further issue is that the KYP regulations should more clearly recognize and accommodate differences in various categories of securities; for example, individual securities trading on the TSX (i.e. BCE or Apple) do not require the same type of firm analysis and approval processes that a complex derivative product would require. Further, the Companion Policy states that it is the CSA's expectation that firms will consider the overall competitiveness of a security compared to reasonable range of similar investments. It is not clear what type of analysis a firm could undertake to determine if an individual security that traded on the TSX is competitive. The Companion Policy should include language to indicate that not all criteria outlined in the guidance are applicable to every type of security.

Understanding securities made available to clients

As noted above, IIROC dealer members have extensive product shelves and as part of ensuring a reasonable understanding of their securities, the list of features and structures that the CSA expects a firm to analyze may not be applicable to all security types.

In addition, the guidance states that the regulators expect firms to undertake an analysis of the legal and regulatory framework applicable to an issuer, including whether a security distributed under an exemption, meets the requirements of the exemption. It is not clear what type of additional due diligence a firm would be able or expected to conduct beyond determining that a regulator, such as a CSA member or SRO approved an exemption.

Further, reporting issuers are subject to significant regulatory prospectus and continuous disclosure oversight and firms should be able to rely on these disclosure documents unless there are reasons to question their validity. We suggest that the Companion Policy is revised to include language similar to IIROC Notice 09-0087:

> Dealer members are entitled to rely on factual information and disclosure documents provided by issuers or manufacturers of products under review, unless there are obvious reasons to question their validity. However, in doing so the dealer member will have to judge whether the disclosure document answers all the relevant questions and whether it provides sufficient, balanced disclosure or is overly promotional in nature.

Due diligence process – third-party experts

Section 13.2.1 of NI 31-103 does not outline specific requirements that firms must satisfy in terms of the due diligence required to understand a security, and we are concerned that the Companion Policy includes a restrictive statement that a firm's due diligence process for evaluating a security cannot be "solely" based on information from "independent" third parties. We understand the CSA's concern of relying blindly on external research; however, it should be clear in the Companion Policy that reliance on independent third-party research is acceptable. We seek clarification that firms can appropriately utilize the expertise of independent third-party research firms that conduct extensive reviews of various securities. It is not realistic to assume that a smaller firm has the capabilities to replicate that research in-house.

Securities of related or connected issuers

The Companion Policy states that firms are not relieved of KYP requirements in respect of securities of related or connected issuers. Members seek clarity regarding the expectations for firms that are proprietary only or proprietary focused when conducting their firm level KYP analysis. Firms have elected to carry proprietary only or to be predominately proprietary only for a number of business reasons. The RDI requires more extensive disclosure about the firm's services and products including their limitations and additional conflict provisions govern controls required.

Guidelines or client profiles

The Companion Policy states that the CSA expects that "firms will consider guidelines or client profiles identifying the type of client for whom a particular security might be appropriate". This language should be revised, to "may", given the professional obligations of advisor to their clients, and their role in determining which clients the securities are appropriate for. It is not clear that it is necessary for firms to develop guidelines or client profiles to satisfy these direct obligations. Further, this requirement demonstrates no deference to the professional judgment of the advisor who is responsible for determining which of their firm's products are appropriate for their clients. Currently, many firms provide advisors with an approved shelf, and information about the risks (potentially a risk rating) of the product and asset class information. It is expected that the advisor will use their skill and judgment to determine for which of their clients the products are suitable. This concept also seems to contradict the general move towards consideration of the individual client.

Requirements applicable to registered individuals

We seek clarification regarding the expectations of registered individuals under subsection 13.2.1(3) of NI 31-103. The text of the National Instrument and the guidance provided in the Companion Policy create confusion as to the level of understanding required by advisors, of a firm's full universe of products.

The rule requires the advisor to take "reasonable steps to understand, at a general level, the securities that are available for them to purchase, sell or recommend through their firm, and how those securities compare." The Companion Policy is less clear and could be read to suggest that the advisor needs a high-level of understanding of every security a firm offers. The guidance reiterates the wording in the rule, and then states:

> This involves a high-level understanding of the structure, features, returns, risks and costs of each security that the firm makes available to clients that the registered individual is able to purchase and sell for, or recommend to, a client. Registered individuals must have a high-level understanding of each such security in order to be able to compare them, and to be able to select a smaller universe to focus on should they choose to do so.[7]

[7] (2018), 41 OSCB (Supp-1) at 187.

It is unclear how, and if, an understanding at a "general level" as stated in the rule is different from a high level of understanding as articulated in the guidance.

In our 2016 response to CP 33-404, the IIAC outlined a number of factors which make it practically impossible for advisors to have in-depth understanding of a firm's full suite of products. IIROC firms have thousands of products available on their shelf. The extensive process for analysis of securities outlined in the Companion Policy would require a full-time commitment, such that the advisor would not have time to serve clients in any meaningful way. The IIAC recommends that the Companion Policy be revised to better reflect the advisor standard articulated in subsection 13.2.1(3) of NI 31-103.

In addition, the Companion Policy should clarify expectations regarding the level of advisor understanding for products outside of their proficiency, or license to sell. For example, IIROC has additional proficiency requirements for options trading. What level of understanding of particular securities is expected from an advisor who is not authorized to sell those products?

Paragraph 13.2.1(3)(a) of NI 31-103

Paragraph 13.2.1(3)(a) of NI 31-103 requires an advisor to understand how the security compares to other securities. This paragraph does not have the same narrowing language regarding the scope of comparison that subparagraph 13.2.1(1)(a)(iii) does, which requires firms to compare "similar securities". We suggest the CSA provide some additional clarifying language so that the comparison is contextual based on the client. Product comparison would be most useful to the client if based on important features and attributes, rather than across the full spectrum of available products.

Removal of current products from shelf

We seek guidance on how firms should address situations where a firm removes a security from their approved shelf list, but where clients, for whom that security is suitable, held that security in their portfolio. This may occur when, as a result of the proposed new KYP requirements, some firms will elect to reduce their shelf, or when firms as a result of continual monitoring and re-assessment of securities, elect to remove some securities. As such, it may be inevitable that the firm's approved list will likely vary periodically in the normal course of business. We believe the most practical and client centric solution would be to allow the client to continue to hold that security. This would avoid negative client experience issues such as potential tax consequences if there was a sale. Since the security is no longer on the firm's shelf, the client would be limited to holding the security. The firm would not be responsible for ongoing KYP of the product.

Transfers in of a security

Subsection 13.2.1(6) of NI 31-103 introduces a new requirement for a firm to undertake a full analysis of each security a client proposes to transfer into the firm before it can be accepted. The timing of the requirement is problematic from a client service perspective, as it effectively temporarily freezes the client's securities while the firm evaluates them. The evaluation process is not automatic, and if there are any market changes during the process, it could negatively impact the client. We suggest that the requirement be revised to allow the firm's review to take place within a reasonable time-period after the transfer, to minimize client service issues.

In addition, if a firm accepts a transfer from a client for a security that is not on the firm's shelf, the client should be able to hold the security. Similar to our rationale listed above with respect to the removal of products from a firm's shelf, this avoids negative client experiences and does not place an unnecessary burden on the firm. Otherwise, if the firm was required to accept and monitor the transferred-in security, it would present practical challenges for firms, as they would have to separately monitor these securities while not enabling them to be more broadly traded. The unintended consequence of this requirement is that firms may reject more transfers in-kind and require cash transfers. This would be a negative outcome for clients who may wish to hold the security for personal reasons or for tax purposes.

Managed Products

The Client Focused Reforms do not address KYP obligations for firms and advisors with respect to managed products. It would be duplicative and extremely onerous if the advisor or firm had to conduct the full KYP analysis on the products that comprise the managed product. In order to ensure that an unnecessary compliance burden does not inhibit use of these products, IIAC members believe that the KYP requirements should be applied at the portfolio level of managed products. Each managed product is required to file a prospectus and continuous disclosure documents with the CSA. In addition, managed products are overseen by a portfolio manager who is subject to a fiduciary standard.

Permitted Client Exemption Request

The CSA has already stated that it will be providing exceptions related to permitted clients for KYC and suitability determination requirements. We request that firms and advisors be exempt from the KYP requirements of section 13.2.1 of NI 31-103 with respect to permitted clients. Permitted clients are sophisticated and do not require the same level of regulatory protection.

SUITABILITY DETERMINATION - SECTION 13.3

We support the amendments that the CSA has made to the proposed suitability requirements from those previously outlined in CP 33-404.

In particular, it was appropriate to revise the proposed requirement to conduct an investigation into the basic financial strategies that clients could use to meet their investment needs and objectives, including basic strategies beyond transacting in securities, as part of the suitability process. This would have required an advisor to inform clients, if the advisor made a determination that non-securities product strategies were more aligned with the client's investment needs and objectives, and therefore "better" for the client. Such a requirement would have raised issues both with respect to an advisor's level of proficiency and registration category in these non-securities related strategies. Further, it was unclear how this standard would have been met and enforced in situations where the advisor, for example, should have declined to provide investment advice if it could be argued that it was better to direct the client to pay down a high interest debt.[8]

Additionally, the revision to section 13.3 of NI 31-103 to introduce a "reasonable basis" test into a suitability determination, addresses the issue with the product selection suitability process outlined in CP 33-404. This provision would have required the advisor to ensure that the security is "most likely to achieve the client's investment needs and objectives." We had previously outlined some of the challenges associated with a "most likely" standard, and questioned who would be better placed to determine which product is "most likely" to meet the investment needs of clients. The IIAC agrees that the reasonable basis test is the more appropriate standard.

We are also pleased that the CSA removed the proposal to require advisors and firms to identify a "target rate of return" for clients. Many advisors do not perform target rate of returns calculations, as they are usually undertaken by a Certified Financial Analyst or Financial Planner.

Finally, we appreciate that the CSA has removed the requirement to perform a suitability analysis once every 12 months, regardless of the type of account.

However, the IIAC has a number of remaining concerns and questions relating to the proposed suitability provisions set out below.

Scope of the suitability determination

Interests of the client are paramount

The IIAC acknowledges the CSA's rationale in respect of the benefits of a regulatory approach that favours the client's interest above other considerations. The Companion Policy provides helpful guidance on how this standard applies to "remuneration, financial gains or other incentives". It would, however, be helpful

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[8] See the IIAC discussion of KYC Client Focused Reforms which discusses the language of CP 31-103 that states that registrants should "take into account whether there are any other priorities."

to have further examples of the client first approach, including factors that the regulator would consider beyond those that are compensation based.

We note that in jurisdictions such as Australia[9], and recently the United States[10], there is a provision that allows the granting of a safe harbor, and sets out the steps an advisor can take in order to be considered to have met this standard. A similar articulation of these steps would provide greater clarity and certainty for the industry.

Most significantly, the CSA has failed to explain how a requirement to put the client's interest first, differs from the best interest standard outlined in the Conflicts of Interest requirements in the Client Focused Reforms. Specifically, the 31-103CP related to conflicts of interest states:

> When addressing conflicts of interest in the best interest of clients, a registered firm and its registered individuals must <u>put the interests of their clients first</u>, ahead of their own interests and any other competing considerations.[11] [emphasis added]

In light of the above, the IIAC is unclear how, or if, these two standards vary, and how, or if, the regulators plan to apply and enforce them differently. Most concerning is whether the courts would interpret these standards differently, or if in fact, judges would simply impose a fiduciary standard.

As we pointed out in previous discussions with the OSC, the CSA, in its 2012 33-403 Consultation Paper, *Exploring the Appropriateness of Introducing a Statutory Best Interest Duty When Advice is Provided to Retail Clients*, determined that a statutory best interest duty was equivalent to a fiduciary duty. It stated:

> We believe that imposing a statutory duty on an adviser or dealer to 'act in the best interests' of clients constitutes imposing a fiduciary duty." And later, "Because acting in a client's 'best interests' is at the heart of a fiduciary duty, we will generally refer in this Consultation Paper to a fiduciary duty as a 'best interest' standard or duty.[12]

In order to provide clarity, the "client's interest first" standard, and best interest standard must be clearly defined, and any differences specifically described. In addition, in order to avoid legal uncertainty, NI 31-103 should also explicitly state that a best interest/putting client's interest first standard is NOT a fiduciary standard.

Finally, it is unclear how this standard would apply in the robo-advisory space where portfolio managers ("PMs") providing advice on these accounts are subject to a fiduciary standard. Would a portfolio

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[9] Corporation Act 2001, Section 961B.

[10] The Securities and Exchange Commission has proposed Regulation Best Interest, which sets out that a broker-dealer would have to act in the best interest of a client at the time the recommendation is made but would discharge this duty by complying with three specific obligations, which includes, disclosure, a care obligation and a conflict of interest obligation. 17 CFR Part 240, Release No. 34-83062.

[11] (2018), 41 OSCB (Supp-1) at p. 193.

[12] (2012) 35 OSCB 9562.

manager satisfy the suitability determination requirements differently if they are already held to a "higher" standard? It is also unclear if PMs registered with IIROC would be held to a different standard.

Portfolio approach to suitability

As with the proposed KYC Client Focused Reforms, many of the proposed Suitability Client Focused Reforms are already incorporated into IIROC Rules and Guidance. In particular, with respect to the shift from trade-by-trade suitability to a portfolio approach to suitability, IIROC Dealer Member Rule 1300.1 sets out that a suitability determination must not only consider many of the same factors outlined in section 13.3 of NI 31-103, but explicitly outlines that a suitability determination includes the consideration of the client's "account or accounts' current investment portfolio composition".

IIROC Guidance Note 12-0109 *Know your client and suitability* also states that as a best practice, it is advantageous to clients, members and industry as a whole, as well as consistent with good business practices, for registrants to conduct "more holistic suitability reviews." The Guidance Note goes on to say that members are encouraged to adopt best practices which would not only allow them to comply with the current order/recommendation-triggered suitability assessments requirements set out in IIROC Dealer Member Rule 1300.1, but also assist in the ongoing maintenance of a suitable client portfolio.

(a) Multiple accounts held by the client at the registrant

The IIAC acknowledges that examining a client's investments across all accounts held with a firm, and in particular with respect to the client's overall concentration and liquidity, as set out in subparagraph 13.3(1)(a)(v) of NI 31-103, may be beneficial. However, it may be challenging for a number of members who do not take such a fulsome approach in terms of examining all accounts that a client may have with a firm. For those firms, they will require time to operationalize this process. This is an important factor for regulators to consider with respect to an appropriate transition period.

Furthermore, it is important to recognize that depending on firms' business models, types of relationship with clients and type of products offered, each may have different definitions of what they consider a portfolio level review of all accounts. For example, for some firms, this is done at a household level rather than at an individual client level.

It will also be challenging to evidence supervision of the requirement for a registrant to take into consideration whether a recommendation for one account materially affects the concentration and liquidity of a client's investments across all accounts held with the firm. There is no question that this may require the building and implementation of new compliance systems and oversight processes.

(b) Investments held by the client outside the registrant held elsewhere

We appreciate the flexibility included in the language of 31-103CP, where it states that "depending on the circumstances", registrants should inquire about the client's other investments or holdings at other firms. It is important to acknowledge, however, that in many cases, a client may be reluctant or refuse to share this information with their advisor. At a practical level, conducting a concentration analysis that includes securities held outside the firm is an unsustainable practice, as the firm or advisor will not have continual, open access to records held at other firms.

The IIAC questions the language of “type of relationship with the client” as one of the circumstances that the inquiry is dependent upon. Does this mean that the inquiry would be different for a managed account as opposed to a transaction account, or that an equities account would require a deeper inquiry than a mutual fund account? Would the amount of tracking and monitoring vary based on the type of relationship and the CSA’s expectations surrounding those relationships?

Lastly, additional details regarding the timing of this inquiry should be outlined. Would this occur one time upon account opening or is there an expectation of an ongoing inquiry? Furthermore, the language refers to investments or “holdings”. Does the CSA envision that registrants would make inquiries into banking, real estate and other holdings?

Account type suitability

Given IIROC Guidance Note 12-0109, IIROC members are familiar with the expectation that the suitability analysis starts before an order is received, recommended or executed. IIROC members are expected at the time of account opening, to ensure that the account type (margin, trust, options accounts, etc.) is appropriate for the client based on the client’s particular circumstances.

With respect to the discussion of fee-based and commission-based accounts, we wish to emphasize the importance of regulators not reviewing the recommendation of one type of account over another by using an after-the-fact assessment of which was cheaper for the client. Any such determination must be made based on the circumstances known to the advisor at the time on a reasonable basis approach.

Factors for determining suitability

With the expansion of factors to be considered in a suitability determination under paragraph 13.3(1)(a) of NI 31-103, we are pleased that the CSA has stated that the registrant’s suitability determination is on a “reasonable basis”. Given the breadth of the factors, it is critical that a reasonableness standard is incorporated.

While the IIAC has no specific issue with many of the factors listed in paragraph 13.3(1)(a), we do find subparagraph 13.3(1)(a)(viii) problematic. The language “any other factor that is relevant under the circumstances” is quite broad. It is unclear what this provision would capture, given the numerous factors currently outlined in subsection 13.3(1), and the inclusion of paragraph 13.1(1)(b) which requires putting the client’s interests first in any suitability determination. As 31-103CP does not discuss subparagraph 13.3(1)(a)(viii), we are unclear what exactly the CSA had in mind with this “catch all” provision. It is also not clear how firms would supervise this as part of the suitability determination advisors undertake. Furthermore, the IIAC is concerned that OBSI for example, may use this catch all to provide compensation to a client for a loss that may not fall under the factors currently listed (and may do so based on after-the-fact considerations).

As a result of this uncertainty and the language contained in paragraphs 13.1(1)(a) and (b), we would suggest subparagraph 13.3(1)(a)(viii) be removed. In the alternative, we would suggest additional clarity in the Companion Policy surrounding this clause, with specific examples included.

Specific factors are indicated

As discussed in the IIAC's response regarding the proposed KYC Client Focused Reforms, the terminology in 31-103CP referring to a "meaningful" suitability determination and a "meaningful interaction with the client" is unclear. Additional clarity would be useful.

Portfolio concentration

The IIAC agrees with the CSA's comment that over-concentration in certain securities can have a significant impact on a client's investments. As such, as part of IIROC Rule 2500 *Minimum Standards for Retail Account Supervision*, first tier daily reviews require firms to have procedures in place to detect undue concentration of securities in a single account or across accounts. Accordingly, the requirement to establish written procedures to calculate, monitor and manage concentration risks in a client's portfolio is a common practice that usually includes concentration thresholds for IIAC members.

Potential and actual impact of costs

The IIAC appreciates that the CSA has included language in 31-103CP that recognizes that there may be reasons why a specific higher cost security available at the firm may be better for a client than other suitable securities. We hope the CSA ensures this principle is carried forward in a final version of 31-103CP, and that the SROs also capture this same principle in their proposed rules and guidance.

However, as we pointed out in our Overview, the IIAC is concerned with the potential overemphasis on costs in this section, without mentioning other important factors that should be considered in conjunction with one another. Furthermore, we would suggest that the language surrounding the expectation to recommend the "lowest" cost security available be revised to instead to refer to a range of lower cost securities.

Consideration of a reasonable range of alternatives

We note the flexibility included in a registrant's obligation to consider a reasonable range of alternative recommendations or decisions available to the advisor through the firm at the time a determination is made, as set out in subparagraph 13.3(1)(a)(vii). However, members have pointed out that such an obligation will carry significant training costs in order for advisors to understand how to properly document that they have considered alternatives.

Reassessing suitability

The suitability triggers set out in subsection 13.3(2) are similar to those currently contained in IIROC Rule 1300.1. However, paragraph 13.3(2)(b) states that a suitability determination should occur when there is a change in a security in the account, without articulating the suitability triggers in the Companion Policy. While our members are familiar with the IIROC suitability triggers under Rule 1300.1(r)(i) to conduct a suitability review when securities are received into the client's account by way of deposit or transfer, which was also proposed in CP 33-404, we are somewhat unclear as to what is meant by "a change in a security in the account". Does this refer to corporate actions such as a stock split, or the issuer being taken over by another company, or an issuer undergoing another material change in its risk profile? Some additional detail and explanation would be helpful.

We also note that subsection 13.3(2) requires a registrant to take appropriate action promptly after one of the trigger events occur. There is no further guidance on this language provided in 31-103CP and we would suggest amending this subsection to refer to a reasonable time period for such a review.

We suggest that the CSA consider incorporating some of the language found in MDFA Staff Notice MSN-0069 *Suitability*. In that Notice, the MFDA discusses how a "reasonable time" for review will depend on the circumstances and sets out some examples. For example, with respect to client transfers, the volume of accounts to be reviewed may be a relevant factor in determining a reasonable time period for reassessing suitability. Where an advisor is transferring a large book of business to the firm, it may be reasonable to have suitability assessments done within a year if there are no trades on the accounts. If a firm or advisor becomes aware of a material change in the client's KYC information, the suitability assessment should be performed no later than one business day after the date on which the notice of change of information is received from the client.

Unsuitable investments

The IIAC supports proposed subsection 13.3(2.1) of NI 31-103 as it adopts the expectations outlined in Guidance Note 12-0109 regarding unsolicited unsuitable orders.

However, while subsection 13.3(2.1) is fairly broad in scope referring to instructions from a client to "take an action", the Companion Policy appears to narrow this to refer to unsolicited orders. We suggest that the Companion Policy be revised to mirror NI 31-103 and not only refer to orders or trades with respect to investments, but also such things as when the client has insisted on opening a specific account type (such as fee-based or margin) that the registrant has advised the client is unsuitable. The same steps, such as documenting when an advisor provides advice but the client declines, should also apply for unsolicited unsuitable account types.

Exemptions

We request further clarification regarding the exemption for registrants dealing with clients in the context of OEO firms. The IIAC notes the reference to the exemption from suitability as set out in the Notice, however, 31-103CP states that SRO rules "may" also provide exemptions from the suitability obligations under section 13.3, for example for dealers who offer OEO services. We recognize that under paragraph

9.3(1)(j), IIROC members are exempt from the suitability determination requirement. We would assume that IIROC would therefore provide an exemption for OEO firms within their rules, but greater certainty would be helpful.

Review by the regulator of the suitability determination

We strongly support the statements the CSA has made indicating that they will not review whether the suitability determination has been met, based on events subsequent to the determination by the advisor. Further, we appreciate the CSA's comment that there is not only one best decision, recommendation or course of action, and the litmus test is what a reasonable registrant would have done under the same circumstances. These comments are especially important given that the CSA has indicated that unsuitable recommendations generate the majority of complaints to OBSI. IIAC members wish to ensure that OBSI recognizes that provided an advisor has a reasonable basis for concluding that a certain decision or recommendation was suitable for the client, and puts the interests of the client first, OBSI will not second guess a decision taken by an advisor.

CONFLICTS OF INTEREST – SECTION 13.4

A registered firm's responsibility to identify conflicts of interest - Section 13.4

The IIAC acknowledges the CSA's position that conflicts of interest represent a key area of concern in the client-registrant relationship, and that requirements in this area are essential in governing registrant conduct under the client protection mandate of the provincial securities commissions.

We appreciate that certain problematic provisions articulated in the 2016 proposals that appeared to require advisors to assess the degree of client comprehension of conflicts have been reconsidered, specifically:

- the provision that representatives have a "reasonable basis for believing that clients fully understand" the implications and consequences of the conflict;

- the expectation that the firm obtain "informed and specific consent" from the client before the transaction is entered into.

However, the IIAC remains concerned about a number of other provisions, and the inclusion of new requirements, as articulated below.

A registered firm's responsibility to identify conflicts of interest - subsection 13.4(1)

We are concerned that the amendment to subsection 13.4(1) has removed the materiality standard in respect of the requirement for firms to identify existing and potential conflicts of interest.

It is unclear how the explicit identification of all non-material conflicts would advance investor protection. Where a conflict is not material, by definition, it would not negatively impact investors. Nor would it cause the registrant to be influenced to put their interests ahead of their client's interests, or cause the interests of a client and a registrant to be inconsistent or divergent. Given the number of clients, accounts and transactions, identifying all potential non-material conflicts, and addressing them as per section 13.4.2 and 13.4.3, represents a significant expenditure of time and effort, which is likely to delay execution of transactions, which are often time sensitive. If the conflict is not material, it is more likely that clients' interest would be prejudiced through such delays, rather than advanced, through this requirement.

The proposed standard is also inconsistent with the IIROC standard articulated in Rule 42, Conflicts of Interest, which requires dealers and registrants to take reasonable steps to identify and address existing and potential *material* conflicts of interest between the interests of the dealer and the registrant, and the interests of the client.

In addition, in MFDA Staff Notice MSN 0054, *Conflicts of Interest – MFDA Rule 2.1.4,* the standard for disclosing and addressing conflicts of interest is clarified as follows:

> In applying the rule in practice, MFDA staff takes the position that the concept of materiality is implicit in the rule. MFDA staff does not expect Members to anticipate every potential conflict,

> regardless of the remoteness of a problem arising, and provide written disclosure to clients of such conflicts. However, written disclosure must be provided in all cases where there is a reasonable likelihood that a client would consider the conflict important when entering into a proposed transaction.

We also note that the *Regulation Best Interest* proposal published by the US Securities and Exchange Commission on April 18, 2018 also articulates a conflict of interest standard in section II (D)(3) *Conflict of Interest Obligations,* based on materiality.

Considering the broad application of the conflicts of interest provision, it would be helpful for the regulation to narrow the requirements to encompass only material conflicts of interest and articulate a definition or provide guidance about what the particular concerns are in this area. For instance, in its letter to the SEC in respect of their *Regulation Best Interest* proposal, SIFMA advocates for a materiality standard articulated by the US Supreme Court in TSC Industries v Northway 426 US 438 (1976) and affirmed in Basic v Levinson. The materiality standard is described as follows: "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the "total mix" of information made available."

If the requirement to address non-material conflicts remains, it would be helpful if the CSA could articulate situations where they envision such conflicts may impact a client, and in what situations a reasonable client would expect to be informed about a non-material conflict. This additional information must be considered in the context of the vast amount of disclosure already provided to clients.

<u>A registered firm's/individual's responsibility to address conflicts of interest - Section 13.4.2 and 13.4.3</u>

We note that the requirement to address conflicts in the "best interests of the client" is consistent with IIROC Rule 42, *Conflicts of Interest*, except in addressing non-material conflicts. Consistency between regulatory instruments is appropriate and provides certainty.

It is unclear, however, if the "best interest of the client" standard is the same standard applicable to the suitability determination stated in paragraph 13.3(1)(b), which is that "the action puts the client's interest first." If the standard is intended to be the same, the language should be amended to reflect that. If not, the difference between the standards should be clearly articulated.

It is also important that NI 31-103 clearly states that the "best interest of the client" standard is not intended to be a fiduciary duty.

It is also unclear what the CSA envisions in the Companion Policy where it provides an example of controls to be considered when determining how to address conflicts in the best interest of clients, which could include "a system for confirming that *effective* conflicts disclosure is provided to clients." The word "effective" is subjective and does not provide practical guidance. Given that the Companion Policy contains a section entitled "*Conflicts Disclosure*", which articulates the key elements of such disclosure, we recommend that the provision refer to disclosure that is consistent with this section, rather than introducing a new and unclear "effectiveness" standard.

Conflicts arising from proprietary products

The stated premise that it is a conflict of interest for a registered firm to trade in or recommend proprietary products raises a number of issues. The ability to offer proprietary products is an integral decision in respect to a firm's business model. Establishing this product offering as a de-facto conflict without recognizing that providing proprietary product is one of several legitimate business models may limit firms' ability to determine what products they make available to clients. This may ultimately reduce the product choice available to clients. We recognize that there are appropriate steps that firms should take to ensure that firms do not favour proprietary products where other non-proprietary products on their shelf have may be more appropriate for their clients. However, it is important to ensure that the additional controls do not represent an unnecessary burden on firms, without providing a benefit to clients.

For firms offering both proprietary and non-proprietary products, the ongoing processes to compare, monitor, disclose and justify their use as against the non-proprietary products, in addition to what is required in the KYP process, may have the opposite effect as intended. Firms may elect to only carry proprietary products, or significantly narrow their offerings of products with similar profiles, to avoid any overlap between products, in order to reduce the administrative burden.

For instance, monitoring the use and level of proprietary products in client portfolios does not necessarily indicate whether the conflict is being addressed in the best interests of the client. The KYP obligations of the firm and the advisor, as well as the suitability and best interest requirement are designed to ensure the product recommended for the client is the one that is most appropriate. Client accounts that are more heavily weighted to proprietary products does not necessarily indicate that there is a conflict issue. It could indicate that the firm has developed a product that is well suited to its clientele.

In order to ensure that clients' access to products is not unnecessarily limited by burdensome procedures and place proprietary products on equal footing with non-proprietary products from a due diligence standpoint, we recommend that proprietary products be subject only to the same KYP process as non-proprietary products, without the expectation that firms take additional steps such as the ongoing monitoring of the level of proprietary products and obtaining independent advice on the effectiveness of firm's efforts to address the conflict, as included in the proposals. Provided that the firm provides the information required under section 14.1.2 *Duty to Provide Information* and 14.2 *Relationship Disclosure Information*, and resolves conflicts in the best interest of the client, this should be sufficient to manage any conflicts inherent in the recommendation of proprietary products.

Conflicts arising from third-party compensation

The concerns around third-party compensation for the sale or recommendation of securities has been widely discussed and debated. The Companion Policy should be interpreted to provide for products with third-party compensation in situations where the advisor's suitability analysis indicates that they are the better choice, vis-à-vis lower cost alternatives.

Conflicts arising from internal compensation arrangements and incentive practices

It is appropriate that NI 31-103 does not restrict or mandate certain compensation arrangements, which could alter the long standing and appropriate dealer business models. The suggested controls for those that have not properly managed their conflicts are a more effective means of addressing such issues.

Provided that firms understand the implications of their compensation arrangements and incentive practices, and manage the specific risks, regulation should not dictate the manner in which their firms compensate their advisors.

Conflicts of interests at supervisory level

This section appears to recognize that depending on the size of the firm, individuals in supervisory positions will have compensation structures that are differently correlated to the performance of those they supervise. Often the compensation for these individuals is comprised of a fixed element, and a variable element based on firm performance. It is not clear what other risk mitigation strategies are envisioned under this provision.

Conflicts of interest disclosure

The scope and detail of disclosure that is expected under new paragraphs 13.4.5(2)(b), requiring disclosure regarding the potential impact on and risk that the conflict of interest may pose to the client, and paragraph 13.4.5(2)(c), requiring disclosure of how the conflict of interest has been or will be addressed, should be clarified. These are both new requirements, as previously the conflict of interest disclosure only required a description of the nature and extent of the conflict of interest.

We are also concerned that the potentially broad scope and requirement for written disclosure in subsection 13.4.5(1) is particularly problematic in respect of the requirement in paragraph 13.4.5(4)(b), which states that such disclosure must be made "in the case of a transaction that presents a conflict of interest, before entering into the transaction with the client."

In particular, if written disclosure is required on a trade-by-trade basis, prior to a trade, this will likely work to the detriment of clients, especially when security prices are at all variable. NI 31-103 and the Companion Policy are somewhat confusing in respect of this provision. While the Companion Policy indicates that pre-trade disclosure of charges under section 14.2.1 can be undertaken orally rather than in writing, the provisions relating to conflicts of interest do not make this accommodation. In situations where an advisor recommends a security, where alternatives are available that carry different commission structures, the Companion Policy indicates that a registrant must disclose this in writing, prior to the trade. This would appear to apply even in situations where the client may already own the security, or the disclosure has been previously made.

Given that registrants must explain the potential impacts of commission-based conflicts, as well as how they address such conflicts in the best interest of their clients at the opening of the account, and that they are obligated to resolve the conflict in the best interest of their client, the requirement for written disclosure at the time the conflict occurs is redundant, and may prejudice the client by delaying the transaction. We recommend that in the case of commission conflicts, an exemption from the requirement for written disclosure be provided, and the provision in the Companion Policy allowing oral disclosure be permitted to allow for timely trade execution.

REFERRAL ARRANGEMENTS – SECTION 13.8

Definitions – referral arrangements

We are concerned with the broad scope of the definition of referral arrangement, in that it could potentially capture *de minimus* and informal consideration, such as a thank-you dinner, bottle of wine or other expression of gratitude for a referral that would not represent a material incentive to the recipient. We recommend that a materiality standard be included in the definition.

Permitted referral arrangements - Section 13.8

It is not clear that the regulatory objective behind the new requirement in paragraph 13.8(1)(a), which mandates that the person or company receiving a referral fee must be a registered individual or registered firm, is the most effective way of dealing with the regulatory concerns articulated in the proposal.

We understand that one of the CSA's concerns is that registered individuals may have an incentive to give up their registration and generate similar levels of income through referrals, without incurring the added oversight and cost of being registered. This would allow them to indirectly and improperly participate in and benefit from activities involving registrable activity. If such individuals are referring clients to IIROC dealers, the concern about such non-registrants undertaking registrable activities without being registered would be unfounded, as IIROC dealers are bound by comprehensive obligations to their clients which would not permit such a situation from existing. IIROC firms and registrants are required to manage their client relationships in the context of their regulatory obligations, regardless of the way in which the client entered the relationship, whether that be through referral for a fee, referral with no fee or through firm prospecting. If the CSA is concerned about non-registrants making improper referrals to firms or making referrals for a fee while undertaking registrable activities, it should be articulated that in this context, it is the responsibility of firms and their registrants to undertake proper KYC and suitability analysis to ensure that a firm can properly service the client.

We recommend that if this is the rationale for the restriction, the CSA target this activity and these non-registrants more directly, rather than placing limitations on legitimate and beneficial referral activities undertaken by firms and non-registrants.

A referral fee paid to a non-registrant can be regarded as a marketing expense, as it is a form of prospecting through third parties. Fees paid to these parties do not prejudice the client, as they will be subject to the same regulatory protections and receive the same level of service as other clients.

Provided that the referral fee does not increase the amount of fees or commissions to the client pursuant to paragraph 13.8.1(c), it is not clear why such a fee would be prohibited.

We believe the registrant's regulatory obligations to clients prevent referrals from non-registrants from posing any risk to potential clients. From a "level playing field" or market structure perspective, the advantages that referral fees provide, benefit both large firms with divisions that can refer potential clients from those divisions to the securities dealer ("right channeling the client"), and also to independent firms that may receive referrals from independent parties, such as accountants, lawyers, financial planners, insurance agents, consultants, credit unions and others.

To this end, we seek confirmation that the proposed provisions relating to referrals apply equally to affiliates and related parties, so that the regulation applies uniformly to firms regardless of their affiliate structure.

We recommend that the restriction on firms and registrants paying for referrals from non-registrants be removed. If the CSA continues to be concerned about these arrangements, we recommend that paid referrals continue to be permitted where the referring firm or individual is a member of a self-regulatory or self-governing body, or industry where the activity is subject to regulation, conduct and ethical requirements. Examples would include lawyers, accountants, chartered financial analysts, financial planners, engineers, etc. Under these circumstances, the referring entity would also be subject to obligations to their client to ensure the referral is appropriate. We recognize that the proposed regulation applies not only to IIROC registrants, but to those that are not subject to the same level of robust regulation and oversight as IIROC registrants. As such, for registrants that operate under a less rigorous regulatory regime it may be appropriate to impose the restrictions on referrals to and from a non-registrant.

If the CSA believes there is a regulatory reason for imposing the restrictions, we recommend an exemption be provided from the provision relating to non-registrants, for IIROC registered firms and individuals, recognizing their high level of regulatory obligation and oversight.

We acknowledge that there is a possibility of conflict where the firm or registrant *receives* a referral fee from a party that does not have professional obligations to a potential client. In those circumstances, it is possible that the potential of referral-based compensation could lead firms or registrants to make referrals where it is not clear that the referral is in the client's interest, or that the company receiving the referral will provide services consistent with the client's interest. The proposed Client Focused Reforms recognize and manage that risk.

Limitation on referral fees - Subsection 13.8.1

We seek clarification as to the regulatory purpose of the requirement that firms not be permitted to provide or receive a referral fee for a time frame exceeding 36 months. Consistent with our position about the nature of the provision of a fee as a marketing expense, it is unclear why the fee arrangement would be subject to a time limit. In the event that a firm is receiving an ongoing fee for a referral, it is appropriate to require the firm to continually evaluate whether the referral is appropriate for the client, and the referred company continues to be appropriate for the firm's client. This due diligence evaluation could be formally undertaken on a regular basis – for example every three years.

Referral arrangement CSA Questions

We respond to the questions posed in the CSA Notice and Request for Comment document as follows:

Q: Does prohibiting a registrant from paying a referral fee to a non-registrant limit investors' access to securities related services?

A: A prohibition would not necessarily limit investors' access to securities related services per se, however, it may result in fewer investors being sent to registrants for advice where it may be appropriate.

Q: Would narrowing section 13.8.1 *Limitation on referral fees,* to permit only the payment of a nominal one-time fee enhance investor protection?

A: Such a restriction would not enhance investor protection, as regardless of how an investor becomes a client of a registrant, the registrant is bound by the regulation and professional obligations imposed on it.

MISLEADING COMMUNICATIONS – SECTION 13.18

IIAC members support the CSA's proposed changes to section 13.18. We agree that a representative's title should be reflective of his or her proficiency level, skills, experience and registrant category to enhance clarity for investors. IIROC members have been complying with similar title/misleading communication requirements for a number of years, pursuant to IIROC Guidance Notice 14-0073 *Use of Business Titles and Financial Designations,* which also imposes similar restrictions on the use corporate officer titles (unless warranted) or other sales-based titles like the President's Club.

We are also supportive of the CSA's decision to revise its proposal outlined in CP 33-404, which contained requirements that were overly prescriptive, and provided generic title alternatives that could potentially mischaracterize registrants without alleviating client confusion.

In addition to the proposed changes to section 13.18, we understand that the CSA may be considering additional rules with respect to titles. We encourage the CSA to collaborate with industry and clients to determine if there are any remaining concerns, prior to undertaking additional rule-making. Further, more prescriptive title restrictions may be more appropriately developed in conjunction with the applicable SROs.

DUTY TO PROVIDE INFORMATION – SECTION 14.1.2

There are some discrepancies between the Notice, National Instrument, Companion Policy and Annex E with respect to how the regulators view the purpose of this information. This results in confusion among industry participants as to what is required. The Notice and Companion Policy state that the prescribed information is not required to be specific to any one potential client and general descriptions are sufficient. This suggests that the goal is to provide general information to potential clients, allowing for a cursory understanding of a firm's offerings and services. However, the requirements in section 14.1.2 and statements included in Annex E, suggest that the document is intended to be more individualized, and used for other purposes beyond a cursory comparison of firms. For example, Annex E notes that the document could help address conflicts of interest and expectation gaps, reduce search costs, reduce information asymmetry, and increase transparency of business models for regulators.

IIROC dealers' account sizes, services, fees and products offerings are highly specific to individual advisors, the client and/or the line of business within the IIROC dealer. Full service IIROC dealers are not analogous to banks or OEO firms where the fees are predominately one-size fits all. The information is not easily commoditized. For example, while section 14.1.2 requires firms to disclose material limitations to products and services offered for an IIROC dealer, there may be very few firm-wide limitations, but a specific advisor that the potential client wishes to engage with could have a much more limited shelf. The firm-wide information would be misleading as to what is available to that specific potential client. Requiring material limitations to products or services may be more useful for clients considering mutual fund dealers or proprietary only firms. It could also be very difficult to keep the information current depending on the level of detail required.

With respect to fees, there can also be significant ranges across the firm. Operational or administrative fees may be more standardized; however, investment management fees can have significant variations within a firm. Consequently, firms do not have firm-wide generic fee schedules for investment management fees as fees will vary as a result of a client's negotiations, asset levels, or householding. Such information is typically provided to clients when firms are able to make accurate assessments of what fee schedule would be applicable to that specific client.

Paragraph 14.1.2(c) would require more detailed fee information to be publicly provided than what is required under the proposed RDI requirements. This requirement is also concerning from a competitive perspective in terms of details of specific fees that firms charge. We recommend that paragraph 14.1.2(c) be revised to remove the requirement to provide a current fee schedule.

Under the proposal, we believe investors will either be provided with information that is too general to be useful (i.e. large ranges of what is available) or it will more closely resemble the RDI which may be overwhelming for potential clients.

Unless it is the regulators' intention to have the publicly available information document mirror the RDI, firms do not have firm-wide internal documents that include the majority of the prescribed information in section 14.2.1 as suggested in Annex E. Requiring this public disclosure would represent a significant undertaking.

We recommend that the CSA work with the financial industry and conduct client research to determine what information will be helpful and how it can be provided in a meaningful way for more complex firms with a broad range of offerings.

RELATIONSHIP DISCLOSURE INFORMATION SECTION 14.2

IIAC members recognize the role of the RDI in furthering the client's understanding of the services and products that they can expect to receive at the dealer member. We support several of the changes to the RDI requirements from the CP 33-404 proposal, including removing the requirement to disclose the proportion of proprietary products and the requirement that the client "fully understand the implications and consequences" of the content being disclosed. In particular, the previously proposed requirement to ensure client understanding would have been unmanageable, as there would be no way to measure client understanding and confirm compliance with the requirement.

IIROC's Relationship Disclosure Document Requirements

IIROC members have had enhanced RDI requirements for a number of years. In conjunction with CRM, in 2012, IIROC re-assessed the RDI document and in Notice 12-0107, introduced Rule 3500 which provided more prescriptive requirements of what firms were required to disclose. In addition, pursuant to Rule 3500.5, IIROC members are required to provide the prescribed information to clients in a single document entitled the Relationship Disclosure Document ("RDD"). This differs from CSA's rules that allow the RDI to be provided in a single, or separate documents.

As a result of this distinction, while we understand the CSA's objectives of ensuring the RDI includes all information that a reasonable investor would consider important, members are concerned that if the RDD has too much information, it could decrease the likelihood that the client will read the document.

Section 14.2 of NI 31-103

Certain items in subsection 14.2(2) of NI 31-103 note that a "general description" of a firm's products or services is required. We believe that language is necessary and the IIAC would like to highlight that since RDI/RDD's are standardized and not client specific, each item in sub-section 14.2(2) NI 31-103 should have similar language. For example, the proposed subparagraph 14.2(2)(o)(i) requires an explanation of fees and charges on a client's investment returns. That information cannot be specific to an individual client, as firms would not have sufficient information (such as householding information) at that stage of the relationship to conduct the type of assessment necessary to provide accurate information. The RDI/RDD would have to have general information about the various fees the firm charges and how those fees could impact investment returns. In addition, clients are provided with supplementary documents such as the Client Agreement and their Fee Schedule which will provide the client with specific information regarding their relationship with the firm.

It should also be noted, that while we understand the purpose of subparagraph 14.2(2)(o)(iii) requirement to disclosure investment fund expense fees or other ongoing fees, that information may not be applicable to many of a firm's clients. IIROC members have access to a variety of products and many of the products will not have investment fund expense fees or other similar ongoing fees. This requirement underscores the general or standardization nature of the information provided in the RDI/RDD.

Investment impact of costs and restrictions

The Companion Policy notes that the firm is required to tell the client if it does not have products or services that are suitable for the client. An example is provided regarding how the differences between investment goals would impact the types of potential accounts that would be suitable for a client. It is not clear how the CSA expects firms to convey this information in a standardized document, unless the CSA is merely requiring a statement to that effect in the RDI.

APPENDIX C: QUEBEC IMMIGRANT INVESTOR PROGRAM EXEMPTION REQUEST

We believe that QIIP accounts should be considered out of the scope of the Client Focused Reforms for the reasons listed below. If the CSA believes that the QIIP accounts would be captured within the scope of the proposals, we then submit that these accounts should be exempt from the rules application. The application of the Client Focused Reforms to the QIIP activity would indirectly put an end to this government program as the rules could prohibit certain essential components of the program, such as the necessary payments to immigration agents.

Unique Features of the QIIP account

The QIIP has been created by the Québec Government to increase economic growth by providing immigration benefits to foreign citizens that have significant wealth, and that can contribute that wealth to the Quebec economy. Furthermore, local companies can benefit from grants generated by the immigrant's deposit in the QIIP account.

QIIP accounts are therefore particular in nature in terms of their purpose. While they are held by IIROC dealers for the immigrant account holder, they are not considered to be "investment accounts". The dealer/advisor is only able to invest the funds with Investissement Québec and the dealer holds a note for a period of five years, after which, the capital (minus any fees) is returned to the immigrant investor. The dealer/advisor is not able to invest the funds in any other manner. As a result of this structure, QIIP accounts are not subject to the *Securities Act* (Québec). We believe that no element of the QIIP falls into the definition of forms of investment outlined in Section 1 of the *Securities Act* (Québec).

QIIP Accounts – The role of the dealer

The Québec government authorizes financial dealers, including IIROC-regulated dealers to participate in the QIIP. Once it has been determined that the immigrant is eligible/approved for the program, the dealer facilitates the acceptance of the funds from the immigrant and then places the deposit with Investissement Québec. The dealer will then hold a note reflecting that investment for the duration of the program.

Fees paid to the immigration agent

If the immigrant elects to use an immigration agent, then the immigration agent would charge a fee for the multitude of services rendered. When an immigrant is represented by an agent, the immigration agent must prepare a complete file to be handed over to the financial intermediary on behalf of the immigrant. The work done by the immigration agent includes: opening the immigrant's file, assessing admissibility of the immigrant to the program, ensuring the client deposit is made to the QIIP account and dealing with administrative aspects related to the *Ministère de l'Immigration, Diversité et Inclusion du Québec*. The immigrant could pay the fee directly, or in some instances, the dealer may pay all or a portion of the immigrant agent's fees. IIAC members believe that the fee does not constitute a referral fee. The fees appropriately reflect services rendered. Furthermore, if the dealer and the immigrant would, at a later date, enter in a typical “investment advice” relationship, the dealer would need to open a different account for the client and could not use the immigrant’s QIIP account. The immigration agent would not be involved in the new relationship between the firm and its client or receive any fee in respect of that new non-QIIP account.

QIIP Accounts should be exempt from the following Client Focused Reform sections:

If the CSA determines that QIIP accounts are within the scope of the Client Focused Reforms, then we submit that the QIIP accounts should be exempt from the following sections:

- Section 13.2 (KYC Requirements): In order to be eligible for QIIP accounts, the immigrant/client must provide extensive information. The dealer becomes involved after the initial information collection process when the immigrant has been approved to participate in the program. The dealer is also provided with a template agreement from the Québec government which dictates what information the dealer must collect. As previously noted, the immigrant is only able to invest with Investissement Québec. Therefore, the new KYC requirements which are designed to assist suitability determinations are not applicable. If the client were to open another account, then the rule scope of the Client Focused Reforms would apply.

- Section 13.2.1 (KYP Requirements): This is an account type and not a product. Dealers have been approved by the Québec government to offer these accounts to these approved immigrants.

- Section 13.3 (Suitability determination): As previously mentioned, the dealer/advisor is only able to invest with Investissement Québec and the dealer/advisor is not making any recommendations. If the Québec government determines that the immigrant (client) is approved for the QIIP, the dealer/advisor should be able to rely on that assessment and complete the investment process with Investissement Québec.

- Section 13.4 (Conflicts of Interest): Payments made by the dealer to immigrant agents with respect to QIIP accounts should not be considered to be a conflict of interest. We fully understand why the CSA is trying to address conflicts of interest. However, we must stress that the QIIP accounts and the payments to the immigration agents related to these accounts are not creating conflicts of interest. The immigration agents are not providing investment advice or investment related services to investors. The agents are processing immigration applications for the benefit of the Québec government. Furthermore, the registered personnel of IIROC-regulated dealers do not have the knowledge and experience to provide immigration-related services currently performed by unregistered immigration agents. These services are often provided by the agent in foreign countries, in the language of the immigrant. The registered personnel of an IIROC dealer deals with investments and/or trading while the unregistered immigration agents provide completely different services to an immigrant. It should be noted that the immigration agent could not easily obtain a securities registration since the work performed is different than the brokerage and investment activities performed by registered personnel.

- Section 13.8 (Referral Arrangements): As previously stated, we do not believe that the fees the immigrant agent (an unregistered individual) receives should be considered to be a referral fee due to the services rendered by the immigrant agent. The QIIP does not require a "registered" immigration agent due to the fact that the program and the activity conducted by the agent is not regulated by the *Securities Act* (Québec).

- Section 13.8.1 (Limitations on referral fees): In addition to the reasons above that the fees paid to immigrant agents are not referral fees, the proposed limitations on referral fees should not be applicable. While the dealer does not make ongoing payments to an immigrant agent with respect to the same client (it is one payment per client), the dealer may use the same immigrant agent for a number of years and make multiple payments to that agent. In addition, since the fees charged by the immigrant agent are related to the numerous services rendered, and should not be considered to be referral fees, the 25% limitation is not appropriate.