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British Columbia Securities Commission
Alberta Securities Commission
Financial and Consumer Affairs Authority of Saskatchewan
Manitoba Securities Commission
Ontario Securities Commission
Autorité des marchés financiers
Financial and Consumer Services Commission, New Brunswick
Superintendent of Securities, Department of Justice and Public Safety, Prince Edward Island
Nova Scotia Securities Commission
Securities Commission of Newfoundland and Labrador
Superintendent of Securities, Northwest Territories
Superintendent of Securities, Yukon
Superintendent of Securities, Nunavut

Dear Friends:

Re: Client Focused Reforms – CSA Consultation Paper 81-408

We thank you for this opportunity to submit our thoughts on the proposed Client Focused Reforms.

Pacific Spirit Investment Management Inc. is licensed as a Portfolio Manager in the Provinces of British Columbia, Saskatchewan, and Ontario. Our firm works exclusively with individual investors and we do not manage funds for institutional investors. We manage approximately $206 million for approximately 170 client families.

We manage each client account separately – each account holds its own investments which are consistent with the Investment Policy Statement for that account. We do not offer any proprietary products – no proprietary funds, no proprietary pools. We are fee-only. The only compensation we receive is the portfolio management fee that we invoice our clients quarterly. We do not receive any commissions, referral fees, trailer fees, or soft dollars.

We generally prepare a basic retirement plan for clients as part of the onboarding process when we enter into a new client relationship. We believe that the preparation of a plan serves as an excellent communication tool between

ourselves and our client and the plan provides inputs for the Investment Policy Statement.

We have two registered Advisers (Portfolio Managers) who both hold the CPA, CFA, and CFP designations.

Our clients may hold individual equities and fixed income investments as well as mutual funds and ETFs.

Our Comments on the Client Focused Reform Proposals

Disclosure Fatigue

The proposed amendments require substantial additional disclosure to clients. It is rare that our clients read the currently mandated disclosures. As the amount of disclosure increases, client engagement in the process will continue to decline, which would be an undesirable outcome.

We recommend that the required disclosures be kept as simple and as brief as is possible. The Regulators should strive to have the required disclosures fit on a four page document when written in 12 point font.

Prescriptive Regulation vs Goal-Oriented, Outcomes-Based Regulation

The proposals are very heavily prescriptive to the point of outlining what is required to assess an investment, to assess portfolio construction, to assess client risk tolerance, etc. The regulators are dictating how industry participants are to run the specifics of their core expertise. We believe that the regulators have forgotten that most advisers in the Portfolio Manager area hold the CFA designation (in fact it is now a requirement to become an Adviser) which is a rigorous program of training in investment evaluation and portfolio construction. It is our opinion that the regulators should not regulate the core competencies of Portfolio Managers. We do not believe that the Regulators fully understand our business.

We would prefer Goals-Oriented, Outcomes-Based Regulation. For example, mandate that client portfolios should be well diversified and there should be a reasonable expectation that the securities, when combined as a portfolio, will achieve the client's objectives as stated in the Investment Policy Statement. Then leave the Portfolio Managers to do their work to achieve those goals.

Osler, the respected law firm, has noted that the suitability requirements have eight categories of input, with an additional 35 recommended sub-categories which must be considered in respect of each proposed transaction for a client account. We fear that advisors will become documenters rather than doing value added work for clients such as investment research and client contact, education, and counselling.

Osler also noted that the rigorous, prescriptive KYP approval and monitoring processes will likely be costly for many firms to implement and may reduce the options available on product shelves.

The author of this letter entered this profession more than 20 years ago because it offered an intellectually challenging platform through which he could help people achieve their financial goals. Our firm motto is “Dream It, Plan It, Live It” which reflects the value add that we offer clients. We help them achieve their dreams. The author fears that the work environment will shift heavily towards compliance documentation rather than value added (from the client’s perspective) work. The compliance burden will be too great and will detract from the true role of our industry which is to create wealth for our clients and their families.

Referral Fees

Referral fees are defined too broadly and the Regulators are too vague as to how they will interpret these new provisions and as a result Advisers are unable to plan appropriately. The Companion Policy uses an example of a “representative who is planning to retire may decide to sell their business, including their book of clients, to another registrant in return for an ongoing payment.” The CP further states that “Depending on the circumstances, if the regulators are satisfied that the transaction is a bona fide sale of a business then the ongoing fees provided, in exchange for the book of clients, **may** (emphasis added) not be considered a referral fee.”

Industry participants need clarity to plan our exit strategies and offering an opinion that a payment **may** not be considered a referral fee is insufficient.

It is our understanding that payments for an Adviser’s business or a book of business are usually structured over a five year period (60 months), therefore the guidance and the Regulators assessing position should reflect the realities of the industry.

Also, there should be clarity offered in respect of partial sales of a book of business so these types of transactions will also be exempted from the referral fee restrictions. It may be that an adviser wishes to exit a particular type of business or may wish to surrender their registration in a given jurisdiction and may sell part of their book of clients as a part of that process. The regulations should be clear that such partial sales will be exempt from consideration as referral fees.

The exemption of payments for the full or partial sale of a business or book of clients should also apply whether or not the seller remains in the industry as a registrant or exits the industry entirely.

An adviser invests considerable amount of effort in building their business and educating their clients and they should, as business people, be able to freely sell this asset like any other business.

Is there a reason why the proposals cap referral fees at 25 percent of the fees or commissions collected from the client by the party who received the referral? How was the 25% determined?

Conflicts

The Companion Policy states that "if a registered individual recommends a security that they own, this will constitute a conflict that must be disclosed to the client before or at the time of the recommendation." I am not sure how this can be a conflict if our interests are aligned - we both own the same investment. I can see the conflict if one was selling and one was buying, but with each owning the security the interests are aligned. We are asked many times by prospective clients if we personally own the investments we use to populate our client portfolios. They are asking to gain assurance that we "eat what we cook" and that we believe in our management capabilities. In the real world this reassurance that interests are aligned is very important.

If you do require disclosure, it should be sufficient to make a one-time disclosure to the client that the registered individual may own the same investments as the client, without having to make a disclosure each time a security is purchased.

Paragraph 14.2 (2) (o)

The disclosure of the potential impact that a registered firm's charges, applicable investment restrictions, and any costs embedded in investment products could

have on a client's investment returns is a duplication of the annual cost disclosures required by Portfolio Managers and mutual fund companies, but in another format and at another time. Is the extra disclosure worth it in relation to the Disclosure Fatigue that we referenced earlier in this letter?

The disclosure of the potential impact that a registered firm's charges, applicable investment restrictions, and any costs embedded in investment products could have on a client's investment returns is too focused on one aspect of the relationship – the cost side – and ignores the tremendous value that an adviser brings to the relationship. Should you not, in the full best interest of the client, require that there be disclosure about the benefits that an investment manager brings to the table?

There is also a presumption in the requirements that a limited range of products may result in reduced overall returns. Has there been research that supports that conclusion in the Portfolio Manager world?

Holding Out as Independent

The Companion Policy indicates that "If a registered firm holds itself out as independent but offers proprietary products, this could reasonably be expected to mislead a client ..." What are the registered firms indicating they are independent of … the banks, the brokerage industry, the mutual fund industry? The registered firm should define what they are independent of. Could it also not be argued that a firm that does not have pools or funds also has a proprietary product which is the expertise of their firm?

Fee-Based Compensation

The Companion Policy requires registrants to evaluate on an ongoing basis whether a fee-based compensation arrangement is in the best interest of the client, given the clients circumstances, investment needs and objectives, and the account activity. We do not believe that an account needs to be actively traded to be well managed. Art Phillips, founder of Phillips Hager & North, once said that a portfolio is like a bar of soap … the more it is handled, the smaller it gets. We do not believe that an account needs to be actively traded to be beneficial to a client. Ask Warren Buffett what his preferred holding period is … it is forever. A significant part of our business is behavioural management – keeping the client faithful to the long-term program, keeping the client from making mistakes, and educating our clients so that they are more informed and can make better

decisions. In addition, our fee covers not only portfolio management but also some related additional services, including preparing tax information, etc.

We do not offer a compensation basis other than fees. We believe that fee basis compensation aligns the interests of the adviser and the client. If our fee was transaction based our clients would begin to question why we are transacting – is it to generate fees for ourselves or to make a prudent investment. Our fee basis (percentage of assets under management) eliminates this doubt. Our clients are always free to terminate their relationship with us if they do not see the value in the relationship. Our clients may terminate their portfolio management agreement with no notice.

Embedded Commissions in Fee Based Accounts

Occasionally DSC funds are received into a new account when a new client's portfolio transfers in. We do not receive any of the embedded commissions. We carefully evaluate on a case by case basis whether the DSC funds should be redeemed. Sometimes we determine that the DSC fund(s) or another fund in the same fund family should be held so as to avoid an immediate loss on the redemption of the fund. Why should we be required to make the client whole if we do not benefit from the embedded commission and retaining the fund is, at that point, in the best interest of the client?

Conflicts of Interest and Materiality

Materiality is defined as the quality of being relevant or significant. Therefore, immaterial conflicts are not relevant or insignificant. If a conflict is not material, why generate a conflicts management framework to deal with conflicts that are not relevant or are insignificant.

You should also be prepared for unintended consequences of a zero tolerance for client conflicts.

Client Directed Trades

Provided the request does not involve insider information, the purchase is not significant to the client's portfolio, and there is an understanding that the Portfolio Manager is not managing the security and is not providing advice with respect to the security it is our opinion that they should be allowed. It is a client service to process the trade.

Risk Assessment

It is our opinion that the recommendations, by focusing on short-term volatility, downplay the significance of the risk of a client not attaining their financial goals. Indeed there is risk related to short-term volatility and the client's reaction to that volatility and the potential for the client to abandon the program in a time of market stress. There is also the risk of loss from an investment that does not perform satisfactorily. On the other hand there is the long-term risk of inflation and the erosion of lifestyle because fixed income investments do not, on an after-tax basis, generate sufficient returns.

It would seem from the proposals that a Portfolio Manager may not accept a mandate from a client where the client's risk tolerance is stretched so that they can achieve their long-term goals. It is our belief that a client educated, in advance and on an ongoing basis, by the Portfolio Manager about risk and volatility and counselled at the appropriate times to "stay the course" can accept more risk in a portfolio than they would if they were without counsel. Is it the Regulators role to tell an investor that they may not strive to achieve their life goals because achieving the goal may require taking on more volatility risk. The client should be the one to make the determination on whether they will stretch their risk tolerance in order to achieve a goal.

Client investment objectives

Speculation is not an investment objective.

The Companion Policy states that "a registrant should consider setting out the investment return that would be required to meet the client's financial goals taking into account the client's risk profile." We have difficulty with this statement. We identify the asset mix that has the highest likelihood of delivering the client to their financial goals. Because we are dealing with the future, there are no guarantees. We back test the plan based on market history. There may be future outcomes that do not meet the client's objectives, but we work to find the asset mix (or mixes) that reduce the risk of a plan failure to a low percentage. No where do we specify a required rate of return as we cannot guarantee a rate of return and returns are volatile. In addition, specifying a required rate of return assumes that the portfolio will achieve a constant rate of return year after year. That is not the way that the real world works. The markets are volatile and there can be long periods of underperformance.

We counsel our clients not to take on debt for investing. We also provide financial planning services to our clients if they request such services and they are within our skill set. The Companion policy would seem to require registrants to provide financial planning services. Most registrants are not trained in financial planning and should not be required to provide financial planning services.

Know Your Product

The requirement that "in the case of a security transferred by a client from another registered firm that is accepted by the registered firm … the firm must not permit the security to be transferred into the client's account or trade in the security to be made unless …" Many times when we receive transfers in from a former adviser there are securities that are received that were not on the list provided by the client as the former adviser may be trading right up to the day that the account is transferred or the client may only have an account statement that is stale-dated. The policy does not reflect this reality. The policy should indicate that the Adviser should promptly assess the securities received to ensure that they are suitable and that they should, in a manner that is in the best interests of the client, liquidate those securities that they deem are unsuitable. It may be that this process will take some time as a security may be thinly traded, may be suspended, or for some other reason prudence would indicate time should be taken in selling the position.

Know Your Client

There is a requirement that KYC information be updated no less than once every 12 months for managed accounts. The policy does not appear to grant any flexibility in this regard. In real life it may be impractical to ensure KYC's for some clients are updated every twelve months. A client may, without forewarning the adviser, leave on a year-long around the world sailing trip (with limited communication ability, and likely very limited interest in dealing with Know Your Client issues) just prior to the annual update of the KYC. Technically the adviser would be offside, even though there is no reasonable way they could achieve the update. Please give some flexibility in this matter.

Prohibition on Loans from Clients

Prohibiting loans from clients may impede registrants ability to maintain adequate capital if the loan comes from a related corporation which is also a client of the registrant.

Thank you for this opportunity to submit our thoughts.

Sincerely,

PACIFIC SPIRIT INVESTMENT MANAGEMENT INC.

John S Clark

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President