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INVESTMENTS

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VIA EMAIL

October 19, 2018

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: The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor, Box 55
Toronto, ON M5H 3S8

Me Anne-Marie Beaudoin
Corporate Secretary
Autorité des marchés financiers
800, Square Victoria, 22e étage
C.P. 246, tour de la Bourse
Montréal (Québec) H4Z 1G3

Dear Sir/Madame:

RE: CSA Notice and Request for Comment on the Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* and to Companion Policy 31-103CP *Registration Requirements, Exemptions and Ongoing Registrant Obligations* - Reforms to Enhance the Client-Registrant Relationship

Franklin Templeton Investments Corp. (**"FTI"**) welcomes the opportunity to make a submission with respect to the Canadian Securities Administrators (**"CSA"**) Notice and Request for Comment on the Proposed Amendments to National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations* (**"NI 31-103"**) and to Companion Policy 31-103CP *Registration Requirements, Exemptions and*

Ongoing Registrant Obligations (**"31-103CP"** or the **"Companion Policy"**) (NI 31-103 and 31-103CP are collectively referred to as the **"Client Focused Reforms"** or the **"Proposals"**).

FTI and its two Canadian subsidiaries, Fiduciary Trust Company of Canada (**"FTCC"**) and FTC Investor Services Inc., are registered in most provinces and territories in Canada as adviser, investment fund manager, mutual fund dealer and/or exempt market dealer. FTI is a wholly owned subsidiary of Franklin Resources, Inc., a global investment organization operating as Franklin Templeton Investments. Through its subsidiaries, Franklin Templeton Investments provides global and domestic investment advisory services to the Franklin, Templeton, Franklin Bissett, Franklin Mutual Series, and Franklin Quotential funds and institutional accounts. In Canada, FTI has almost 500 employees providing services to nearly 370,000 unitholder accounts and over 150 pension funds, foundations and other institutional investors.

FTI believes in placing the interests of investors ahead of the interests of registrants and we support regulatory initiatives that achieve this objective. We believe in the value of financial advice and that such advice should play a critical role in investors' investment decision making - investors who have access to financial advice have better financial outcomes. The best way for investors to achieve their financial objectives is to have access to a wide variety of investment products coupled with access to professional financial advice in areas such as investments, tax and estate planning.

While FTI supports the CSA's stated goals of better aligning the interests of registrants with the interests of their clients, improving outcomes for clients and making clearer to clients the nature and the terms of their relationships with registrants, we are concerned that the Client Focused Reforms may not achieve these goals for the reasons stated below.

FTI is a member of the Investment Funds Institute of Canada (**"IFIC"**). We have reviewed and generally support the comments made by IFIC (although not every specific one) in its letter dated October 19, 2018. FTI also wishes to provide its comments on the Client Focused Reforms and, in particular, highlight our concerns regarding the amendments to the rules relating to referral arrangements.

General Comments

FTI has some general concerns with the Client Focused Reforms, which include:

1. Companion Policy Guidance

Many of the changes proposed in the Client Focused Reforms are amendments to 31-103CP. In fact, the amendments to the Companion Policy are much more extensive than the amendments to NI 31-103. We are concerned with the highly prescriptive nature of the 31-103CP amendments.

Companion polices have historically been published as industry guidance and used as an aid in the interpretation of the related rules and regulations.
The Companion Policy amendments, in this instance, are extensive, lengthy, and prescriptive in nature. Prescriptive requirements are contrary to the CSA's principles-based

approach to securities regulation. We also find that certain elements of the 31-103CP amendments have been cast as regulatory expectations against which compliance with the actual regulations will be measured and scrutinized (there are many references to what regulators "expect" in 31-103CP). We believe this is inconsistent with the role of policy guidance.

We request that the CSA amend the proposed 31-103CP amendments to explicitly state that the Companion Policy is industry guidance only, it does not have the force of law and there is more than one way to achieve the stated objectives. On this basis, the expectation would be that no audits or enforcement proceedings would be taken based on non-compliance with the Companion Policy, particularly if a registrant has taken or adopted an alternative method or approach in complying with the requirements of the rules. Registrants should not be required to implement the 31-103CP amendments in a manner inconsistent with, or inapplicable to, their business models. Alternatively, the CSA should incorporate into NI 31-103 any aspects of 31-103CP that it considers to be requirements.

2. Focus on Cost

The Client Focused Reforms seem to reflect a regulatory preoccupation with lowest cost products. In both the know your product ("**KYP**") and suitability requirements, there is a suggestion that clients will have better investment outcomes if the lowest cost investment products and/or services are chosen. The Companion Policy establishes the expectation that the default option is the lowest cost security available to the client. In the Ontario Securities Commission's regulatory impact analysis statement, set out in in Annex E of the Client Focused Reforms ("**Annex E**"), it states that over time regulators anticipate that the new KYP requirements will result in improvements including a higher proportion of lower cost, better performing securities to clients.

Given regulatory settlements with certain registrants in recent years, we are concerned that the language in the Companion Policy may cause registrants to default to the lowest cost security for their clients, without necessarily evaluating other important product features such as product structure and purchase options in determining which products are the most suitable for a client. We acknowledge that costs affect client outcomes and should be a consideration in a registrants' suitability determination, but we do not agree that cost should be the only or primary consideration. To assert otherwise would be to undermine the true nature of the suitability determination and the skill and judgment that a registered individual uses in making that assessment.

Furthermore, we do not believe it is the role of securities regulators to interfere in the commercial relationship between registrants and their clients by setting expectations for product choices based on cost. These expectations discount the value of financial advice and have the effect of favouring certain business models and/or products over others.

We urge the CSA to amend the Client Focused Reforms to remove any bias for lowest cost products and explicitly state that registrants should consider many other factors, in addition to costs, in satisfying their obligations.

3. Unintended Consequences

We believe that certain requirements in the Client Focused Reforms may lead to unintended consequences, which reduces investor choice in investment service providers and investment products.

For example, while well intentioned, the KYP requirements impose onerous requirements on both registered firms and registered individuals to compare products on their firm's shelf to similar products in the market. This may cause firms to narrow their product shelves. Annex E acknowledges the potential for this unintended consequence, as some dealers may choose to move to a proprietary-only model. These requirements would have a negative impact on independent fund managers like FTI that compete for shelf space on dealers' product shelves and would ultimately not be in the best interests of clients by reducing the selection of suitable investments.

Furthermore, and as described more fully below, we believe the proposed amendments to referral arrangements could lead to situations where clients are not receiving the most appropriate level of service at the most effective cost.

For the reasons cited above, we encourage the CSA to re-examine certain aspects of the Client Focused Reforms that have unintended consequences and seek further consultation with the industry on the proposed amendments to referral arrangements.

4. Applicability of Client Focused Reforms to Permitted Clients

We believe the Proposals should include an exemption from the enhanced KYP, know your client and suitability requirements for all permitted clients, including managed accounts. Permitted clients are sophisticated clients who have a higher level of investment knowledge than retail clients and often have advisers (either internal or external) that assist them in choosing their investments. Equating retail and institutional clients based on their level of sophistication, risk appetite and investment knowledge ignores important differences between these types of clients. Enhanced obligations under the Client Focused Reforms appropriate for a retail client are not necessary or pragmatic for a permitted client.

Specific Comments Regarding the Client Focused Reforms

FTI's specific comments with respect to the Client Focused Reforms are as follows:

1. Know Your Product Requirements

(a) Investor Choice

As noted above, certain KYP requirements may result in reducing investor choice and access to the most suitable products. For example, some of the KYP requirements, which require registered firms and registered individuals to understand their product shelf as it compares to the "universe" of other firms' products, may lead those firms to narrow their product shelves to more easily manage their due diligence, educational training, and compliance obligations.

We support the obligation for registered firms, and their registered individuals, to understand the products they offer, but we believe that requiring the need to know the "universe" of comparator products may inevitably force firms to offer fewer products on their product shelves. Fewer product options for a firm's clients does not serve the best interests of those clients.

We also question the KYP requirements for registered individuals. Many registered firms (both advisers and dealers) devote significant internal resources to understanding and vetting products before they are placed on the firm's approved list. A registered individual should be able to rely on the work of their sponsoring firm without independently undertaking a similar exercise, which would result in a duplication of effort and a reduced product shelf.

(b) Product Due Diligence

The Proposals significantly expand a firm's KYP obligations to include due diligence beyond information made available by an issuer. This may result in registered firms reducing their product shelves in order to decrease the amount of due diligence required to support their product offerings.

We question why regulators would not allow a registered firm to rely on disclosure documents from issuers. These disclosure documents are subject to a thorough regulatory review process and subject the issuer to statutory liability. Third party verification of product information, as set out in the Proposals, add a layer of potential error to, or the alteration of, the information being relied upon by a registered firm. It could also create a conflict of interest whereby a third-party aggregator of issuer information or data may be biased in promoting one issuer over the other or not providing a fully comprehensive picture of an issuer's products over another, particularly if there are commercial incentives at play.

We recommend that registered firms be allowed to take a risk-based approach whereby standard products require less in-depth inquiry and complex products would require a more detailed review. Additionally, we believe that the CSA should consider a carve-out for retail mutual funds from a comprehensive due diligence review, given that mutual funds are highly regulated and their structure is well understood.

2. Suitability Requirements

We reiterate our concern that the dominant focus throughout the Client Focused Reforms - that better client investment outcomes can only be achieved through low cost products and lower fees - does not paint a realistic picture of what is in the best interests of the client. If suitability is to be looked at from an overall portfolio perspective, the reality is that the best product for a client's portfolio will consider multiple factors including the type of client, level of client investment knowledge, risk tolerance and product type, with cost being one of, but not the most predominant, factor.

We also believe that the enhanced suitability standard set out in the Proposals of "putting the client's interest first" has always been and currently is, the industry practice and standard and does not need to be explicitly stated or defined in the suitability rules. As is

the case currently, if a registrant has reasonably concluded that an investment is suitable for a client, the resulting effect is that the registrant has already determined that the action puts the client's interest first. Therefore, we urge the CSA to amend the Companion Policy to reflect this.

3. <u>Conflicts of Interest</u>

We support the adoption of a best interest standard in the management of conflicts of interest. We also agree that conflicts that are not material, consistent with the guidance provided in 31-103CP, can be addressed through appropriate policies and procedures and that conflicts disclosure should be easily understood by investors. We agree with the CSA that conflicts arising from the sale of proprietary products and internal incentive programs need to be addressed by registered firms in the best interests of their clients, but believe that disclosure alone may not be an effective mitigant. We believe conflicts arising from the sale of proprietary products and internal incentive programs need to be avoided. A fair and equal playing field requires equal compensation for selling proprietary and third-party products.

(a) Disclosure of Material Conflicts of Interest

We believe the obligation to identify and address all conflicts of interest, where a reasonable person would expect to be informed of such conflict, requires only material conflicts of interest to be disclosed. To mandate otherwise results in over burdening investors with disclosure that may dilute the effect of disclosure relating to material conflicts of interest and would ultimately not affect their investment decisions. As a result, we suggest that the requirement in section 13.4.5 (1) of the Client Focused Reforms, be amended to require disclosure of material conflicts of interest of which a reasonable client would expect to be informed.

We also believe that discretion and judgment in determining the materiality of a conflict, should be left in the hands of registrants exercising their business judgment in a fair and transparent manner.

(b) Disclosure to Mitigate Conflicts of Interest

We believe that the current practice of satisfying the obligation to address conflicts of interest in the best interests of the client through appropriate disclosure should remain. Where a conflict of interest cannot be avoided, disclosure is an appropriate and effective way to mitigate the conflict. This is consistent with the current standard of practice and the approach adopted in other areas of NI 31-103, including the disclosure of referral arrangements, disclosure related to fees and conflicts in the relationship disclosure information, and disclosure related to policies on fair allocation of investment opportunities.

We request that the CSA amend the Proposals to state explicitly that disclosure can effectively mitigate conflicts and that registrants must exercise their business judgment in: (i) determining which material conflicts cannot be adequately addressed through disclosure alone; and (ii) implementing controls for those conflicts.

(c) Registered Individuals' Responsibility to Address Conflicts of Interest

We have some concerns about the practicality of having registered individuals obtain the consent of a registered firm before proceeding with any dealing or advising activity that involves a conflict of interest. Therefore, we recommend that the CSA allow registered firms to provide standing instructions for recurring conflicts identified by a registered individual (e.g., third-party compensation).

4. Referral Arrangements

We found the inclusion of amendments to the requirements for referral arrangements in the Client Focused Reforms surprising considering that this was not contemplated by securities regulators in the CSA Consultation Paper 33-404 *Proposals to Enhance the Obligations of Advisers, Dealers and Representatives Towards their Clients* (**"CP 33-404"**). Specifically, we are concerned with the proposals in the Client Focused Reforms to: (i) prohibit the payment of referral fees to non-registrants; (ii) limit the length of time a referral fee can be paid; and (iii) limit the amount of referral fees that can be paid.

We understand some of regulators' concerns with referral arrangements as outlined in Annex E. We also understand the regulators' intent in targeting individuals that are no longer registered and subject to regulatory oversight, referring clients to registrants in exchange for a fee. However, we do not believe that "good" industry participants should be penalized for the actions of "bad" ones.

Historically, referral arrangements from both registered firms and non-registered firms have been a significant source of business in the financial services industry, one that is highly driven by relationships and the ability to provide a robust approach to meeting a client's financial needs. Referral arrangements leverage the expertise of financial industry participants and provide a more comprehensive and tailored level of service and value, all in keeping with what is in the best interests of the client.

FTI's referral business has historically been conducted mainly through FTCC, a federally licensed trust company and a registered portfolio manager with over $9 billion in assets under management. Since 2004, FTCC has offered investment management, trust and estates services to its clients. As a portfolio manager, FTCC is able to provide more sophisticated investment advice and a higher level of service to its clients on a cost-effective basis. Referral arrangements are a long-standing part of FTCC's business model. FTCC has referral relationships with both registrants and non-registrants and has established due diligence protocols and standards for its referral arrangements.

We believe that the CSA's concerns with referral arrangements are outweighed by the unintended consequences that could result if the Client Focused Reforms are implemented in their current form. The impact of the proposed amendments on existing business arrangements will be substantial and ultimately not in the best interests of clients. We believe that a robust due diligence process for referral arrangements between registrants and their referring partners (whether registered or non-registered) would satisfy regulatory concerns. This would give regulators, through their compliance review process, the opportunity to examine the due diligence conducted by a registrant in selecting its referral partner(s).

Service providers in the financial services industry provide many different services to investors including financial, tax, succession, estate and retirement planning, insurance consulting and advice and/or financial education. We believe that these non-registrant service providers are acting in their client's best interests by referring them to a registered dealer or a registered adviser. Any referral fees paid to these service providers are fully disclosed to, and agreed upon by, the client, per current regulatory requirements in NI 31-103, prior to the referral.

Consider a client who currently invests in mutual funds with a registered mutual fund dealer or segregated funds with an insurance agent. If a client has sizeable assets, they may qualify for discretionary investment management services provided by a registered adviser. The client may obtain a higher level of service at a lower cost (even after the payment of a referral fee) by being referred to a registered adviser. However, if the registered mutual fund dealer or insurance agent is not going to be compensated for the referral, they are unlikely to refer the client, resulting in an outcome that may not be in the client's best interests.

For purposes of illustration, we provide below an actual example of the cost-effective outcome for a client that has been referred to FTCC through a referral arrangement, in comparison to one that is invested in mutual funds directly. In this example, the client holds Series F units of a Franklin Templeton mutual fund in their account and the advisory fee shown is based on the historical average fee collected by a registered dealer, based on FTI's experience:

Client Cost - Direct Mutual Fund Investment		Client Cost - Referral Arrangement	
Fund Management Fees:	1.00%	FTCC Fees:	0.85%
Financial Advisor Fee:	0.75%	Referral Fee:	0.50%
Total Fee:	1.75%	Total Fee:	1.35%
+ HST at 13%	0.23%	+ HST at 13%	0.18%
Client Pays	1.98%	Client Pays	1.53%

The cost savings to the client under the referral arrangement are evident and increase if/ when the client's assets managed by FTCC increase because of FTCC's tiered portfolio management fee structure.

We question why the CSA would restrict referral payments to non-registrants who are not performing registrable activities. If one of the CSA's concerns is that non-registered individuals are continuing to perform registrable activities after referring a client to a registered firm, we believe this can be addressed through targeted enforcement by the CSA of existing rules (prohibiting non-registrants from engaging in registrable activities) rather than by banning such activities in total.

We believe that a ban on the payment of a referral fee to non-registrants is unnecessary, particularly where the referring party is subject to regulatory oversight and/or standards of conduct by other regulatory/professional bodies which, for example, is the case for

insurance professionals, financial planners, lawyers and accountants. These referring parties have not necessarily surrendered a securities registration to obtain a referral fee for no work. They continue to perform services for their clients in their respective fields. In that regard, we suggest that the CSA consider introducing enhanced client disclosure regarding the types of services provided by the referring party for which a referral fee is being paid.

We also question why the CSA would limit the length of time a referral fee can be paid. As noted above, referring parties are often providing many other services to their clients and such services do not cease being provided at the end of three years. We believe that limiting the length of time a referral fee can be paid could open the door for "referral shopping" – referring entities taking their referral business to other firms at the end of every three-year term. "Referral shopping" would not only introduce a different type conflict of interest, but it would cause client service disruption. We suggest that to avoid this unintended consequence of the Proposals, registrants be required to review the referral arrangement with their clients every three years to ensure that the client is continuing to receive value for the payment of a referral fee. This type of review ensures that where the client is still receiving benefit and services from the referral arrangement beyond the three-year limitation, the referring party continues to receive compensation through the referral fee.

Finally, we question the proposed limits on the amount of referral fees that can be paid. The CSA should not be interfering in the commercial relationship between registrants and their clients, especially when such relationships are fully disclosed to, and agreed by, clients at the outset of the relationship.

Given the potential for unintended consequences and the significant impact on existing business arrangements, we request that the proposed amendments relating to referral arrangements not form part of the Client Focused Reforms and that the CSA further consult on this topic before proposing limitations on referral fee arrangements. This will allow for a more comprehensive dialogue between the regulators and the industry on a long standing and important industry practice. As part of those consultations, we urge the CSA to consider alternatives such as: (i) enhancing the disclosure of the services provide by the referring party in exchange for the referral fee; and (ii) requiring registrants to review the referral fee payments with their clients every three years to ensure that their clients are continuing to receive value.

5. Transition Timeline

The CSA has proposed a phased implementation schedule for the Client Focused Reforms. As noted above, we believe that any rule amendments relating to referral arrangements should be deferred until consultation with the industry occurs. For most of the other Client Focused Reforms, the proposed implementation timeline is two years. We do not believe that two years is adequate to comply with the extensive new requirements given the systems, operational and compliance changes that registered firms will be required to implement. We think a three-year transition timeline would be more appropriate.

Conclusion

Thank you for your consideration of this submission. Please feel free to contact me at 416.957.6010 should you have any questions or wish to discuss our submission.

Yours truly,

FRANKLIN TEMPLETON INVESTMENTS CORP.

Brad Beuttenmiller
Senior Associate General Counsel