BMO Financial Group

Via Email

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Canadian Securities Administrators
comments@osc.gov.on.ca, consultation-en-cours@lautorite.qc.ca

Re: Canadian Securities Administrators (CSA) Proposed Amendments to NI 31-103 (Proposed Rule) and 31-103CP (Proposed CP) – the Client Focused Reforms

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BMO Financial Group is pleased to comment on the Client Focused Reforms on behalf of BMO Asset Management Inc., BMO Investments Inc., BMO InvestorLine Inc., BMO Nesbitt Burns Inc. and BMO Private Investment Counsel Inc. (BPIC).

Through these affiliates, we provide a range of products and services to support our clients' diverse needs and expectations. These include in-person and online advice, discretionary investment management, fund management and online self-directed investing.

We support the CSA's overall investor protection objectives of better aligning registrant and client interests, improving client outcomes and clarifying the nature and terms of the client-registrant relationship. While the Proposed Rule and Proposed CP support these objectives, we believe they may also result in unintended consequences for clients. We highlight some of the consequences below together with suggested changes to mitigate the potential for negative client impact.

In addition to our comments, we refer you to industry association letters from the Canadian Bankers Association, Investment Funds Institute of Canada, Investment Industry Association of Canada and the Portfolio Management Association of Canada. These letters provide details on how the Client Focused Reforms may negatively impact clients as well as suggestions to mitigate this possibility.

Guidance

Flexibility and clarity

We agree there is no *one size fits all* approach to registrant regulation. Unfortunately, the Proposed CP contains prescriptive language which may limit flexibility intended by the CSA and create unintended requirements. We highlight areas of concern below and suggest the CSA clarify language so we can meet our regulatory obligations and client expectations across our diverse product and service offerings.

Know Your Client (KYC)

Tailoring the KYC process

We agree that the scope of KYC varies depending on a registrant's business model and the nature of its relationships with clients, and we appreciate the CSA explicitly stating this in the Proposed CP. We are concerned, however, about other language in the Proposed CP which appears to limit this intent such as the suggestion that a registrant can only understand a client's financial circumstance by obtaining a detailed breakdown of the client's financial assets and liabilities, including types of securities. This level of detail may be unnecessary for certain business models or types of clients. For example, high net worth or institutional clients often use multiple registrants for specific mandates. They may not wish to share a full picture of their wealth or other investment portfolios across registrants, nor may these be necessary for a registrant to understand the client and execute the client's mandate.

Reviewing and updating

The Client Focused Reforms recognize that clients play a key role in ensuring registrants meet their obligations to keep KYC information current. At the same time, however, the Proposed Rule prescribes that a registrant "reasonably ought to know" of a significant change in the client's information.

We suggest the CSA reconsider this language. Expecting registrants to anticipate the range of potential changes that may impact a client's KYC creates an uncertain and possibly unrealistic standard. Further it may be difficult for firms to implement effective compliance methodology such as training, testing and monitoring to satisfy this requirement. The client-registrant relationship may be sufficiently enhanced through other proposed changes, such as the new requirements to review and update KYC within specified timeframes.

We also suggest the CSA clarify that registrants can meet the KYC review and update requirements based on reasonable efforts to reach the client (supported by notes or other evidence). In our experience, clients may not respond in a timely manner for numerous reasons, and repeated outreach by a registrant to meet the proposed review obligations can create a negative client experience.

Client objectives and registrant proficiencies

We suggest the CSA reconsider the following language in the Proposed CP which implies some registrants require proficiencies beyond those associated with dealing or advising in securities:

> *Depending on the nature of the relationship with the client, and the securities and services offered by the registrant, registrants should take into account whether there are any other priorities, such as paying down high interest debt or directing cash into a savings account, that are more likely to achieve the client's investment objectives and financial goals than a transaction in securities.*

We believe this language is at odds with the CSA's stated objective to clarify the client-registrant relationship because it implies to clients that registrants are qualified to examine financial circumstances beyond the scope of their investment services.

Know Your Product (KYP) and Suitability Determination

The proposed KYP requirements will be challenging and time consuming to implement, with unintended negative consequences to clients. We believe the CSA can ease the implementation burden and mitigate negative impact to clients by modifying the proposals in key areas noted below.

Tailoring the KYP process

We believe that tailoring the KYP process should include flexibility and appropriate exemptions for registrants.

We suggest the CSA remove prescriptive language in the Proposed CP, such as "we expect", "will include", "must include" and "will consider". We also suggest the CSA state that registrants should tailor their KYP process to reflect business models and the nature of their relationships with clients, similar to the CSA's approach for KYC. Doing so may mitigate unintended consequences to clients, including reduced product offerings and higher costs for advice.

For example, one approach to understanding securities for firms with large shelves is to use technology or other processes to group securities into asset classes (e.g. fixed income and equity classes). Firms may also use these groupings to train individual registrants on the shelf offering. Without this flexibility in the KYP process, we believe firms will reduce shelves because of the excessive amount of work involved in comparing every security available – reducing client product options.

We believe a tailored approach is also appropriate for the proposed requirement that a firm compare each security on its shelf with similar securities not on its shelf. We suggest the CSA limit the comparison requirement to what is on a firm's shelf (not the market). A limitation of this kind will reduce the likelihood that implementation costs will be borne by clients.

Without flexibility, the comparison assessment, which includes assessing competiveness (as mandated by the Proposed CP), will be extremely challenging and costly to implement given the number of securities available to Canadian investors. We expect these overall increased costs of compliance will eventually be borne, at least in part, by clients.

Tailoring of the KYP process should also include recognition of and exemptions from relevant KYP requirements for proprietary dealers. The CSA tailored its approach to KYP in Consultation Paper 33-404 in 2016 for differences between proprietary dealers and mixed-shelf/non-proprietary dealers. The reasons for such tailoring continue to exist today. For example, the 2016 Consultation Paper did not require proprietary dealers to compare the products they sell to products they don't sell. This should carry over to the final rule.

Modifying transfer-in rule

The CSA should revise the Proposed Rule to accept all transfers (using the ATON or other system) and permit registrants to conduct the KYP obligation after the security is received. It will be challenging for a registered firm to complete the KYP process before allowing a security to be transferred in, specifically

through the ATON system, as this process does not allow the transfer to be paused or stopped while KYP work is in progress. Clients will be negatively impacted by delays in transfers.

Clients may also be negatively impacted in circumstances where the securities to be transferred-in are not on the recipient registrant's shelf. Under the proposals, the client may have to maintain the original account to hold those securities or to sell them prior to moving to a new registrant. This could have tax consequences and may not align with the client's intent to consolidate their investments. Registrants should have flexibility to hold such securities upon transfer even if the firm does not choose to broaden its shelf with the security.

Guidance on suitability and outside investments

We suggest the CSA reconsider the expectation in the Proposed CP that:

> *Depending on the circumstances, a registrant should inquire about the client's other investments or holdings held elsewhere in order to inform its suitability determination.*

This language suggests registrants may require proficiencies beyond the scope of their specific registration proficiencies. This does not align with the CSA objectives to clarify the client-registrant relationship and it may create regulatory and practical issues as well as lead to a negative client experience.

For example, a securities registrant does not have proficiencies to provide advice on real estate investments or insurance investments, including life insurance policies and segregated funds. Further, clients may choose to have distinct relationships across multiple securities registrants, with different offerings and they may choose to limit what they disclose across these relationships. This broad inquiry may also raise regulatory concerns. For example, if a portfolio manager reviews securities held in a client's order-execution-only account, the portfolio manager may be indirectly assessing suitability of the securities, contrary to IIROC rules.

Conflicts of Interest

Limit to material conflicts

We suggest the CSA limit the conflicts of interest assessment to material conflicts of interest only. The materiality assessment should flow through to other conflict of interest requirements, including disclosure. Disclosing non-material conflicts may confuse clients and be of limited value.

Referral arrangements

A proposal to ban registrants from fee-based referral arrangements with all non-registrants may negatively impact clients by reducing the likelihood of 'right channeling'. Right channeling may come from many avenues, such as financial planners, insurance advisors, tax professionals or bankers. These channels may be particularly important for certain client segments, such as millennials (see OSC Report *Missing Out: Millennials and the Markets*). Further, referral arrangements typically involve normal

commercial relationships between parties with fees paid between the parties with no impact to the client's fees, and clients are aware of these through disclosure requirements.

Modifications for Portfolio Managers

Permitted clients

We request the CSA include an exemption from the enhanced KYC and suitability requirements and the new KYP requirement for portfolio managers of non-individual permitted clients (including investment funds) in managed accounts, consistent with the CSA's 2016 Consultation Paper. We also request an exemption from the disclosure and controls requirements for proprietary products where the client is a permitted client. We believe these exemptions are appropriate given client expectation and need in this type of client-registrant relationship.

Pooled Products offered by Portfolio Managers

We also suggest the CSA modify proposed disclosure and controls for proprietary products offered by a registered portfolio manager.

Portfolio management firms offer clients access to product specialists and a range of asset managers to build diversified portfolios that are tailored to the needs of the client base they serve. Clients typically pay a fee for assets under management, and firms may bundle portfolios into cost effective solutions, including investment funds. These funds are not available as a retail offering and, for example, in the case of BPIC, BPIC acts as the investment fund manager for the funds and engages both internal and external sub-advisers.

Detailed disclosure and controls may be confusing to discretionary portfolio management clients as they are contracting for an investment management service, not a retail investment fund. We suggest the CSA modify the Proposed Rule and Proposed CP to reflect these differences.

Training

Individual registrants are subject to proficiency and continuing educational requirements, which vary across registration categories. In our experience, effective training programs also vary across business models and may include internal and external conferences, industry guest speakers and mentorship. The CSA may wish to reconsider prescriptive language in the requirements, including that training be in writing, to preserve flexibility. Firms are best positioned to determine effective training for individual registrants, which ultimately benefits clients.

Transition

The Client Focused Reforms are extensive in scope and will require significant technology and system enhancements. Firms will also need time to train individual registrants and operationalize compliance programs. This will be particularly challenging for areas of the Proposed Rule that impose a reasonableness standard, as the possibilities of what a registrant may "reasonably ought to know" of a

change in a client's circumstance or what a "reasonable investor" would consider important in deciding to become a client will be broad and vary across business models and relationships with clients.

Registrants are concurrently facing reform in other areas, such as anti-money laundering and reforms impacting Canadian deposit insurance. Registrants will benefit from a longer transition period to coordinate changes, such as technology builds.

Finally, reforms are happening at a time when registrants are seeking ways to innovate and enhance the client experience to meet evolving client needs and expectations. A shorter transition period may jeopardize this innovation as firms may not have the resources to address both.

Given the above, we believe we need at least three years to plan for and operationalize the Client Focused Reforms. Ideally, for the SRO regulated firms, the implementation period should begin after the SROs have modified their rules to align with the Client Focused Reforms.

Moving forward

We welcome the opportunity to meet with CSA members to share more about our diverse products and services and to discuss areas of the reforms that may negatively impact our clients and be challenging to implement.

Regards,

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